

TESTIMONY
Presented to the
Subcommittee on General Farm Commodities and Risk Management
U.S. House Committee on Agriculture
by
Chuck Coley
Chairman, National Cotton Council
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Introduction

I would like to thank Subcommittee Chairman Conaway, Ranking Member Boswell and Members of the Subcommittee for the opportunity to offer the views of the National Cotton Council regarding U.S. farm policy. My name is Chuck Coley, and I am a third generation cotton and peanut farmer from Vienna, Georgia. I also am President of Coley Gin and Fertilizer which includes a cotton gin and warehouse; a peanut buying point and warehouse; and a fertilizer and crop protection product distribution company. I am currently serving as Chairman of the National Cotton Council.

The National Cotton Council (NCC) is the central organization of the United States cotton industry. Its members include producers, ginner, cottonseed processors and merchandisers, merchants, cooperatives, warehouse and textile manufacturers. Cotton is a cornerstone of the rural economy in the 17 cotton-producing states stretching from the Carolinas to California. The scope and economic impact extends well beyond the approximately 19 thousand farmers that plant between 9 and 12 million acres of cotton each year. Taking into account diversified cropping patterns, cotton farmers cultivate more than 30 million acres of land each year. Processors and distributors of cotton fiber and downstream manufacturers of cotton apparel and home furnishings are located in virtually every state. Nationally, farms and businesses directly involved in the production, distribution and processing of cotton employ almost 200 thousand workers and produce direct business revenue of more than \$27 billion. Accounting for the ripple effect of cotton through the broader economy, direct and indirect employment surpasses 420 thousand workers with economic activity well in excess of \$100 billion.

The NCC believes that sound farm policy is essential to the economic viability of the cotton industry. We appreciate the dedication and diligent work of the leadership of the House Agriculture Committee during last fall's efforts to achieve a joint deficit reduction package. While that effort did not advance a farm bill to conclusion, the U.S. cotton industry supports the commitment to conclude a farm bill in 2012. It is critically important to provide certainty to those involved in production agriculture since they make long-term investment decisions based in part on federal farm policy. The NCC also strongly supports balanced commodity programs that address the specific needs of individual commodities across different regions of the country versus a one-size-fits-all approach.

The combination of the marketing loan, Direct Payments (DP) and Counter-cyclical Payments (CCP), as structured in the 2008 Farm Bill, has served the cotton industry extraordinarily well and, in recent years, has required minimal federal outlays. However, deficit reduction efforts are placing unprecedented pressure on the existing structure of farm programs. We understand that the Agriculture committees are facing a daunting challenge of providing an adequate safety net with sharply reduced funding.

The U.S. cotton industry faces the unique challenge of resolving the longstanding WTO dispute with Brazil. In developing new farm legislation, the U.S. cotton industry pledges to work with Congress and the Administration to resolve the Brazil WTO case and remove the imminent threat of retaliation against exports of U.S. goods, services and intellectual property. As you know, the case includes findings against parts of the upland cotton program as well as the export credit guarantee program used by cotton and many other commodities. We believe our proposal resolves the cotton portion of the dispute. However, the export credit guarantee program must also be addressed and we look forward to working with other agriculture groups to resolve that aspect of the case.

In light of budget constraints and trade considerations, the industry recommends a revenue-based crop insurance program available for voluntary purchase which will strengthen growers' ability to manage risk. By complementing existing products, the program would provide a tool for growers to manage that portion of their risks for which affordable options are not currently available.

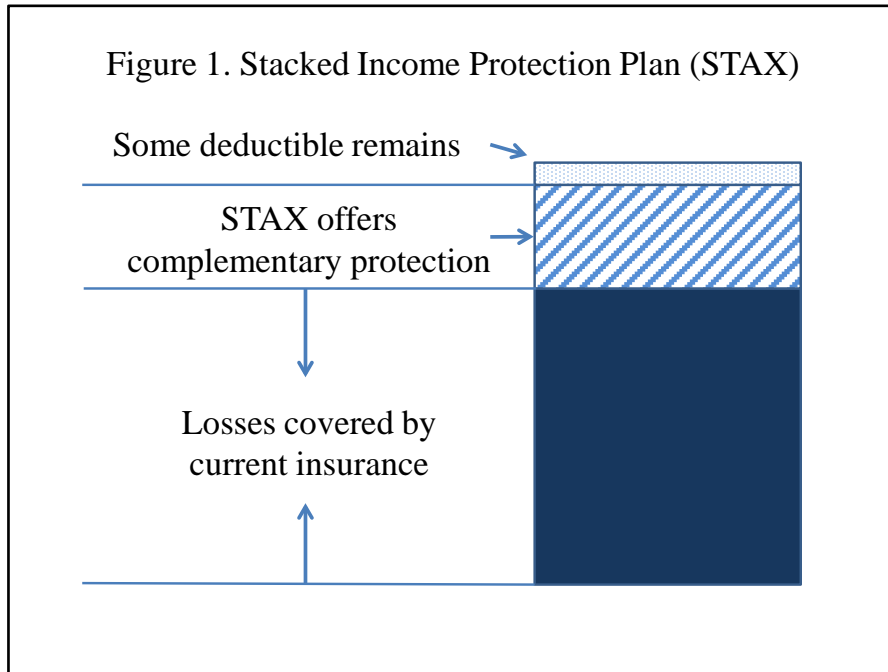
The revenue-based crop insurance safety net would be complemented by a modified marketing loan that is adjusted to satisfy the Brazil WTO case. This structure will best utilize reduced budget resources, respond to public criticism by directing benefits to growers who suffer losses resulting from factors beyond their control, and build on the existing crop insurance program, thus ensuring no duplication of coverage and allowing for program simplification. The revisions will provide confidence to lenders and ensure market-oriented production decisions that ultimately serve the long-term financial health of merchandizers, processors, related businesses and rural economies.

Stacked Income Protection Plan

The recent cotton market has been characterized by extremes. Cotton prices exhibited unprecedented volatility, essentially tripling between April 2010 and April 2011. However, the exorbitant surge in prices, which was in part fueled by unexpected cotton export restrictions by India, placed tremendous pressure on textile manufacturers, and cotton demand suffered as a result. By the end of 2011, cotton prices had retreated, losing much of the gains of the earlier rally. As market prices experienced greater turbulence, portions of the U.S. Cotton Belt faced extreme weather conditions. The Southwestern region, most notably Texas and Oklahoma, suffered through the worst drought conditions on record in 2011. Based on USDA data, the percentage of planted acres that were un-harvested reached an all-time high. Unpredictable and extreme weather conditions continue to afflict many parts of the country. Last year, portions of the Mississippi Delta region lost crops due to spring-time floods, while areas in the Southeast faced drought conditions. Unfortunately, unusual market and weather events have occurred when input costs are at an all-time high. As a result, operating margins are volatile and extremely tight.

Farmers understand that agriculture is an extremely risky endeavor, but they also understand that effective risk management is the key to long-term viability. While the goal of farm programs is not to completely remove the risk associated with farming, farm programs should strive to provide opportunities for effective risk management. The Stacked Income Protection Plan (STAX) accomplishes that goal. STAX is designed to provide a fiscally responsible and effective safety net for upland cotton producers. The program will be administered in a manner consistent with current crop insurance delivery systems and is designed to complement existing crop insurance programs. While this proposal does not change any features of existing insurance products, the STAX product is explicitly structured so as to avoid duplication of other insurance coverage.

STAX is designed to address revenue losses on an area-wide basis, with a county being the designated area of coverage. In counties lacking sufficient data, larger geographical areas such as county groupings may be necessary in order to preserve the integrity of the program. The “stacked” feature of the program implies that the coverage would sit on top of the producer’s individual crop insurance product (Figure 1). While designed to complement an individual’s buy-up coverage, a producer would not be required to purchase an individual buy-up policy in order to be eligible to purchase a STAX policy.



The STAX revenue product would be funded using available upland cotton baseline spending related to the CCP, DP and Average Crop Revenue Election (ACRE) programs. In addition, producers would bear a portion of the cost of the program by paying some part of the premium. However, producer premiums would be offset to the maximum extent possible through the use of available upland cotton spending authority for the CCP, DP and ACRE programs. The cotton industry believes that the premium offset should be no less than 80%, which is the current subsidy level for all enterprise unit policies.

The basic design of the STAX product is similar to current Group Risk Income Protection (GRIP) plans offered through the Risk Management Agency (RMA). The U.S. cotton industry’s proposal includes two notable changes relative to the current GRIP plan. The first is the introduction of a reference price in the formula determining the expected or reference income. Secondly, the industry’s proposed STAX plan would cover only those losses at the upper end of the producer’s risk profile. Indemnities under the STAX plan would be paid on upland cotton planted acres purchasing the plan.

The following table highlights the basic design of STAX. The description in Table 1 is not an exhaustive list of the possible features of the program, but rather a general overview. Specific parameters and features of the program will in part be determined by budget considerations.

Table 1. Basic STAX Overview

<i>Relevant market prices for crop insurance products are determined based on futures markets</i>	Projected Price	Use same procedure as current insurance products. (For much of the Cotton Belt, the Projected Price is determined as the average closing value of the December contract for a relevant pre-planting period.)
	Harvest Price	Use same procedure as current insurance products. (For much of the Cotton Belt, the Harvest Price is determined as the average closing value of the December contract for a relevant harvest period.)
<i>Determine level of price and income protection under STAX policy</i>	Preliminary Price Protection	Higher of the Projected Price and a <u>Fixed Reference Price</u>
	Area-wide Projected Income	Preliminary Price Protection multiplied by the Expected County Yield
	Area-wide Reference Income	The higher of the Preliminary Price Protection and the Harvest Price multiplied by the Expected County Yield
<i>Determine if indemnity is paid under the policy</i>	Area-wide Realized Income	The Harvest Price multiplied by the Actual County Yield
	Area-wide Indemnity	If the Realized Income falls below an <u>Elected Percentage</u> of the Reference Income, then an Indemnity equal to the difference is triggered. However, the Indemnity may not exceed a <u>Defined Percentage</u> of the Reference Income.

The U.S. cotton industry proposes that growers should have the ability to purchase STAX coverage up to a 95% level. The higher coverage level is especially important in production areas that have made significant investments in irrigation. However, producers should have the ability to adjust their upper coverage level depending on their risk profile and their ability and willingness to pay the associated premium. Producers will have the flexibility to adjust the width of the STAX coverage by selecting a lower bound of coverage, thus establishing a maximum indemnity. Furthermore, if a producer purchases an individual or traditional area-wide buy-up policy, the STAX lower bound must be a number at least as large as the coverage level selected in the buy-up policy. For example, a producer who purchases an individual revenue or yield product at an 80% coverage level and also chooses to purchase a STAX policy, the lower bound of the STAX policy can be no lower than 80%. STAX is designed to complement current insurance coverage and not overlap with that coverage.

As previously mentioned, the industry’s STAX proposal includes a reference price in the determination of the county reference income. In a manner consistent with other crop insurance products, price protection under the STAX plan is based on cotton’s December futures contract during a relevant pre-planting period. In recent weeks, the December 2012 contract has traded between \$0.78 and \$0.95 per pound, and the nearby December contract has averaged \$0.82 between 2008 and 2012. Price projections by USDA and the Congressional Budget Office (CBO) are consistent with futures markets trading in the 80-cent range. However, the industry understands the volatility of commodity markets and the importance of downside protection during times of low

prices. As a result, the U.S. cotton industry believes that a reference price of \$0.65 per pound provides important protection during those times of low prices, but this should trigger on an infrequent basis given current projections for commodity markets. Also, since STAX is an insurance product, premiums will adjust to reflect the likelihood of indemnities should the futures market fall below the reference price. In other words, the minimum price does not come without a cost to the producer. Also, it is important to remember that even with a reference price of \$0.65, indemnities are not triggered until actual income falls below the selected trigger level. If a grower has purchased a 90% STAX policy, then futures must trade below \$0.585 (i.e. 90% of \$0.65) before indemnification occurs, assuming actual yields are in line with expectations. At this level, the cotton industry is confident that the reference price is set at a level that will offer protection against sharply lower prices, but do so in a manner that does not induce additional acres of cotton.

As a final point regarding STAX, the industry is urging that the product be fully available beginning with the 2013 crop. We certainly appreciate the efforts of this subcommittee and the full committee to advance the farm bill process as quickly as possible. However, if unforeseen circumstances should delay the legislation and the subsequent implementation of STAX, a transition program would be needed for 2013 if STAX were unavailable until the 2014 crop. The cotton industry stands ready to work with Congress during the farm bill process to develop an acceptable transition.

Other Crop Insurance Issues

Across the Cotton Belt, crop insurance is an essential risk management tool for cotton producers, and the STAX plan will provide another viable option for producers to effectively address their risk profile. Given the diversity of weather and production practices, the menu of insurance choices should be diverse and customizable, thus allowing for the fullest participation and most effective coverage.

In 2008, the introduction of enterprise unit pricing gave producers one more option for insuring against those risks that are beyond their control. The U.S. cotton industry strongly supports the continuation of that option in the 2012 farm bill and urges Congress to provide for the availability of enterprise unit pricing for growers who separate their farms by irrigated and non-irrigated practices.

The industry also supports crop insurance products that allow growers to insure the deductible of their underlying buy-up policy.

Upland Cotton Marketing Loan

The findings of the WTO Brazil case and the subsequent Framework Agreement between the U.S. and Brazilian governments require that changes be made to the marketing loan for upland cotton as part of the development of the 2012 Farm Bill. To address that requirement, the NCC proposes that the level of the upland cotton marketing loan be adjusted based on the historical Adjusted World Price (AWP).

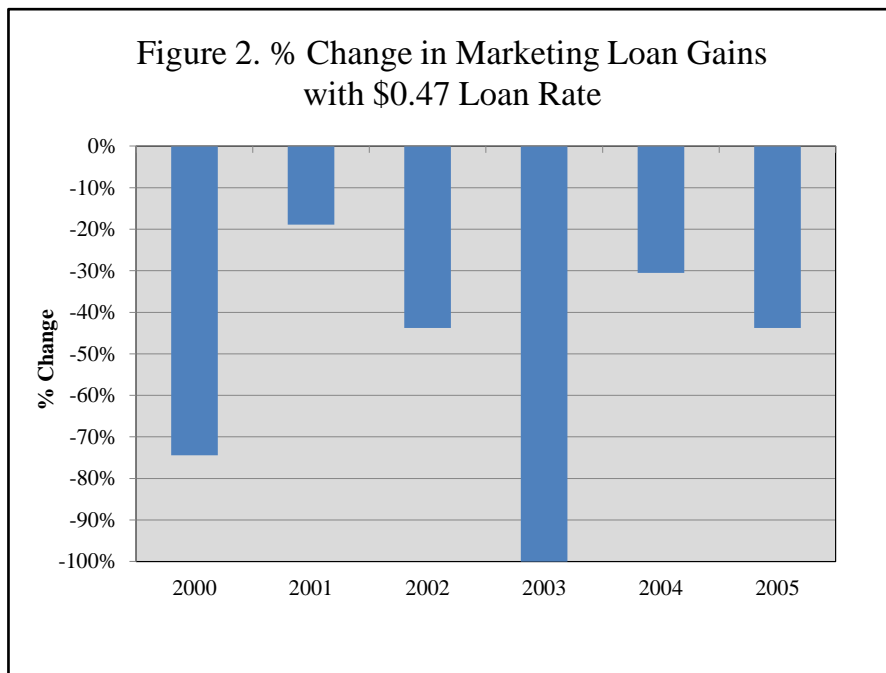
The loan rate for a crop will be determined in the fall prior to planting the crop and be set equal to the average of the AWP for the two most recently completed marketing years provided the 2-year moving average falls within a set maximum and minimum loan level. If the 2-year moving average exceeds \$0.52, the loan rate is set at a maximum level of \$0.52. If the 2-year moving average falls below \$0.47, the loan rate is set at a minimum level of \$0.47. All other features of marketing loan remain unchanged from current law.

As an illustration, the loan rate for the 2013 crop would be announced in the fall of 2012 based on the average AWP prevailing over the 2010 and 2011 marketing years, which represent the two most recently completed marketing years. Once announced, the level of the loan remains fixed for the duration of the marketing year.

The WTO dispute with Brazil focused on data and market developments during the early 2000s, which was a time of chronically weak prices with the AWP below the marketing loan for extended periods. Had the proposed formula been in place during those years, the marketing loan for upland cotton would have declined to \$0.47 for much of the period. With a loan rate of \$0.47, any marketing loan gains would have been substantially lower than actual levels – with reductions generally above 20% and in some cases, more than 70% lower than actual levels (Figure 2).

As previously mentioned, existing features of the upland cotton marketing loan should be retained in the 2012 farm bill. These include an effective determination of the AWP for purposes of loan redemption in times of low prices, as well as the provision of storage credits should the loan redemption price fall below the loan rate.

In order to be eligible for a marketing assistance loan, upland cotton must be stored in an approved warehouse. Unlike most bulk commodities, upland cotton cannot be farm stored, so to utilize the loan a producer has no option other than to enter cotton in a warehouse where storage and handling charges accrue until the cotton is marketed. Since cotton is stored in identity preserved units (each bale has a distinct identity), storage and shipment require more time, effort and expense than other crops. Storage credits allow the U.S. to remain competitive in times of low prices and should be maintained in new farm legislation.



Resolution of the Brazil Dispute

The NCC understands the importance of resolving the Brazil WTO dispute within the 2012 Farm Bill. Since the industry first unveiled the STAX proposal last fall and even following the actions by the Senate Agriculture Committee in late April, the Brazilian government has repeatedly voiced their objections to STAX. In our opinion, those objections are unfounded and the industry believes that STAX, as originally proposed, addresses the concerns of the WTO panel.

In this longstanding trade dispute, the WTO panel concluded that the combination of the marketing loan, target price and former Step 2 provision of the marketing loan combined to cause significant price suppression and serious prejudice to Brazil's cotton industry.

The Step 2 provision of the upland cotton marketing loan was eliminated in 2006. In the context of the current farm program, the only remaining provisions relevant to the Brazil dispute are the marketing loan and the target price. NCC's farm policy proposal rectifies both of those programs by eliminating the upland cotton target price and introducing a formula that would lower the marketing loan rate in times of low prices.

Moving upland cotton's support into an insurance program is consistent with the determination of the WTO panel that found no trade distortion or price suppression related to insurance programs. The WTO panel essentially treated insurance programs in the same light as direct payments in terms of production and price impacts. Under the NCC's proposed changes, coupled with past program eliminations, total support to upland cotton deemed to be trade-distorting by the WTO panel would have declined by 60% over the period 1999 to 2005, which is the period on which the Panel's findings are based. Further, total support to cotton, including Direct Payments and insurance premium subsidies, would be down by 40% under the industry's original proposal.

The NCC believes the combination of STAX, as originally proposed by the industry, and the modified marketing loan significantly reduces U.S. trade-distorting support for upland cotton. It should be noted that the STAX included in the Senate package goes even further by eliminating the reference price and reducing the maximum coverage from 95% to 90%. These changes directly address the top concerns cited by Brazil. Further, NCC economists have estimated that total support to upland cotton for the 1999-2005 period under the provisions of the Senate package would be 52% lower than actual support.

While 1999 through 2005 was the focus of the case, constraints on future support to upland cotton also are important to note. Under the Senate package, the combination of deficit reduction and program adjustments lead to a reduction in cotton's projected support of more than 40% when compared to a continuation of current programs. It is abundantly clear that STAX and the modified marketing loan generate lower support for upland cotton and provide a sound basis for resolving the dispute.

Insulation from market forces was a focal point of the WTO dispute. Brazil argued that traditional support programs provide a buffer to growers from the true signals of the market. This is not the case in STAX or other insurance programs. Revenue triggers are directly related to the current level of futures markets. Fortunately, cotton prices have increased over the last two years, and as a result, price elections under crop insurance are higher. However, when the market moves lower, support under STAX and insurance programs will move lower as well. STAX does not "lock-in" high revenues through artificial means such as moving averages of prices or limits on annual changes.

STAX simply looks to the market and allows growers to buy a level of coverage based on market signals. Furthermore, the higher coverage levels are not based on individual experience but rather area-wide triggers. There is no guarantee for the producer's individual income.

Provisions of the upland cotton program are just one aspect of the WTO dispute with Brazil. Brazil also successfully challenged export credit programs for cotton and a number of other agricultural commodities. NCC remains committed to working with both Agriculture Committees, the Administration and other commodity organizations in an effort to resolve all aspects of the case.

Economic Adjustment Assistance Program

NCC also supports the continuation of the Economic Adjustment Assistance Program (EAAP) for domestic textile manufacturers. The EAAP, authorized in the 2008 Farm Bill, is a success story that is revitalizing the U.S. textile manufacturing sector and adding jobs to the U.S. economy. The program provides a payment to U.S. textile manufacturers for all upland cotton consumed, whether U.S. grown or imported. The payment rate from August 1, 2008 through July 31, 2012, is 4 cents per pound of cotton used, and will be adjusted to 3 cents per pound beginning on August 1, 2012.

Recipients must agree to invest the proceeds in equipment and manufacturing plants, including construction of new facilities as well as modernization and expansion of existing facilities. The assistance program, which is consistent with WTO commitments, is modeled after trade adjustment assistance programs and is not designed to affect the price or competitiveness of raw cotton.

The EAAP has led to higher employment and increased cotton consumption by U.S. textile mills. Over the past 18 months, the Bureau of Labor Statistics reports that U.S. textile mills have added more than 6 thousand jobs. Based on a recent survey of EAAP recipients, 70% of respondents cited increases in the number of employees while the remaining 30% noted that labor requirements had either stabilized or more hours were required of existing employees.

The EAAP has allowed investments in new equipment and new technology. Survey responses indicated that companies had constructed new buildings, improved existing buildings, and invested in new spinning equipment and new technology for the purpose of expanding capacity and adding new product lines.

The EAAP has also allowed companies to reduce costs, increase efficiency and increase competitiveness. U.S. textile companies cited an increased ability to be more competitive against foreign competition and opportunities to reclaim market share from Asian competitors were also noted by survey respondents. Other benefits include lower energy costs, greater efficiency in style changes enabling faster adaptability to market conditions, improved quality control, increased capacity, reduced water use and more flexibility to meet customers' needs.

Future investments funded by a continuation of the EAAP will allow further recovery by the U.S. textile industry. Companies have expressed their intent to build new plants, add additional spinning and weaving technology, and replace existing equipment with more efficient machinery.

Payment Limits and Eligibility

The NCC has always maintained that effective farm policy must maximize participation without regard to farm size or income. Artificially limiting benefits is a disincentive to economic efficiency

and undermines the ability to compete with heavily subsidized foreign agricultural products. Artificially limited benefits are also incompatible with a market-oriented farm policy.

While the cotton industry understands the pressures for even more restrictive limits, we would like to remind the Subcommittee that the 2008 farm bill contained significant changes with respect to payment limitations and payment eligibility. In fact, the 2008 farm law included the most comprehensive and far-reaching reform to payment limitations in 20 years. The limitations were made more restrictive, and the adjusted gross income test was substantially tightened. As part of the 2012 farm bill, the NCC would oppose any further restrictions on payment eligibility including lower limits or income means tests. Likewise, we have serious concerns with any efforts to change the requirements that determine whether an individual is considered to be actively engaged in the farming operation. Arbitrary restrictions on the contribution of management and labor are out of touch with today's agricultural operations and would only contribute to inefficiencies.

Extra Long Staple Cotton

Extra Long Staple, or "Pima" cotton producers support continuation of a loan program with a competitiveness provision to ensure U.S. Pima cotton remains competitive in international markets. The balance between the upland and pima programs is important to ensure that acreage is planted in response to market signals and not program benefits.

Export Promotion Programs

Continuation of an adequately funded export promotion program, including the Market Access Program (MAP) and Foreign Market Development (FMD) Program, are important in an export-dependent agricultural economy. Individual farmers and exporters do not have the necessary resources to operate effective promotion programs which maintain and expand markets – but the public-private partnerships facilitated by the MAP and FMD programs, using a cost-share approach, have proven highly effective and have the added advantage of being WTO-compliant.

We appreciate the opportunity to provide these comments and look forward to working with the House Agriculture Committee in the development of a 2012 farm law that effectively meets the needs of cotton producers while addressing the challenges posed by budget constraints and trade concerns.