The Cotton Industry Then and Now
Looking Back Across Five Decades
The More Things Change – The More They Remain The Same

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When I joined the cotton industry in November 1966, I had already worked on the passage of the Food & Agriculture Act of 1965. I had been temporarily detailed to assist in accomplishing the legislative agenda of the Johnson Administration, but I knew little about agriculture, particularly cotton.

There were some things I wish I had done to better prepare myself. I had not read the transcript of the Office of Price Stabilization (OPS) hearings conducted during the Korean War to determine whether the price increases of raw cotton could be passed up through the marketing chain in order to exempt the textile manufacturers from having to buy high and sell into a market fixed at lower prices. Had I done so, I would have noted the astute observation of the Director of OPS, Michael DiSalle, who stated at the conclusion of the oral testimony that: "Cotton is not an industry – it's a theology."

Another thing I should have read was Dan Morgan's wonderful book, "Rising In The West," which tells the harsh story of the dirt farmers in Eastern Oklahoma being driven off their land during the "Dust Bowl" days of the Great Depression and migrating to the San Joaquin Valley in California. One reason I had not read it because Dan would not write it for another 20-years. Were I to have had the benefit of reading that revealing book, I would have learned much about the people of the Southwest. Principally, that they did not trust Yankees, and they had a great dislike for lawyers.

I knew little of the culture of cotton industry. From an historical perspective, its public image was not positive. Child labor, protective tariffs, slavery, sweat shops, and anti-unionism were issues related to the cotton and textile industries in America. As a result, the fiber itself and the U.S. cotton industry had a negative public image, especially in the U.S. Congress. That has all changed for a number of reasons as the last five decades have been ones of significant progress socially, politically, and economically. I would also note that the excellent work of Cotton Incorporated helped to change the image of both the fiber and the industry. True, the cotton program has been challenged by Brazil in the WTO and is a prime target for reform in the seemingly endless Doha Development Round, but I'll save that for another speech.

Permit me to begin with how I came to cotton. In the mid-1960s, I made my initial mark in Washington at the outset of my career on the issue of auto safety. Among my duties as Assistant Director of the American Automobile Association's (AAA) Legal Department was researching the state and federal laws dealing with motor vehicles on a daily basis. I quickly noted significant disparities in the various state laws and the limited regulations or requirements that the General Services Administration imposed on the auto manufacturers for vehicles purchased by the federal government. My research resulted in a number of reports and magazine articles. One of my articles, dealing with the warranty of merchantability on defective automobiles, was read by a Senate staffer and soon the AAA and I were involved in a series of hearings that led to the passage of historic legislation regulating auto and tire manufacturing. Early in this process, a young lawyer in a rumpled suite from a small town in Connecticut – a place called Winstead - showed up in my office to discuss these issues. It was Ralph Nader, who is now a household name.

During that time, I was also active in the Presidential Campaign of President Lyndon B. Johnson, and served as an advance man and campaign aide for him and Vice President Hubert H. Humphrey, through their term in office. Through this activity, and again during my work on the 1965 Farm Bill, I met the leadership of the cotton trade as they were active in the Democratic Party at a national level. I was recruited by Ned Cook of Cook Industries in Memphis and Harris Kemper of Galveston, Texas. It took a while, but they finally convinced me that there were a multitude of good people in the cotton industry – that times were changing – that I could play a key role in that change.

That is the background that brought me to Memphis for six weeks of on-the-job training in a multitude of firms learning everything there is to know about buying, selling, and shipping cotton. At that time, cotton was purchased – it was not sold. Domestic mill buyers and foreign merchants would visit the firms on Front Street in Memphis, the Cotton Exchange Buildings in Houston and Dallas, and offices of firms in Montgomery and elsewhere throughout the cotton belt. The visiting buyers would inspect the samples and take up the cotton on the spot.

One of the basic principles was, "That cotton well-bought was considered half-sold." Merchants would sample the cotton when purchased and re-sample it again before it was sold. The old-time merchants thrived in this subjective system of manual classing. It allowed them to profit both in the buying and the selling of a bale. Now, in the electronic age, merchants rarely see the samples and never see the bales. The only value of the samples is to resolve claims. The move from manual classing to instrument or HVI classing in the early 1990's was a difficult transition for the cotton trade - the technology eliminated the magic of the manual class.

Picture a brash, young, liberal, arriving on Front Street in 1966. I felt as though I had stepped back in time. People in the cotton industry were of another era. Contrary to where I came from – New York City – they were polite, soft spoken, and sparse in their use of words. Another predominant characteristic was that as highly successful individuals, many of them did not favor change in how their business was conducted.

They opposed disruption, favored stability, consistency, and reliability in the business they knew best, but in a few years, most of those people, having failed to adapt, would be history.

The week I spent working with Billy Dunavant convinced me that this would happen. Billy was a contrarian and did not share the views of his father's generation. He sold cotton, he did not wait for the buyers to come to him. When it became difficult to order cotton out of warehouses that focused on the incoming new crop cotton, Billy decided to truck cotton directly from the gin to the mill – he took a cost-effective detour around the warehouse and established the practice of gin direct sales. And, when there was a scarcity of trucks – he bought trucks. He also pioneered the concept of forward contracting. That one week of training with Billy Dunavant enabled me to see the future first-hand.

As I moved across the cotton belt meeting the industry that year, I learned that old habits die hard, but I knew then that I had entered the cotton industry at a critical point in its history. The industry was divided, if not at war. There was rancor between and among the segments and from region to region. For many years, National Cotton Council Conventions (NCC) were a five-day battle over farm policy issues. The debate raged in the committee rooms, the board meetings, the hallways, and the public receptions. In comparison, today's NCC Conventions are boring. The policy disagreements are worked out in special committees and task forces, the executive committee, and the board whenever they arise – policy development is now a virtual concept in the cotton industry. Now, there is usually full agreement on issues when the conventions convene. The unity of purpose facilitates the industry's effectiveness in the Congress and the federal agencies and cabinet departments.

Over the years, the farm programs have evolved from the high price support loan rates and restricted acreage allotments to the point where producers are now free to plant whatever they want. Now, we have payments that are tied to acreage base histories in combination with the marketing loan system which covers price risk at the low end and counter-cyclical payments that phase in when the average price falls short of a legislated target price. I could spend a long time discussing the program changes over the years, but I will not bore you with those details, except to say that each of the 13 farm bills I worked on over the years was a significant challenge for all involved.[1] It took the combined

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[1] In 1965, the Congress decided that we would compete by denying our competitors a guaranteed minimum price. We accomplished this end by repealing the high price support loan concept and establishing the U.S. price support loan at 90% of the world price. The CCC then owned 16 million bales of cotton. To reduce the surplus the program included paid mandatory and voluntary diversion programs upwards of 35% of the allotted acreage. Producers were also provided direct payments to assist them in covering their production costs.

By the late 1960's our surplus stocks were depleted. We then established what turned out to be a highly effective Cotton Research & Promotion Program on a nationwide scale through a mandatory producer contribution.

talents of individual producers, industry leaders, trade association representatives, USDA officials like Charlie Cunningham who had the courage and foresight to tell us what would work and what would not, House and Senate staffers, and many knowledgeable and dedicated Members of the House and Senate who championed our proposals.

Now back again to 1966. During the marketing season – September through March, considerable time was spent manually sorting warehouse receipts and class cards. I can remember spending a Saturday and part of Sunday at Dunavant's office on Front Street stapling class cards and warehouse receipts together, assembling them in 100 bale lots of equal quality, binding them with large rubber bands, and putting them in shoe boxes. The entire Dunavant staff was working that weekend, all 10 of them, including Billy Dunavant. Contrast that to today's paperless process. One person on one laptop can sort out a firm's inventory and print out a list in a matter of seconds.

Speaking of the shoe boxes full of class cards & receipts, it was a common practice at the country gin points to pack those shoe boxes together and ship them on a Greyhound or Trailways bus to a buyer in a regional market. In the late 1960's the Post Office Department seized a shipment of these receipts at the bus station in Lubbock, Texas and demanded that postage be paid on every single class card and receipt in the shipment. I helped negotiate a Consent Order, had the cards and receipts released to the buyer, and then I met with senior Post Office Officials in Washington. When they informed me they intended to continue to enforce their outdated regulations, I thanked

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In the 1970's, a prosperous period for all commodities, we introduced the set-aside program maxing out the acreage reductions at 28% of the base acreage, froze the acreage allotments allowing cotton to be planted without restrictions, and initiated a 15 cent per pound direct payment that was soon replaced by the target price concept. In the 1977 legislation we began to determine the loan rate pursuant to the Liverpool or Cotlook Index and introduced the controversial 18-month loan.

The Russian grain embargo precipitated a stressful period in the 1980's resulting in high stocks and the Payment In Kind (PIK) program. In 1985, the cotton marketing loan was introduced and enhanced with the Step 2 program in the early 1990's.

In 1994, a basic change took place in U.S. politics when control of both houses of the Congress shifted to the Republicans for the first time in 40 years. The results were immediate for U.S. cotton policy resulting in an elimination of acreage reduction programs, the 18-month loan, and the target price concept. Added to that were new market transition payments.

In 2002, the target price concept returned under a new name, the counter-cyclical payment, and the market transition payments were continued. Then, along came the Brazilians, who successfully challenged the Step 2 Program in the World Trade Organization leading to its elimination by Congress.

The 2008 Farm Bill continues the 2002 programs with some changes in payment eligibility requirements along with an elimination of payment limitations on marketing loan payments.

Looking back to 1966, we still have market oriented loan levels and direct payments. What we have eliminated are government mandated acreage reductions, but in doing so we have added are a whole lot of bells and whistles every few years.

them for their meeting and immediately took a taxi to Capitol Hill. Fortunately, the Congressman from Lubbock was George Mahon (D-TX), who happened to be Chairman of the House Appropriations Committee. He listened to my pitch and asked his secretary to get the Post Master General on the phone. Needless to say, the case was closed and the Postal Inspectors never bothered us again.

Congressman Mahon was always very helpful. On another occasion a few years later, we had a prolonged strike in the Gulf Ports. Cotton was piled up on the piers in New Orleans, Galveston, and Houston at great expense to the trade. With the help of the then Texas Governor, Preston Smith, who was also from Lubbock, we expedited the incorporation of a Texas stevedoring entity for the sole purpose of negotiating a separate contract with the International Longshoremen's Union (ILA). With that problem solved I went on to the next one - I needed ships for the longshoremen to load once we reached an agreement on a labor contract. I made it known that we would accept their full demands for wages and working conditions. I went to Congressman Mahon, and explained the industry's plight. I informed him that the Federal Maritime Administration (FMA) had Navy cargo ships in mothball fleets along the East Coast and it would help if he could arrange for a few of them to be released so we could charter them, crew them, and negotiate a contract with the ILA to load them. "Neal, who is in charge of the Maritime Administration," he asked. I told him the Secretary of Commerce. Here again, he asked his secretary to call the Secretary of Commerce and about a half hour later I was sitting in his office explaining how the U.S. balance of payments and the flow of commerce would be adversely impacted and what I desired to do. I was told they would see how quickly they could get this done and I returned to my office. About an hour later, I received a call from the Executive Director of the Far East Conference, the shipping cartel that controlled ships operating in the Gulf. I knew him well, and had many dealings with him over the excessive rates the Conference was charging. He cursed me considerably, calling me a strike breaker, and told me I was forcing his people to the table. It was the only time I ever had the upper hand with him. The strike was settled two days later.

Getting back to 1966, there were some 1,200 cotton merchants and FOB buyers in the cotton belt. There also were about a thousand cotton gins, who in many instances acted as agents for the trade. That was a significant number of people when you consider that they were handling a 10 million bale crop. I remember my first American Cotton Shippers Association (ACSA) Convention in 1967 in San Francisco. We had over a thousand people in attendance. Now, our meetings are significantly smaller as the number of firms has been reduced. Today, fewer people are handling more cotton, which in recent peak production and export years has been valued as high as $7 billion. The attrition in the trade continues as the current financial crisis has taken a severe toll in the cotton industry with two major firms leaving the business in the past year and many firms trimming back.

Much has changed in transportation. In the 1960s and early 1970s the great bulk of the crop was shipped by rail to the domestic mills and by break-bulk cargo ships in export. Now, all the cotton consumed in our diminishing domestic market is shipped by truck and all of the exports are shipped in containers, which are loaded in the interior.

The trade patterns have also radically changed. Europe, except for Turkey, is an insignificant market. Other than our excellent NAFTA markets in Canada and Mexico, our primary markets are China and Southeast Asia. In contrast, in 1966 Europe was still a healthy market, but our primary market was Japan – some 2-million bales, along with Korea, which was then a 500,000 bale market quickly moving towards becoming a 2-million bale market in the 1970s through the use of 36-month CCC export credits. Now, Japanese and Korean textile manufacturers have moved off-shore to Vietnam and other low cost of production countries in South East Asia.

We have also seen significant changes in the storage of cotton. Because of poor service, the cotton trade became actively involved in the warehouse industry and now controls about a third of the storage capacity. Service is still a problem in a minority of warehouses dedicated to storage revenue and not service. The industry has been trying to resolve this issue throughout my career. Finally, it took litigation and protracted negotiation, but we now have USDA regulations in place, strongly advocated by the cotton trade, requiring warehouses to report weekly on their compliance with the minimum USDA shipment standards for loan cotton.

One of the most significant changes over the years was the turn-about in price transparency for producers. When I came into the industry, producers would have to call the gin or wait until the morning paper to learn what the daily spot and futures prices were. Supply-demand reports were infrequent – the markets were more opaque. Today, that is no longer the case. Producers can get instant price information on their Blackberries or cell phones, laptop computers, and watch market recap reports on special commodity television programming. Producers are more keenly aware of market trends and have made great strides in the use of the futures market, particularly their use of put options for minimum price protection and call options to seize additional income from rising markets.

Another area of progress was getting cotton removed from the International Maritime Organization (IMO) and the U.S. Coast Guard's list of hazardous products. It took seven years to bring this about, but the change immediately resulted in a 20 percent reduction in insurance rates. My colleague Bill May and I started that process at the cotton desk at Lloyd's of London. We were there to see the man who had handled these matters going back to the pre-World War II years. We missed him by one week as he had retired leaving no forwarding address. But, he did leave his handbook with a young woman who knew very little about cotton. The handbook simply stated that in the 1600's cotton was originally classified as a hazardous because it was prone to spontaneous combustion. And, believe it or not, this was the sole justification for the IMO and Coast Guard listing. We had to disprove a negative, and the industry did so with extensive testing. Once we had our positive results, we had to wade through the international bureaucracy, which took the better part of five years.

Another major change has taken place in the cotton futures' market. In 1966, cotton was traded by the New York Cotton Exchange on Beaver Street in lower

Manhattan. The then, No. 1 Upland Cotton Contract traded Middling Inch cotton – that is, when it did trade. In March 1967, the current, Strict Low Middling 11/16 inch, No. 2 Upland Contract began to trade. I had the honor of representing ACSA at the opening of that contract. There was a record snow storm in New York that day - only one floor trader showed up, Perry Moore, who was then in his late 70s. Once the bell opened the trading, he was a whirling dervish buying and then selling contracts to himself until his phone began to ring. It didn't take long for merchants across the world to discover that Perry was only broker present. Perry got a lot of new business that day.

As the 16-million bales of cotton in CCC-owned stocks were depleted in 1967 and 1968, the volume, volatility, and liquidity of the contract increased considerably. I might add that Perry Moore continued to trade well into his 80s.

In the 1980s, Congress lifted the ban on options, and a new and valuable risk management instrument was created. The 1980s also saw the advent of the investment funds, which had a dramatic affect on the cotton market. With the funds in the cotton market, supply-demand was no longer the governing factor on price moves. At this juncture, an important change took place in the trading strategies of cotton merchants, the use of futures and options as a primary profit center in merchandising the physical cotton. This required significant capitalization, which left fewer players on the field.

In the 1980s, the New York Cotton Exchange sold its building, which sat on highly valuable property and moved into the commodity annex connected to Tower Two in the World Trade Center. Then, in the 1990s, the Cotton Exchange merged with the Coffee, Sugar, & Cocoa Exchange to become the New York Board of Trade. This change was driven by the floor brokers, who owned most of the seats and controlled the votes. They wanted ready access to other commodities being traded on the same floor. As a result, the cotton industry's representation on the board and its ability to influence trading terms and conditions was severely diminished. Then, a few years ago, the members of the NYBOT exchanged their seats for stock in a publicly traded entity known as the Intercontinental Exchange or the ICE.

Now, the cotton trade has no representation on the ICE board. True, there is a Cotton Committee that makes recommendations to the ICE Board, but the industry's recommendations have been tempered by the dictates of increased volume and income. The cotton industry and the ICE have conflicting interests. The industry needs the contract for accurate price discovery and hedging, which incidentally is the primary purpose of the Commodity Exchange Act. Now, that has become secondary. The speculative interest and its trade volume, not the commercial trade's concerns are paramount.

Much has been said of the excessive speculation of the last decade. It found the cotton market a little over a year ago. The policy mistakes of the Congress in exempting the Over-the-Counter markets from regulation along with the Commodity Futures trading Commission's granting exemptions from the Federal Speculative Position Limits to the index, hedge, institutional endowment, sovereign, and pension funds allowed this to happen. These policy actions set up the cotton industry for the killing that occurred when the No. 2 Contract went all-electronic on March 3rd. As a result, the trading environment has been radically altered.

There is so much more that I could discuss, including the new seed varieties resulting in a doubling of yields and the reduced use of pesticides, but I will not do so today.

I will discuss one more important development and that is the diminution in contract compliance. In 1966, a contract default by a merchant or a textile mill was a rarity. That is no longer the case. There are a number of foreign textile mills who have failed to honor arbitrations awards, and there is one foreign owned U.S. merchant, now in bankruptcy, that is in default on contracts with U.S. producers for approximately 750,000 bales. Another U.S. merchant has defaulted on contracts with U.S. producers and foreign mills, and still another is in jeopardy of doing so. Much of this is related to what happened in the futures market on March 3rd and the unavailability of credit due to the meltdown in the world's financial structure.

Change has been ever present in our industry and is increasing in its magnitude. While I wholeheartedly endorse and was active in bringing about many of these changes, what I regret is the depletion in the ranks of the independent entrepreneurs, who were making decisions for themselves. These were solid thinkers who knew every aspect of the business, buying, selling, futures trading, classing, financing, ginning, warehousing, and transportation because they did it themselves every day. They were leading citizens in their communities and were politically active – a vital dimension that no longer exists.

So as my era in the cotton industry comes to a conclusion, I wish everyone success. When I look back through those five decades and the roads I traveled to this destination - 43 ACSA Presidents, 9 U.S. Presidents, 14 USDA Secretaries, thousands of Senators, Congressmen and staff, and thousands of public officials, colleagues, and friends throughout the world - I can say that I experienced an incredible journey, accompanied by incredible people, making it all worth while.

Thank you.