Testimony

Presented by
John Pucheu, Chairman
on behalf of the
National Cotton Council
before the
U.S. House Agriculture
Subcommittee on General Farm Commodities
and Risk Management
March 28, 2007

The National Cotton Council is the central organization of the United States cotton industry. Its members include producers, ginners, cottonseed handlers, merchants, cooperatives, warehousemen and textile manufacturers. While a majority of the industry is concentrated in 17 cotton-producing states, stretching from the Carolinas to California, the downstream manufacturers of cotton apparel and homefurnishings are located in virtually every state.

The industry and its suppliers, together with the cotton product manufacturers, account for more than 440,000 jobs in the U.S. [U.S. Census of Agriculture]. Annual cotton production is valued at more than $5 billion at the farm gate, the point at which the producer sells [Economic Services, NCC]. In addition to the cotton fiber, cottonseed products are used for livestock feed, and cottonseed oil is used for food products ranging from margarine to salad dressing. While cotton's farm-gate value is significant, a more meaningful measure of cotton's value to the U.S. economy is its retail value. Taken collectively, the annual business revenue generated by cotton and its products in the U.S. economy is estimated to be in excess of $120 billion [Retail Values of U.S. Agricultural Commodities, NCC].

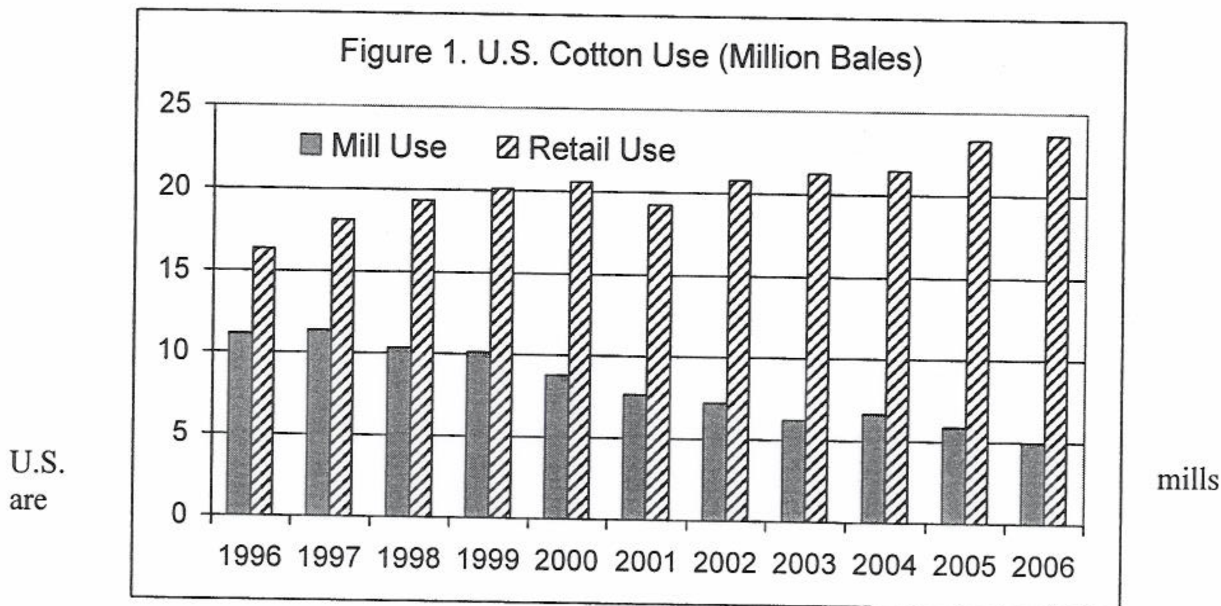
Mr. Chairman, thank you for holding this hearing and for allowing me to present the views and concerns of the members of the National Cotton Council. My name is John Pucheu. I serve as Chairman of the National Cotton Council. My brother and I own and operate a diversified farming operation in Tranquillity, California – a part of the highly productive San Joaquin Valley.

Mr. Chairman, the Council's recent annual meeting was highly productive. In spite of numerous challenges, I am pleased that our leaders once again achieved consensus and reaffirmed our priorities for sound farm policy. Stated simply, we haven't changed our opinion that new farm legislation should be patterned after the basic provisions of the 2002 farm bill. A marketing assistance loan that is available on all production is the foundation of sound farm policy. The combination of direct and counter-cyclical payments provides effective income support when needed most – in times of low prices. We also support maintenance of adequate planting flexibility to allow producers to respond to market signals. And while we are opposed to payment limitations of any kind, we certainly oppose any change that reduces existing limits or further restricts eligibility.

While we believe the basic structure of our farm program provides an effective safety-net, we also recognize that our markets are changing. There need to be adjustments to the administration of the cotton marketing assistance loan to maintain competitiveness. Last August, we worked with USDA as they developed an extensive regulation that allows relocation of bales under loan to better position them to move to market. The regulations also capped the monthly storage charges paid by CCC and require warehouses to report performance on a weekly basis. Recently, we asked USDA to assist in a thorough review of the methodology used to establish loan premiums and discounts; whether location differentials make sense in a market that is approximately 75% exports; and whether the discovery of an accurate world price should use Far East rather than Northern Europe price quotations. We also recommend that the statute and the regulations be changed to provide more flexibility in the way loans are redeemed. We believe these changes can adequately protect CCC's collateral while allowing producers, cooperatives, and merchants to market U.S. cotton more effectively.

Mr. Chairman, we also want to work with you and your colleagues to develop provisions which will assist our struggling domestic textile industry. According to USDA, domestic mill consumption of cotton is forecast at 5.0 million bales for 2006/07 (Figure 1). This is 900,000 bales or 15% below levels of a year earlier. The current projection means consumption will be less than 50% of levels just 7 years ago. It will be the lowest U.S. mill consumption since 1931/32. Quoting from a USDA analyst's report to the recent USDA Outlook Conference *"…this dramatic decline in U.S. mill use has resulted from increased competition of imported textile and apparel products……… China is now the leading supplier of cotton textile and apparel products to the U.S. – accounting for nearly 20% in 2005 and growing rapidly."* While imports rise and domestic mill consumption declines, cotton use at retail actually increased to 23.6 million bale equivalents in 2006 and will continue to increase in 2007 and the foreseeable future. U.S. consumers continue to drive global demand for cotton – thanks in part to the U.S. producer and importer-funded promotion program operated by Cotton Incorporated. U.S. per-capita consumption of cotton rose to 37.9 lbs in 2006. To place that in perspective, PCI Fibres places annual per-capita cotton consumption in the developed economies of Western Europe and

Japan at just over 16 lbs, and USDA is currently estimating that China's consumers purchase only 5.5 lbs of cotton textile products annually.



U.S. mills are competing with heavily subsidized imports without a safety net. In recent months, it has been stated and re-stated that the U.S. needs a robust and viable renewable fuels production base protected by a high tariff and significant tax credit. Mr. Chairman, we support that policy because it clearly benefits farmers and is in the interest of U.S. security. But downstream users of cotton products are not afforded the same high level of protection. That protection was, in fact, traded away during the Uruguay Round of trade negotiations. As a result, we need to provide compensation to our domestic customers – this country's textile production base. We recommend competitiveness assistance to U.S. mills for every pound of cotton they consume. This modest program would have very low costs and could be offset by minor modifications to other aspects of the cotton program.

Mr. Chairman, I want to also make a few comments about the Administration's farm bill proposal. We are pleased that it recognizes the importance of maintaining the structure of current law. We also appreciate the recommendation that the marketing assistance loan continue to operate without onerous, unworkable limits. But it won't surprise you to hear that we are deeply concerned by the proposal to implement a loan-rate formula that would result in a sudden, precipitous drop in the cotton loan rate.

We understand that the proposal to significantly increase the direct payment is designed to compensate cotton producers for the lower loan – but it doesn't do an adequate job. Replacing an important component of our policy that is available on actual production with a decoupled payment based on ancient history doesn't offer adequate compensation – especially to growers in the Southeast and to new growers in places like Kansas and northern Texas. Cutting the loan rate and raising the direct payment may be considered good policy in Geneva, but in my opinion, it certainly doesn't meet the Secretary's objective of equitable farm policy.

We were also intrigued and disappointed by the proposal to terminate the 3-entity rule, which has been in place since 1989 when it was viewed as a significant compromise. The intriguing part is the simultaneous increase of the limits on direct payments, counter-cyclical payments and marketing loan gains. If we could be assured that the termination of the 3-entity rule would be paired with the new limits – though they still disproportionately impact cotton, rice and peanuts – it might be worth considering as a means to simplify farmer's compliance. However, the clear danger is that some will support the termination of the 3-entity rule and insist that limits remain at current levels. You and your colleagues should also carefully consider how husband and wife eligibility is to be determined, if the landowner exemption will continue to apply, and what regulatory changes USDA would make to the definition of actively engaged in farming.

The Administration's proposal to modify the existing adjusted gross income (AGI) test by dropping the level to $200,000 is a bad idea. It is bad policy and bad operationally. Congress added a $2.5 million AGI test to the last farm bill in response to media criticism that high-income individuals – namely Scotty Pippin and Ted Turner – were receiving farm program payments. To ensure high-income individuals were denied benefits while not penalizing individuals who depend on farming, ranching or forestry for their livelihood, a 3-year AGI test was added to the 2002 farm law. An important provision provides an exemption from the means test as long as the individual or entity earns 75% or more income from farming, ranching or forestry. The Administration apparently selected $200,000 as a new ceiling so they can say that less than 2% of Americans who file tax returns have an AGI at that level. The Administration also contends that 4.2% of recipients of farm program payments who filed a Schedule F in 2004 have an AGI above $200,000 and that only 4.7% of all payments received by farm proprietors went to those with an AGI over $200,000. That is catchy spin, but dangerously misleading. The real question is what percent of U.S. commodity production will be affected. For cotton, we believe it will be very significant.

This new AGI ceiling was not chosen with any regard to financial reality on commercial farms. Let's be clear that a farmer's AGI is not profit. There are still a number of expenses that must be covered. In addition to personal expenses, farmers must service debt that, given the costs of today's machinery and land, can easily reach into the millions. Furthermore, the proposal inexplicably eliminates the 75% exclusion for people who farm and ranch – indicating that the purpose behind the means test has changed from one targeted to exclude millionaires who happen to own a farm to one that specifically targets active farmers and ranchers. Oddly, the Administration left the $2.5 million AGI test in place to determine eligibility for conservation programs – which are the payments the aforementioned Mr. Pippin actually received. The Administration's proposal condemns growers and their lenders to the ping-pong effect of "in one year and out the next" which is directly at odds with the Secretary's "equitable and predictable" criteria for the new farm law. Finally, in another interesting twist, the U.S. will receive no credit in the WTO for this type of a means test.

We were also deeply disappointed by the Administration's proposal to eliminate storage credits when prices are low. The practice of paying storage was put in place to ensure cotton was available at competitive prices, yet the Administration proposes eliminating the credits effective October 1, 2007, just as 2006 crop loans are maturing. This would result in significant market disruption and income losses to farmers by changing the existing rule during this marketing year.

Inexplicably, the Administration proposed eliminating the credits in their FY08 budget proposal, but not in their farm bill proposal.

Access to an affordable crop insurance program is an important tool for most farmers. However, given the continued inequities of coverage and service in different regions and for different crops, it is time for a thorough evaluation of the cost and benefits associated with the multi-peril crop insurance program. Also, the cotton industry would be interested in exploring enhancements to crop insurance products that would offer protection on an individual's deductible. The Administration included the concept of supplemental insurance coverage in their farm bill proposal, and many growers are interested in further analysis to identify an effective program that would help mitigate production risk.

The National Cotton Council believes conservation programs will continue to be an important component of effective farm policy. The Conservation Reserve Program, Conservation Security Program and Environmental Quality Incentive Program are proven, valuable ways to promote sound, sustainable practices through voluntary, cost-share, incentive-based programs. However, they are not an effective substitute for the safety net provided by commodity programs. We must maintain an equitable balance in conservation and commodity spending for the development of new farm policy. Furthermore, we support eligibility provisions for conservation programs that are as consistent as possible with commodity eligibility provisions.

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-dependant agricultural economy. It also is valuable to maintain a WTO-compliant export credit guarantee program. 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.

Mr. Chairman, cotton farmers continue to be disappointed by the very overt effort in the WTO Doha negotiations to isolate cotton to squeeze even more concessions from the U.S. The U.S. proposal on agriculture was ambitious and has not received an adequate response from the EU, the G-20, or most significantly, China. The elimination of the Step 2 program and the significant modification of the export credit guarantee program have also failed to elicit positive responses – despite the negative impact on U.S. cotton exports caused by these two changes.

It sometimes seems that the WTO process is convincing other countries they can now dictate U.S. farm policy. Stunningly, an Argentine government official recently derided the Secretary's farm bill proposal, saying the Secretary's proposal was moving in the wrong direction and would not make them happy with respect to cotton. He obviously read the USDA press release accompanying their farm bill proposal that said direct payments for cotton would be increased by 65% and did not note the precipitous decline in the cotton loan rate. While the NCC does not like all aspects of the Administration's proposal, I, for one, do not want Congress writing U.S. farm policy to make Argentine ministers happy. And I trust that is not the goal of our trade negotiators. Our purpose should be to develop policy that is beneficial to U.S. farmers and ranchers while tailoring that policy to minimize trade-distorting elements.

Further, despite the changes made in the U.S. cotton program and despite the very significant offer on domestic support tabled by the Administration, the WTO held another special session on cotton at the request of West African countries just weeks after the Doha round was restarted. While many of the presentations at that meeting were directed to developmental discussions, it is our understanding that developing countries that produce cotton again ignored the efforts being made by the United States, both in trade policy and on the developmental front, and used the WTO session as a platform to attack the U.S. cotton program. These countries want elimination of the U.S. cotton program, and they want the WTO to pay them $400 million in compensation.

Mr. Chairman, I must stress again that the U.S. has responded over and over to requests for reform and to requests for assistance. The Step 2 program was terminated at the end of the 2005 marketing year, and the negative impacts are being felt by producers of the 2006 crop. Furthermore, the export credit guarantee program has undergone significant revision, and I have already mentioned the significant agricultural offer tabled by the United States. I have not, however, mentioned that the U.S. committed to end all export subsidies for cotton by the end of 2006 and has complied with that promise even though we did not have to.

The U.S. has also responded to the very real needs of African countries. Two of the four African countries that initially targeted U.S. cotton have submitted qualified proposals and received significant promises of assistance under the Administration's Millennium Challenge. According to the WTO's table of assistance, Benin and Mali have received commitments from the U.S. totaling over $750,000,000. This level of assistance amounts to almost 20 cents per pound on all cotton produced in these two countries, annually, over the next 6 years. This level of directed support actually dwarfs the compensation being sought through the WTO. Sadly, however, U.S. officials have stated that these governments are devoting very little of these funds directly to the cotton sector.

The U.S. is providing the means to assist cotton farmers in Benin and Mali, but their own governments are not taking full advantage of our generosity. Instead, they demand high-level cotton sessions in Geneva and continue to brow-beat the WTO looking for more and more inequitable concessions on cotton.

Mr. Chairman, U.S. negotiators must send a clear signal that enough is enough. The U.S. should not continue to provide more concessions (often unilateral) while receiving virtually no positive indications from our trading partners that they will also move down the trade liberalization road. The strong stand by the U.S. in Geneva last July was fully appropriate. Unfortunately, the U.S. seems to have been apologizing ever since. The U.S. must not make additional concessions on domestic support until our market access objectives are met and exceeded. The U.S. should not agree to a Doha result that effectively exempts China – the fastest growing economy in the world – from concessions. The U.S. should not make further inequitable concessions on cotton beyond those made in Hong Kong.

The Secretary frequently cites the Brazil cotton case as evidence that the U.S. farm law must be changed in order to be unchallengeable. The truth is that U.S. farm law can always be challenged

under current WTO rules and there are no concrete signs that a new farm bill or a new Doha Agreement will change this.

Mr. Chairman, I would like to make some brief comments about our concerns with sluggish U.S. cotton sales, high levels of cotton under loan and persistently low prices. Total export commitments to China for the 06/07 marketing year stand at only 1.5 million bales, down 5.2 million bales from last year's number of 6.7 million bales. U.S. exports to other buyers in Asia are also off from last year's pace, but to a lesser extent. At this point last year, other key Asian countries had purchased 2.1 million bales of U.S. cotton. In the current marketing year, they've committed to 1.8 million bales, a drop of about 10%.

It is the case that cotton still under loan is above the levels observed at this same time in past marketing years. As of mid-March, there were 11.3 million bales of the '06 crop of upland cotton still under loan. In recent years, cotton under loan in March averaged about 4.0 million bales. However, it is very important to note that 6.5 million bales of the '06 crop have already been redeemed from the marketing loan. This suggests that the loan is not the market of last resort and that cotton is not locked in the loan. Simply put, there is more cotton in the loan because of the lack of demand from key export markets. When demand improves, cotton will move out of the loan to satisfy that demand.

Instead of assigning undue blame for the current market situation to the marketing loan, it is better to focus on the number of reasons why U.S. export sales have been lagging. First, as I previously mentioned, the loss of the Step 2 program has hurt the competitiveness of U.S. cotton. The U.S. has a smaller presence in the world market as a result of the loss of Step 2. Second, subsidies, trade restrictions, and other actions are having significant impacts on world cotton trade and prices – and frankly, are having a much greater impact than the remaining provisions of the U.S. cotton program. This second point is well supported by several statements made by USDA analysts in their report prepared for the recent USDA Outlook Conference.

> *"A combination of moderately higher world production and sharply highly world consumption is reducing world stocks for the 2006/07 season. Significant increases in production for China, India, Brazil and Turkey will more than offset reduced production in the United States, Australia, Greece and Syria."*
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> *"For India, both area and yields rose in 2006/07 from the year before, as the ongoing adoption of genetically engineered Bt cotton continued transforming cotton authorization across the country. Since much of the Bt cotton planted in India is illegal, estimates of the extent of Bt adoption vary widely."*
>
> *"Higher production is also expected in Pakistan in 2007/08 as more normal weather and the spread of Bt cotton boosts yields. Commercial cultivation of Bt cotton is not legal in Pakistan, but has reportedly spread to several 100,000 hectares."*
>
> *"Production in West Africa's Franc Zone in 2007/08 is likely to be about unchanged compared with the year before cotton prices were higher in U.S. dollar terms during the first half of marketing year 2006/07, but for the Franc Zone, this was offset by the*

strength of the Euro versus the U.S. dollar. A rebounding EU economy drove the Euro 8 percent higher with respect to the dollar, and the CFA Franc is linked to the Euro."

"China imported a record 19.3 million bales in 2005/06; however, imports for the first half of the current season have fallen well short of the year ago level. The primary factor slowing the pace of imports appears to be government-imposed import quotas, which have been more restrictive thus far this season than last. In January 2007, the WTO TRQ of 894,000 tons (4.1 million bales) was released; however, because a portion of the quota is reserved for state enterprises, it has not all been allocated to mills."

"China has used a sliding scale import duty on non-WTO TRQ imports that attempts to assure a minimum import price to help support the domestic price for cotton."

"The apparent goal of the more restrictive import policies is to use domestic cotton first before allowing significant imports. The government imposed constraints on imports have made it difficult to ascertain the underlying demand from the world's largest cotton consumer, and importer; thus in turn, has resulted in unusual uncertainty for the world cotton market."

"The [U.S.] cotton product trade deficit in 2006 expanded to a record 18.1 million bale equivalents, more than double the trade deficit of just 8 years ago. During 2006, U.S. cotton textile and apparel imports reached the equivalent of 22.8 million bales of raw cotton, 4 percent above 2005. In contrast, cotton product exports decreased slightly to 4.7 million bale equivalents in 2006, and now account for 86 percent of U.S. cotton mill use compared with 55 percent in 2002."

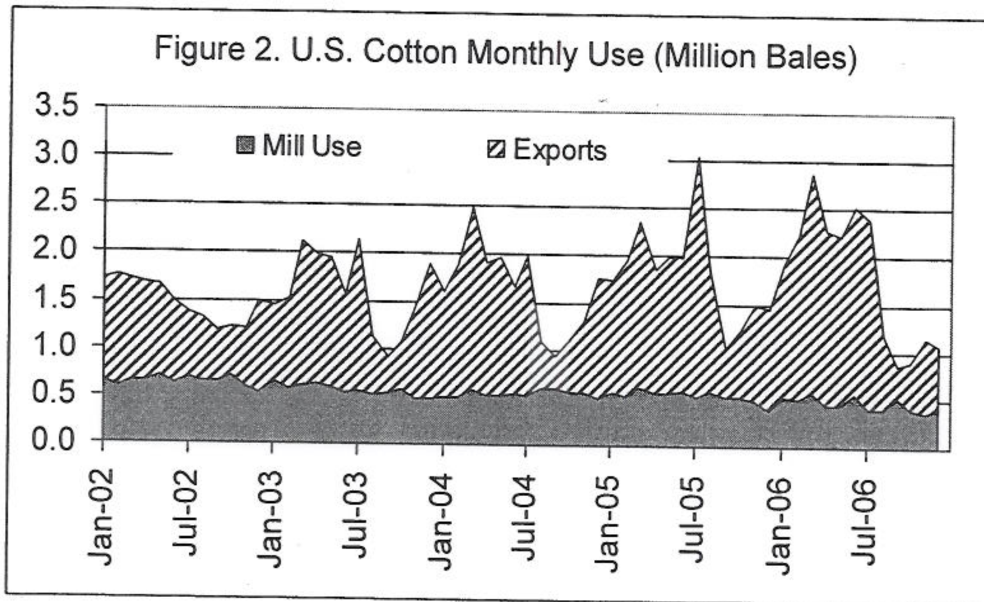
"China's extensive and complex system of import quotas and government cotton reserves has limited the correlation between price movements in China and the rest of the world in 2006/07."

"Subsidies to cotton producers are also being put in place in China, and the Government has frequently intervened in local markets, buying cotton for the government's reserves."

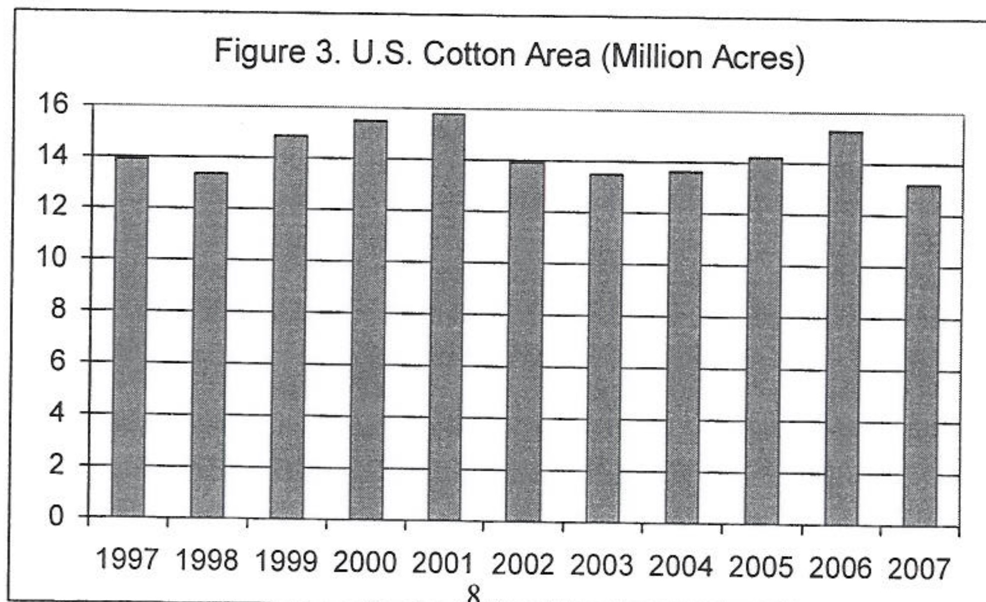
Cotton Outlook, Vol. 85 No. 10 March 9, 3007 pg. 7
".....Beijing has announced a subsidy for the purchase of good quality planting seed...this is part of an overall package for agriculture valued at 8.87 billion Yuan....a massive increase of 48.6 percent over last year......for cotton, farmers in eight regions will benefit....the funds earmarked will be sufficient to pay the subsidy on 40 percent of prospective plantings."

Mr. Chairman, as previously noted, export markets account for approximately 75% of total disappearance of U.S. cotton. Exports, and subsequently total use, can be highly variable, particularly within the marketing year (Figure 2). The industry recognizes the pressures that a highly-variable demand situation can place on the storage and distribution system. Through cooperation with USDA, the cotton industry is working to improve the flow and efficiency of the system to ensure that we remain the supplier of choice to the world cotton market. In a market

environment with a high level of variability and uncertainty, I will reiterate the importance of the safety net provided by an effective farm program. The farm program provides the necessary stability to make the long-term investments that will keep the industry competitive and productive.



I will conclude my testimony by apprising the Committee of the Council's assessment of U.S. cotton acreage. In recent years, cotton acreage in the U.S. has fluctuated between 13.5 and 15.5 million acres as farmers have adjusted acreage based on agronomic practices and relative returns between cotton and competing crops. For this year, we fully expect that the surge in corn and soybean prices will cause producers to adjust their crop mix, and cotton acres will decline. The Council's acreage survey, conducted in late December and early January, reported cotton acreage intentions at 13.2 million acres – a 14% decline from last year's level (Figure 3). Of course, since the time of the survey, corn and soybean prices have increased further, and the actual cotton acreage decline will likely be even greater. This year's acreage adjustments are a clear indication that planting flexibility works and farmers are responding to market signals.



Mr. Chairman, thank you for the opportunity to testify today. I will be pleased to respond to your questions.

Committee on Agriculture
U.S. House of Representatives
Required Witness Disclosure Form

House Rules* require nongovernmental witnesses to disclose the amount and source of Federal grants received since October 1, 2004.

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Organization you represent (if any): NATIONAL COTTON COUNCIL

1. **Please list any federal grants or contracts (including subgrants and subcontracts) <u>you</u> have received since October 1, 2004, as well as the source and the amount of each grant or contract. House Rules do <u>NOT</u> require disclosure of federal payments to individuals, such as Social Security or Medicare benefits, farm program payments, or assistance to agricultural producers:**

Source:________ **Amount:**________

Source:________ **Amount:**________

2. **If you are appearing on behalf of an organization, please list any federal grants or contracts (including subgrants and subcontracts) <u>the organization</u> has received since October 1, 2004, as well as the source and the amount of each grant or contract:**

Source:________ **Amount:**________

Source:________ **Amount:**________

Please check here if this form is NOT applicable to you: ________

Signature:________

* Rule XI, clause 2(g)(4) of the U.S. House of Representatives provides: *Each committee shall, to the greatest extent practicable, require witnesses who appear before it to submit in advance written statements of proposed testimony and to limit their initial presentations to the committee to brief summaries thereof. In the case of a witness appearing in a nongovernmental capacity, a written statement of proposed testimony shall include a curriculum vitae and a disclosure of the amount and source (by agency and program) of each Federal grant (or subgrant thereof) or contract (or subcontract thereof) received during the current fiscal year or either of the two previous fiscal years by the witness or by any entity represented by the witness.*

PLEASE ATTACH DISCLOSURE FORM TO EACH COPY OF TESTIMONY.

BIO/INTRODUCTION
John E. Pucheu, Jr.
Cotton Producer, Tranquillity, California, and
Chairman, National Cotton Council of America (2007)

John Pucheu was elected chairman of the National Cotton Council of America in February 2007 at the Council's annual meeting. John served as the Council's vice chairman in 2006.

A partner in Pucheu Brothers Ranch of Tranquillity, California, John has held a number of other national leadership positions. He was chairman of the American Cotton Producers (ACP) in 2004 and 2005. Earlier, John served on the Council's Board of Directors and was a director of Cotton Council International. He is a director and past chairman of Supima and the Cotton Board.

John also has been active in California, where he served as president of the California Cotton Growers Association and Board chairman of Calcot.

He holds a degree in agricultural economics from the University of California, Davis, and is a graduate of the California Ag Leadership Program.

John has been farming since 1966 and also serves as a director to Westside Farmers Coop gin. His operation includes upland and Pima cotton, processing tomatoes, onions, sugar beets and alfalfa for seed.

John and his wife, Susie, reside in Tranquillity and have a daughter and a son.