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Cotton

Background for 1990 Farm Legislation

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Abstract

Government programs since the 1930's have supported prices and attempted to adjust cotton acreage and production to meet market needs, with varying degrees of success. The Food Security Act of 1985 is generally considered successful in dealing with the cotton sector despite several problems. The marketing loan provisions of the act helped make cotton competitive in 1987 and some world market share was won back by U.S. cotton. However, in 1988-89 problems with the adjusted world price formula and with the storage terms resulted in owners of cotton holding stocks rather than releasing them to the market even though U.S. stocks were high.

Keywords: costs and returns, exports, cotton, cotton production, farm programs, policies, program benefits

Foreword

In 1990, Congress will consider new farm legislation to replace the expiring Food Security Act of 1985. In preparation for these deliberations, the Department of Agriculture and many groups throughout the Nation are studying preceding legislation to see what lessons can be learned that are applicable to the 1990's. This report updates **Cotton: Background for 1985 Farm Legislation,** (AIB-476) by Irving R. Starbird. It is one of a series of updated and new Economic Research Service background papers for farm legislation discussions. These reports summarize in a nontechnical form the experience with various farm programs and the key characteristics of the commodities and the farm industries which produce them. For more information, see the Additional Readings listed at the end of the text.

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Summary

The health of the U.S. cotton industry depends on the world economy. U.S. exports vary greatly from year to year, depending on foreign cotton output and general economic conditions, which contribute to supply and price instability. However, the United States will likely continue to be the world's leading cotton exporter.

The world cotton industry experiences stiff competition from manmade fibers in all major end uses. Cotton was the single most important fiber used by the U.S. textile industry until the 1960's, when manmade fibers surpassed it in use. Factors that often favor manmade fibers over natural fibers include specialized and predictable qualities and relatively stable supplies and prices.

The influence on the U.S. cotton industry of the world economy and intense competition among world textile producers is particularly apparent in the U.S. textile trade pattern of the 1980's. The rapid expansion of the U.S. economy in the early-to-mid-1980's, accompanied by a rapidly appreciating trade value of the U.S. dollar up to early 1985, made the U.S. market particularly attractive to foreign textile producers. During this period, double-digit annual growth in textile imports was common. More recently, the depreciation of the dollar versus foreign currencies has ameliorated textile import growth and improved the competitive position of domestic textile output in world markets. The U.S. balance of trade in textiles will likely continue to be heavily influenced by foreign competition, the strength of the domestic economy, and the trade value of the U.S. dollar.

Since the turn of the century, U.S. cotton producers have frequently experienced excess production capacity, high stocks, and low product prices. Government programs since the early 1930's have attempted to support prices and adjust acreage and production to market needs. These programs may have stabilized and improved net incomes and slowed the transfer of resources out of cotton production. However, until recently, cotton farms continued to increase in size in response to economic and technological forces.

While there have been year-to-year changes in acreage planted to cotton, the long-term trend has been downward. On the other hand, production has remained relatively stable because of substantial increases in yields. Since 1980 the farm value of the cotton crop has not been enough to pay all costs of production. But Government payments have made cotton production profitable overall. Still, one in five cotton farms had negative net farm income in 1987, a very good year for cotton farmers. No deficiency payments were made to cotton producers from 1974 through 1980 since prices received were above target prices. However, large deficiency payments were made during 1981-88 when Government payments (except in 1983 and 1986) comprised between 12 percent and 23 percent of total income from cotton.

As with wheat and feed grains, Government programs for cotton to control production, stabilize prices, and support farm income have been in effect for 50 years. Acreage allotments, marketing quotas, and price supports based on parity were in effect during the early years, with the exception of 1943-49 and 1951-53 when allotments and quotas were temporarily removed. Allotments remained in effect at varying levels from 1954 through 1970. The 1965 Food and Agriculture Act was a turning point in cotton policy in that price supports and income supports were clearly separated. The market price of cotton was supported at 90 percent of the estimated world price level. This allowed domestic market prices to seek world price levels. Payments to farmers were based on their participation in an acreage reduction program. By the end of 1970, the huge surpluses of cotton were gone. The voluntary program to reduce acreage had met the objective of reducing stocks, but the direct payments in excess of $600 million during the late 1960's had resulted in relatively high U.S. Treasury costs.

The programs of the 1970's continued to recognize the importance of the world market price in setting the loan rate of cotton. The 1973 Act established target prices, which provided for direct payments to producers if market prices fell below target price levels. The 1977 Act set target prices on the basis of cost of production, but this adjustment was removed in the 1981 Act, which established the 1981-85 target prices at successively higher levels. The programs of the early 1980's continued the market oriented loan rate formula, combined with relatively high deficiency payments. However, substantial acreage reductions to reduce surpluses were required, culminating in the payment-in-kind program of 1983.

The Food Security Act of 1985 established cotton farm policy for the 1986-90 crop years. Some major features of past farm acts were retained, including acreage limitations, nonrecourse loans, and target prices. But, the act also gave the Secretary of Agriculture more discretionary authority for administering the program. In contrast to earlier programs, the 1985 Act specified declining target price minimums through 1990. A major new provision of the act, the marketing loan, provided a loan repayment plan allowing loans to be repaid at levels below the loan rate if world market prices (adjusted to U.S. quality and location) were below the loan rate. The program performed effectively during 1986/87 and part of the 1987/88 season as both exports and domestic cotton use increased and stocks fell. Since then, changing foreign conditions and problems with the mechanics of the program itself forced numerous adjustments in program provisions as U.S. cotton struggled to be competitive in world markets.