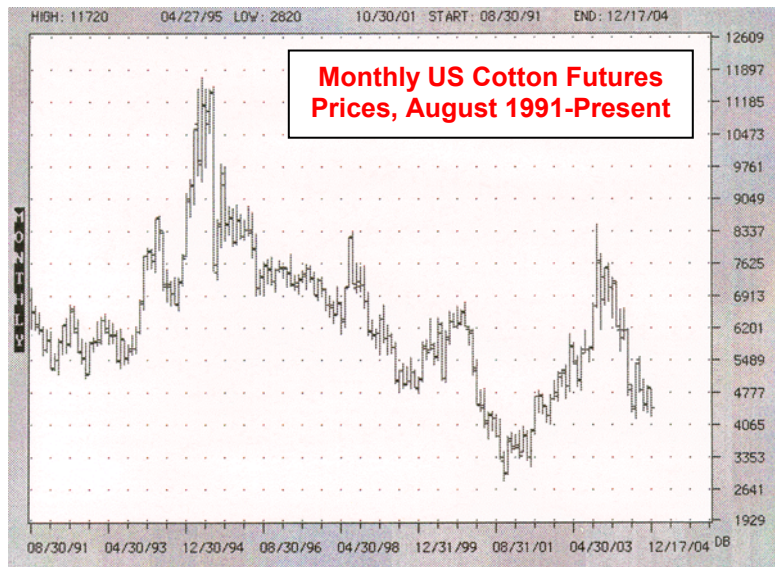


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A Look at Trade and Competitiveness From the Farm Level

In the months and years ahead, US agriculture (and the US cotton industry more specifically) faces several issues and challenges related to trade (exports, global market share, and price/cost competitiveness vis-à-vis other countries). Trade policies such as the WTO agreement (the outcome and implications of the present Brazil dispute, for example) and other trade issues and agreements will impact agriculture. Further, these trade issues will also have over-riding implications for the next farm bill and perhaps even the present one.



I am not going to use this space to foolishly pretend that I know all or even a lot about what is going on in the trade area because I don't. Honestly, very few if any of us do. Suffice it to say, a person has to be involved deeply in those aspects of the industry day-to-day and year-to-year to know expertly the details of the issues. In this regard, I firmly believe and trust that the cotton industry has the voice and political wherewithal to take us in the right direction.

But I think it is high time that we begin to look at trade and consider its' implications from the viewpoint of the farmer. Ultimately, it is the agricultural producer that will feel the impact and bear the consequences of economic and policy decisions. Often, discussion and negotiation takes place that speaks of and considers only what is politically and socially expedient. The farmer is often treated as "collateral damage" and the impact on the farmer considered little if at all.

At the heart of the current cotton dispute are government subsidies. The US cotton government program has 3 producer payments—LDP, DP, and CCP. The LDP is the only payment on actual production. The DP (Direct Payment) and CCP (Counter-Cyclical Payment) are paid on 85% base acres, not actual production and there is no requirement to produce or even produce the base crop to be eligible. Further, DP and CCP are "capitalized" into land values and, in a tenant situation, a large portion paid to the landowner not producer if the form of higher land rent.

Cotton does not stand alone in these payments. Most major US row crops have essentially the same program structure under the 2002 farm bill. Yet, interestingly, the bulk of the attack seems to be aimed at cotton. Beginning with the "Freedom To Farm" farm bill in 1996, payments such as AMTA (now DP) and now CCP were "decoupled" from production in order to comply with "Green Box" and "Amber Box" restrictions and limits under GATT (now WTO).

Using cotton as an example, the function of the LDP (Loan Deficiency Payment) is to (1) keep cotton out of the government loan (by offering the producer an LDP/POP payment) and (2) to allow cotton, if in loan, to be redeemed at the AWP when below the loan rate resulting in a MLG (Market Loan Gain). Either way, the program allows cotton prices to move low if needed while at the same time keeping cotton moving through the domestic and export pipelines and providing price support for the producer.

“Competitiveness” is often or may be defined relating to cost of production. Whoever can produce a product the cheapest might be said to have a “comparative advantage”. But, competitiveness can be influenced by policies that affect price, marketing, and trade. The idea (theory) of “free trade” is one where all barriers are eliminated, the playing field is level, and thus production is free to find its comparative advantage.

Let’s look at competitiveness from a farm level viewpoint. What does competitiveness really mean and what does it imply? You may be shocked, or maybe not.

In 2003, the US average total cost of production for cotton was 75 cents per lb. The average cost in the Southeast was 72 cents and 64 cents for the Delta. What this says is that the average US farmer did not cover total production cost without LDP’s and other payments. For the US and for the 2 regions considered, operating costs and a portion of overhead cost could be met, but not all costs. So what do we do? Can other countries produce cotton cheaper than the US? If so, what does this imply?

Since 1991, US cotton prices (basis futures) have probably averaged around 60 cents or less. Can US cotton producers profit and compete at these prices? More importantly, can US producers profit and compete at lower prices if the US cotton program were changed significantly as a result of trade disputes and negotiations?

Cotton Cost of Production, 2003

	Southeast	Delta	U.S.
Yield Per Acre	731	875	651
Operating Costs Per Acre	\$316.63	\$332.52	\$269.12
Overhead Costs Per Acre	\$206.66	\$225.81	\$216.37
Total Cost Per Acre	\$523.29	\$558.33	\$485.49
Operating Cost Per Lb	\$0.43	\$0.26	\$0.33
Total Cost Per Lb	\$0.72	\$0.64	\$0.75

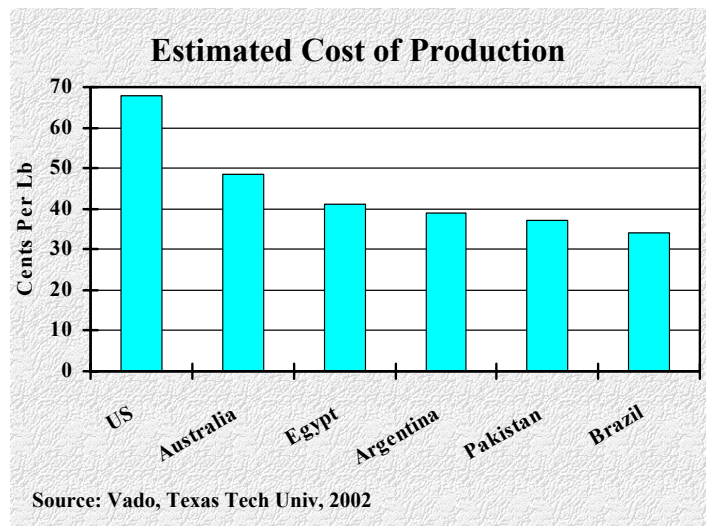
Source: USDA. Operating cost includes hired labor. Does not include land rent. Value of cottonseed deducted from ginning cost. Overhead costs include farmer/operator labor, annual depreciation and interest on machinery/equipment, taxes, insurance, and land.

Assuming, based on published data, that some countries can produce cotton cheaper than the US, the answer to these questions lies first in taking a serious look at the condition of the playing field. Operating costs per acre (or hectare) are determined by agronomic conditions, inputs required, quantity used, and cost per unit applied. The largest operating cost items for the US producer are seed, fertilizer, chemicals, and fuel.

Are US farmers paying more or less per unit? Are there regulations which add to US costs? Labor accounts for about 15% of operating cost and about 16% of overhead cost for the US producer. Are other countries more or less dependent on labor and how much is labor paid? How do production systems compare? US cotton production is highly mechanized while other countries might be more labor dependent. The US average hired farm labor wage rate is approximately \$9.00 per hour and farmer/operator labor is much higher valued. Cost per lb is determined by yield. How do US yields compare to other countries? If our cost per lb is higher, it is because cost per acre are higher, yield is lower, or both?

About 45% of the total cost of production for the US cotton producer is “overhead” or fixed costs. I believe it is safe to say that most US producers can cover operating cost even at low market prices without LDP’s. For cotton on rented land (where rent would be an operating cost rather than an overhead cost) this would not be as accurate a statement.

Overhead includes annual fixed costs on machinery and equipment, farmer/operator labor, and land. US agriculture is a high-investment, high-risk business. Machinery and equipment is not cheap, land is relatively expensive, and farmer/operator labor and management valuable. Operating costs per acre and per lb may be different for the reasons previously mentioned, but it is also likely that differences in overhead costs are the real driving force behind any comparative advantage.

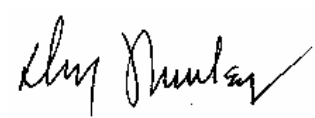


How much should it mean to US society and economic well-being to be self sufficient in food and fiber? What is it worth to the average US citizen-tax payer to have a viable, profitable, stable US agriculture?

When policy makers talk about trade and competitiveness, when other countries complain about US farm program and program subsidies, if you really look deeper, there is much more to it than first meets the eye. In terms of cost competitiveness, what you are really comparing and competing on is also society values, economic and political goals, and standard of living. For example, how can the US compete against countries where labor is valued at a fraction of US rates and land valued at 20% or less of US values? How can/should the US compete against countries where farming is a (the main) tool for economic growth and development?

The mainstay of US farm programs has always been that what is good for the farmer is good for the country as a whole... that we as a society value agriculture and a stable, cheap, self-sufficient food and fiber supply. We also have been blessed to have the land and production capacity to supply food and fiber to the rest of the world. US farm programs have been designed to be flexible and competitive on price while providing income support in the form of payments and subsidies when prices need to move low to balance supply and demand. This model is now being challenged and the challenges seem to grow as we have become more involved in trade and reliance on exports.

The US cotton industry needs exports. Two-thirds of US cotton production is now used by overseas mills. The US is the world’s largest cotton exporter. A solution must be sought that will not jeopardize US export potential and market share while continuing to provide income stability for the US producer. As a side-note, the US cotton industry I believe needs to be continually challenged to find ways to lower US production costs through better technology and/or higher yield potential. It is not clear that advances over the past 10 years have lowered costs or improved yield and significantly lowered the cost per lb of lint. The profit equation considers price, costs, and yield. If and when trade negotiations result in price and subsidy changes, that medicine would be easier to swallow if offset by advances in yield and lower cost per pound.


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