



## 1999 Cotton Management Economic Notes

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### New Federal Subsidies for Arizona Cotton

Unusually low cotton prices face Arizona's farmers as they head into the 1999/2000 marketing year, sparking interest in government policies to raise farm incomes. By mid-October, Congress responded to low prices for many commodities by increasing subsidies across the farm sector, including cotton. Cotton industry watchers expect President Clinton to sign the legislation into law the week of October 18.

**Cotton prices not a pretty picture.** Arizona's upland cotton prices at the start of the 1999 harvest hit a 10-year low. The October 15 price for Desert Southwest 31/35 stands at 50.8¢ per lb. At this price, cotton revenues may cover cash outlays, but not all ownership costs. The 1998 Arizona Field Crop Budgets, published by Cooperative Extension, give returns over cash expenses for a representative Maricopa cotton farm at \$329 per acre—but this at a lint price of 68¢ per lb. At 51¢ per lb., returns over cash expenses drop to \$131 per acre. The budgets also report ownership costs may total nearly \$300 per acre, leaving—before government payments—a deficit of nearly \$170 per acre. For Pinal County, returns over cash expenses are essentially zero, with ownership costs estimated at nearly \$300 per acre.

**Government payments still important.** Prior to the 1996 farm bill (known by its acronym FAIR), program participants received deficiency payments when the market price of cotton dropped below the government's target price. FAIR changed the basic nature of farm programs. It replaced target prices, deficiency payments, and acreage limits with fixed, declining payments, not tied to prices. A farm's past program crop production governs the size of payments. The FAIR subsidies, called Production Flexibility Contract (PFC) or AMTA payments, are scheduled to expire in 2002. PFC payments to Arizona cotton producers have ranged from nearly \$44 million in 1996 to \$38.1 million in 1998.

Government payments since 1996 have included more than the PFC payments. In response to unusually low farm prices in 1998, the government approved a special subsidy package called Market Loss Assistance (MLA). MLA payments added to the PFC payments made through FAIR. For Arizona cotton, 1998 MLA subsidies added nearly \$19 million to the \$38 million in PFC payments. In addition, program participants still have the opportunity to take out loans on program crops. These non-recourse loans let farmers use the crop as payment of the loan debt, should crop prices drop below the loan rate. For program participants, this sets a minimum price at the loan rate. For participants who do not take advantage of the government loan, the program provides benefits equal to the amount the adjusted world price drops below the loan rate. These payments are called Loan Deficiency Payments (LDP), or more popularly, POP payments. The FAIR Act set the loan rate at a low 51.92¢ per lb., anticipating that POP payments would not be made. But low world cotton prices have resulted in POP payments to Arizona cotton producers in 1998 of nearly \$8.5 million.

The government provided sizable payments to Arizona cotton growers in each of the last 10 years

Recent Prices (October 15, 1999)	Upland (¢/lb)	Pima (ELS) (¢/lb)
Spot - uncompressed	50.76	80.25
Dec '99 Futures	54.23	
Jul '00 Futures	57.50	
Dec '00 Futures	58.75	
Adj. World Price	33.27	

Note: Upland Spot for Desert SW grade 31-3, staple 35, add 300 points for compressed bales, Pima Spot for DSW grade 03, staple 46,

(except for 1995), and especially high levels in the low price years 1993 and 1998. In 1998, program payments to Arizona's cotton farmers were over \$65 million or nearly \$100,000 on average for each cotton-producing farm.

## Latest Policy Changes

**Supplemental PFC payments.** On October 13, emergency farm legislation cleared Congress, on its way to the President's expected signature. The legislation could put new payments into farmers' hands within two weeks of the President's signature. Arizona cotton farmers should receive Market Loss Payments in addition and equal to their 1999 PFC payments. For 1999, we estimate that Arizona cotton growers will receive \$60.2 million in combined PFC and MLA payments, up from \$57 million in 1998.

**Payment limits raised.** The new farm aid relaxes payment limits for POP payments from \$75,000 to \$150,000 per person. For Arizona's larger cotton farms, this provides significant assistance. For example, the POP payment rate for the week of October 14–21 was 18.65¢ per lb. For a farm with a 2.5 bale / acre yield, this amounts to \$224 per acre. Before the limit change, a 335-acre cotton farm would bump into payment limits. Under the new law, POP payments could be received on double the acreage (670 acres in this case). POP payments totaled nearly \$8.5 million dollars for

Arizona cotton farmers in 1998. Final data for 1999 are not available yet, but we expect 1999 POP payments will be even larger.

**Crop insurance discounts.** The new legislation continues crop insurance premium discounts of 30 percent. Federally subsidized crop insurance provided good returns to Arizona cotton farmers from 1995 to 1998 (see [ag.arizona.edu/arec/ext/cotton.html](http://ag.arizona.edu/arec/ext/cotton.html), Vol. 7, #1 of this Newsletter). Arizona cotton producers received a return of \$1.78–\$3.37 per policy-holder dollar expended. Not every policy or producer reaped such good returns, but on average, crop insurance paid handsomely. The continuation of 1999 subsidies for premiums make expected insurance returns even more attractive.

**Step 2 increased.** The new legislation replenishes the depleted funds for the Step 2 program through 2003. New Step 2 funds would improve the price paid to cotton producers because they, in effect, increase the demand for U.S. cotton.

**Other provisions.** The new legislation provides \$1.2 billion for weather-related crop losses nationwide. It also authorizes generic marketing certificates that could relieve marketing problems associated with limitation on marketing loan gains and LDPs.

In addition, new USDA rules allow cotton producers more flexibility for locking in LDP rates (see box).

### **Lock-in LDP Rate Before Ginning**

Effective after October 6, 1999, upland cotton producers will be allowed to lock in the adjusted world price (AWP) to calculate loan deficiency payments (LDPs) after harvest, but before ginning. Previously, producers could only request to have their LDPs or POP payments based on the prevailing AWP after their cotton had been ginned and baled. Given that some cotton remains in modules for months, this change widens the "marketing window" for setting LDP rates. Once a LDP has been requested on a quantity of cotton, the AWP and resulting LDP rate is locked-in at the time of the application and is irrevocable (see [www.cotton.org](http://www.cotton.org) for more details).

Uncertainty regarding the recovery of East Asian economies—coupled with the possibility that China's large carryover stocks will overwhelm the market—is keeping international cotton prices depressed. China's current inventory of 17.4 million bales will likely exceed U.S. production this year and amounts to almost half of world carryover stocks. Currently, the LDP rate is at a very attractive rate of 18.65¢/lb. (Loan Rate of 51.92¢ minus AWP of 33.27¢). This increases the current price of DSW 31/35 received from 50.76¢ to 69.41¢, or 27% of total revenues.