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Trade: How cotton subsidies harm Africa

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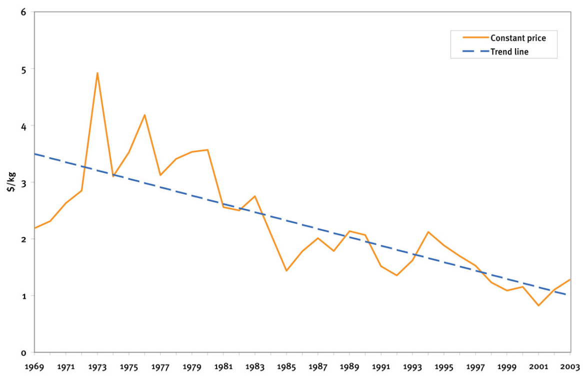
Cotton trade and production are highly distorted by policy. In recent years, subsidies have accounted for as much as a fifth of producer earnings. Attempts by poor countries, including cotton-producing African states, to get the World Trade Organization to rule such producer support illegal have generally failed. But in April last year (2004), Brazil successfully challenged the legality of US subsidies. Our research suggests that the impact of lifting subsidies globally could be highly beneficial to some African countries, particularly if the EU drops its support to cotton producers in Greece and Spain.

The effect of subsidies has been to depress world cotton prices, damaging poorer countries that rely on exports of cotton for foreign exchange earnings. US support to its cotton producers, by virtue of its magnitude, is seen as particularly damaging and responsible for most of the reduction in earning potential of other cotton-producing countries. But European subsidies, though smaller, are disproportionately damaging, notably to West and Central African countries.

More than 70 countries produce and export cotton but eight are responsible for more than 80% of global output: China; the USA; India; Pakistan; Uzbekistan; Turkey; Brazil; and Australia.

For industrialised countries, cotton is a minor component of economic activity but its production plays a major role in some Least Developed Countries in West and Central Africa. In Benin, Burkina Faso, Chad, Mali and Togo, cotton accounts for 5–10% of GDP, more than one-third of total export receipts and over two-thirds of the value of all agricultural exports. In a low-income economy where most of the poor live in rural areas, income from export crops is one of the best short-term measures to alleviate poverty. Smallholder cash-crop producers spend extra income on local goods and services, thus spreading the benefits to other poor households. Cotton is relatively labour intensive and may also generate employment. In African countries, cotton production is concentrated in poorer regions so higher cotton incomes contribute to poverty reduction.

World cotton prices (constant US$ 1995)



Source: Data from ICAC and World Bank Development Indicators, 2005.

Some of the largest cotton producers, such as China, India, Pakistan and Turkey, scarcely export since their production is almost entirely for domestic use. In 2001, five countries – the US, Uzbekistan, Australia, Greece and Brazil – accounted for 70% of all exports. West and Central African countries accounted for 10%.

Recently, for a number of reasons, world cotton prices have been unstable and falling. There have been unpredictable changes in production and exports from India, Pakistan and China; reductions in the costs of production and synthetic fibres continue to make inroads. But subsidies granted by key cotton-producing countries have a major impact, notably in the US, China and the EU.

'US and EU subsidies deprive Least Developed Countries of income. Reducing subsidies would increase the foreign exchange earnings of poor people and help poor people'

In May 2003, Burkina Faso, on behalf of Benin, Mali and

Chad, presented the WTO with a new cotton proposal which called for phased elimination of all support for cotton production and financial compensation to least developed cotton producers. Supported by 13 other West and Central African countries, they made it clear that the elimination of subsidies for cotton production and export was their 'only specific interest' in the Doha Round.

The proposal failed with the rest of the Cancún agenda but in May 2003 Brazil won a landmark victory at the WTO when it was ruled that the US had granted excessive subsidies to cotton growers between 1999 and 2002, depressing prices at the expense of Brazilian and other growers.

Brazil used the WTO dispute mechanism to complain about US subsidies, contending that they depressed world prices and harmed Brazilian cotton growers, while significantly increasing the US share of the global cotton market.

The interim decision determined that US direct payments to farmers, though not coupled specifically to cotton production, did provide an incentive for production, and thus were trade-distorting, thereby accepting that it is possible to calculate the damage from subsidies even if they are formally decoupled. The ruling could affect agricultural support provided by other developed countries (such as within the EU) in cotton and other sectors (such as sugar).

The impact of cotton subsidies on prices can only be estimated, but some research suggests that their removal could result in a world price increase of 11% or more. Our own recent research predicts that price increases could be as high as 18–28% depending on assumptions regarding the structure of the cotton market. In cash terms, West and Central African countries could gain between $94m and $360m in cotton production earnings.

ODI's study takes into account that the importance of national origin and quality is important in world cotton trade. In general, this would lead spinners to tolerate some price increases before switching sources. However, the impact of the removal of EU support might be particularly beneficial to particular poorer countries. European subsidies may account for as much as 38% of the loss of earnings in West and Central Africa.

Our study has important policy implications. Firstly, US and EU subsidies deprive Least Developed Countries of income. Reducing subsidies would increase the foreign exchange earnings of poor countries and help poor people. Second, EU subsidies may be particularly damaging to West and Central Africa. This is because cotton production in Greece and Spain actively competes with that of these countries and their subsidies are the highest in the world. Third, despite preferences for a particular country's cotton, markets will respond eventually to higher prices. West and Central African countries would have much to gain from the removal of EU subsidies.

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