Business Session VI

Efficiencies Through Free Markets: Reducing Incentives for cotton in order to save cotton?

Chair: Dr. Terry Townsend, Consultant, Cotton Analytics

Panelists:
Mr. B.K. Mishra, Chairman and Managing Director, Cotton Corporation of India
Mr. Scott S. Sindelar, Minster Counselor for Agricultural Affairs, American Embassy, New Delhi
Mr. Colin Iles, Glencore Grain BV
Mr. Mitesh Shah, Head South Asia, Louis Dreyfus
Mr. Arun Sekhsaria, Managing Director, D.D. Cotton Pvt. Ltd.

Subsidies Support Production, but at What Cost?

Mr. Sindelar described the 2014 farm bill in the United States and the provisions for the cotton sector. He said that in response to discussions in the WTO, direct payments to cotton farmers under the previous farm programs have been eliminated, and cotton is now treated separately from other crops in the United States. Cotton farmers are now are eligible to purchase same-season revenue insurance called STAX(insurance against a decline in prices and/or a drop in yields below the 5-year average between January and October each year). They can also purchase crop insurance (insurance against a decline in yields from average levels). Insurance premiums are subsidized by the government. In addition, the U.S. government provides a price floor for cotton with a program called the "marketing loan," but the price floor is 45 cents per pound rather than 52 cents as used to be guaranteed.

Mr. Sindelar observed that the subsidies received by farmers will be much smaller and U.S. cotton production is now even more exposed to world market conditions than it used to be. Nevertheless, he acknowledged that farmer in the United States do indeed still receive subsidies. Subsides are beneficial in protecting the incomes of farmers, they level the playing field with farmers in other countries who receive support from their governments, and they ensure that the U.S. will continue to produce cotton.

Mr. Mishra noted that the cumulative price support operations of the Cotton Corporation of India from its inception in 1970 to now total about US$1 billion equivalent in Rupees, not discounting for cumulative interest on expenditures. If those expenditures were divided by production since 1970, the cost per kilogram of Indian production would be nearly insignificant.

The Minimum Support Price operations of CCI help protect vulnerable small holders from ruinous declines in prices below the cost of production, they help ensure that farmers will be in business in subsequent years when increased production is needed, and the MSP operations help offset the impacts of subsidies provided by the governments of other countries to their producers.

Mr. Iles, Mr. Shah and Mr. Sekhsaria noted that government programs divert spending from infrastructure, research and extension, that such programs can be highly expensive, that such programs can result in fraud and waste, and that such programs encourage all farmers, even inefficient farmers, to keep producing even when there is a surplus of cotton. It was noted that the highest national cotton yield in the world of 2,500 kilograms of lint is in Australia, where no subsidies are provided and farmers must be efficient to survive. In countries that provide subsidies, inefficient farmers are supported to continue growing cotton, and the national yield is lower as a result.

Mr. Sindelar noted that other commodities in India and elsewhere are also distorted by government measures, and that whenever governments encourage over-production or inefficient application of inputs, the resulting misallocation of resources results in a net decline in national income and social welfare.

Mr. Townsend drew attention to the “rent seeking behavior” that always occurs when governmentsintervene in markets. (Rent seeking behavior is the term used by economists to refer to lobbying by the private sector for beneficial interventions by government.)

Mr. Iles noted that the private sector can adjust to government interventions in markets that are communicated transparently and clearly well in advance. However, ad-hoc interventions, like export bans, that are announced abruptly and without full disclosure as to duration, can be highly damaging, especially if they are applied retroactively.

Mr. Mishra described a trial being conducted in one village by CCI to make direct payments to farm households in lieu of price support activity. He said it is too early to determine whether the trial is a success. Members of the panel agreed that direct payments to farm households can be effective and relatively efficient, provided that there are adequate safeguards against fraud.