

COTTON OUTLOOK TO 2009-10

China's raw cotton imports to rise strongly in 2005-06

William Mollard, Frank Drum and Kate Penney

- **With world consumption of raw cotton forecast to outweigh cotton production, and stocks to fall, the world cotton price (Cotlook 'A' index) is forecast to increase by 12 per cent in 2005-06 to average around US57c/lb.**
- **Significantly lower world raw cotton prices in the leadup to the planting of the 2005 northern hemisphere cotton crop is expected to result in a lower planted area in China, India and Pakistan. Assuming that yields return to levels that are more consistent with the five year average in these countries, world raw cotton production is forecast to fall in 2005-06.**
- **Import demand in China will be a dominant factor affecting world raw cotton prices in 2005-06. With raw cotton consumption in China expected to grow, lower forecast production is expected to result in a substantial increase in imports.**
- **Over the medium term, world cotton prices are expected to decline in 2004-05 dollar terms as productivity improvements in raw cotton production result in increases in supply outweighing growth in consumption.**

Prices fell sharply in latter part of 2004

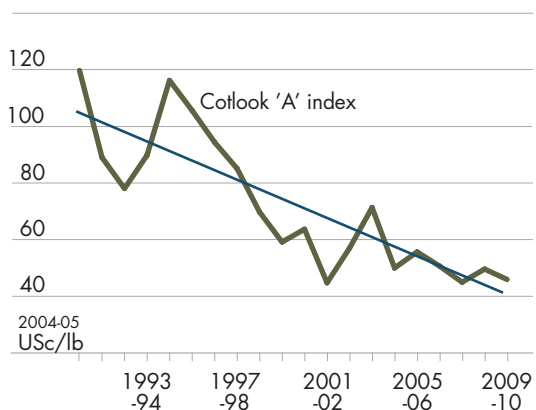
A record planted area in China prior to the 2004-05 season and expectations of a record raw cotton crop in China resulted in the world raw cotton price falling sharply in mid-2004. In addition, with substantial increases in production

expected in the United States, India and Pakistan, further downward pressure was placed on prices. The Cotlook 'A' index declined from just under US80c/lb in late 2003 to under US49c/lb in late 2004.

The decline in cotton prices was consistent with the overall speculative position adopted in the cotton futures market. The net positions of noncommercial contracts on the New York Board of Trade provide an indication of the overall speculative position in the futures market. A long position refers to the purchase of a futures contract to establish a longer term market position. A short position occurs when a trader's net position shows an excess of open sales over open purchases.

From a yearly high of over 37 000 contracts in late January 2004, net long positions fell sharply

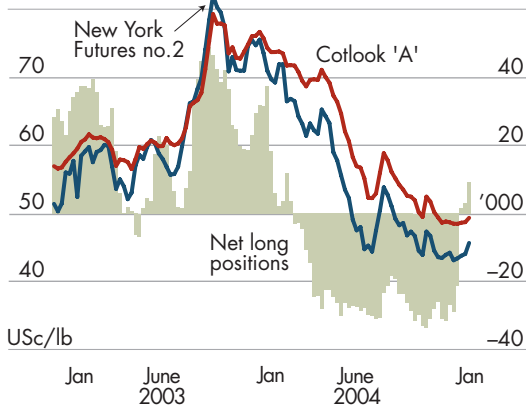
Raw cotton world price



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Cotton

Weekly, ended 25 January 2005



to a negative 33 000 contracts (net short) in early November 2004, a reflection of upward revisions to world production in 2004-05. In early 2005, net long positions became positive, a likely indication of expectations of lower world production and hence higher world cotton prices in 2005-06.

World production to decline in 2005-06

World raw cotton production in 2005-06 is forecast to decrease by 10 per cent to 22.6 million tonnes. Production in the major raw cotton growing countries in 2004-05 increased strongly as yields rose as a result of favorable seasonal conditions. In addition, favorable world prices in the leadup to the planting of the 2004-05 crop encouraged an increase in raw cotton plantings in China, India, Pakistan and Brazil.

With planted area in Pakistan, India and China being sensitive to prevailing world raw cotton prices in the leadup to planting, low world raw cotton prices are expected to result in a fall in planted area in these countries in 2005-06. Production in these countries will also be determined by seasonal conditions in 2005-06.

The International Cotton Advisory Committee reports that cotton is grown on an estimated 100 million farms in more than 80 countries, with the average area planted to cotton by growers around 0.4 hectares. The majority of the smaller scale cotton farms are found in less developed countries, such as China, India and Pakistan.

Small scale cotton growers are often not able to protect themselves against fluctuations in market prices (by hedging) and as such are comparatively more responsive to price fluctuations. In addition, with a lower degree of investment in cotton growing infrastructure in these countries, growers face lower switching costs if prices of competing crops become favorable.

China

China's raw cotton production in 2004-05 is estimated to be around 6.4 million tonnes. With the planted area in China being over 1 million hectares higher than the ten year average (of around 4.7 million hectares) and favorable seasonal conditions, production in 2004-05 is expected to be over 30 per cent higher than that in 2003-04.

The planted area in China in 2005-06 is expected to fall to around 5 million hectares as lower world cotton prices increase the incentive for farmers to switch to substitute crops. In addition, the Chinese Government has introduced a number of measures (such as direct subsidies) designed to encourage grain production. Assuming yields return to their five year average of just under 1.1 tonnes per hectare, raw cotton production in China in 2005-06 is expected to reach around 5.5 million tonnes.

United States

Cotton production in the United States in 2004-05 is expected to reach a record 4.9 million tonnes, driven largely by an increase in planted area and record yields. According to the National Cotton Council of America, US cotton producers intend to increase plantings by under 1 per cent for the 2005-06 season. Lower corn and soybean prices and the anticipated costs of addressing Asian soybean rust have increased the incentive to plant cotton. Moreover, provisions established under the 2002 Farm Act, effectively insulate US producers from world market price signals and reduce the sensitivity of domestic cotton production to changes in world price.

Consequently, the area planted to cotton is expected to increase marginally in 2005-06. However, assuming a return to average seasonal conditions (and average yields), US cotton production is expected to fall in 2005-06.

WTO ruling on US cotton subsidies

In early 2003, a World Trade Organisation (WTO) panel was established to hear Brazil's challenge to US cotton subsidies. Brazil claimed that US cotton subsidies were leading to significantly lower world prices by encouraging surplus production and enabling the United States to gain market share (causing serious prejudice to the Brazilian cotton industry).

WTO 'Peace Clause'

Under the 'Peace Clause' in the WTO Agreement on Agriculture members are required to show 'due restraint' in their challenges where the total level of support is less than the level provided in the base year. Brazil demonstrated that the level of support that US cotton producers received in 1999 and 2001 was greater than that which occurred in the base year (1992).

Panel ruling

The panel ruled that the US market loss assistance payments, countercyclical payments, marketing loans and Step 2 payment programs had depressed the world cotton price in the 1999–2002 marketing years. It was further noted that the Step 2 payments were prohibited export subsidies (under the Step 2 program, US cotton producers are paid the difference between the domestic cotton price and the world market price). The United States is currently appealing this ruling.

The complexity of Brazil's challenge to the US cotton support programs and the US appeal suggest that the appeal process will be lengthy. Consequently, the provisions established under the 2002 Farm Act are assumed to remain unchanged over the outlook period.

Cotton outlook

	Unit	2002 -03	2003 -04	2004 -05 f	2005 -06 z	2006 -07 z	2007 -08 z	2008 -09 z	2009 -10 z
World a									
Cotlook 'A' index									
– nominal	USc/lb	55	68	51	57	53	48	54	51
– real b	USc/lb	58	70	51	56	51	45	50	46
Production	Mt	19.23	20.62	25.10	22.60	23.80	24.10	23.50	25.30
Consumption	Mt	21.47	21.45	22.70	23.00	23.40	23.80	24.15	24.70
Closing stocks	Mt	8.31	7.73	10.13	9.73	10.13	10.43	9.78	10.38
Stocks-to-consumption ratio	%	38.7	36.0	44.6	42.3	43.3	43.8	40.5	42.0
Australia c									
Area harvested	'000 ha	224	198	315	341	359	386	424	464
Lint production	kt	387	349	551	608	631	697	763	852
Value of production									
– nominal d	A\$m	817	639	971	1 107	992	998	1 263	1 344
– real e	A\$m	856	655	971	1 083	946	929	1 146	1 190
Volume of exports	kt	596	459	402	552	597	634	700	773
Value of exports									
– nominal	A\$m	1 152	982	718	976	969	941	1 194	1 260
– real e	A\$m	1 208	1 005	718	954	925	876	1 084	1 116
Export unit value									
– nominal	A\$/kg	1.93	2.14	1.79	1.77	1.62	1.48	1.71	1.63
– real e	A\$/kg	2.03	2.19	1.79	1.73	1.55	1.38	1.55	1.44

a August–September years. b In 2004–05 US dollars. c July–June years. d Includes cottonseed value. e In 2004–05 Australian dollars. f ABARE forecast. z ABARE projection.

Sources: Australian Bureau of Statistics; US Department of Agriculture; ABARE.

Productivity improvements to increase yields over the medium term...

Over the medium term, increased use of transgenic cotton and advances in cotton growing technology are expected to lower production costs and result in higher yields. Increased yields are expected to offset an expected decline in total world area planted to raw cotton as the return from alternative crops becomes more favorable.

According to the Food and Agriculture Organisation of the United Nations, globally, more insecticides are used on cotton than on any other crop. With intensified use of chemicals, a number of pests are becoming increasingly resistant to available insecticides (increasing production costs). Genetically engineered crops are increasingly being used by cotton farmers in an attempt to reduce insecticide use and pest pressure (reduced insecticide use also has environmental and health benefits).

In the Second Expert Panel on Biotechnology of Cotton report to the International Advisory Committee it was estimated that biotech cotton varieties are planted on 24 per cent of the world cotton area and account for around 35 per cent of world cotton production.

In particular, the area planted to transgenic cotton in 2003-04 was estimated at 76 per cent in the United States and 60 per cent in China. India, in contrast, was estimated to have only 1 per cent planted to transgenic cotton in 2003-04.

Planting of transgenic cotton is expected to expand in India, with increasing plantings of Bt cotton in Northern India. This is expected to increase yields over the outlook period through a reduction in pest pressure (although early results are inconclusive). With the area planted to raw cotton in India averaging over 8.2 million hectares in the past five seasons, increased yields over the outlook period is likely to result in a large increase in raw cotton production.

In addition, application of improved fertilisers, chemicals and better irrigation practices in countries with comparatively less advanced cotton growing practices are expected to increase productivity over the outlook period.

World cotton production is forecast to reach 25 million tonnes in 2009-10.

World consumption growth to fall in 2005-06

World raw cotton consumption growth is expected to slow in 2005-06 as world income growth declines in line with assumed slower world economic growth. Income growth primarily affects cotton consumption through its effect on clothing demand (clothing is the primary good produced with cotton). While clothing is a necessity, it is also a semidurable product, the purchase of which can be delayed.

Lower forecast economic growth in the United States and continued subdued growth in the European Union is expected to slow growth in demand in the final consumption of textiles and apparel in 2005-06 (industrialised nations

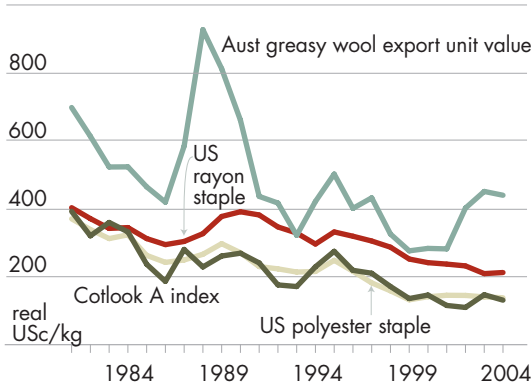
Conditions of China's entry to the World Trade Organisation

In December 2001, China became a member of the World Trade Organisation (WTO). As part of its accession, China committed to liberalising its economy. During the first twelve years of China's integration, member countries are permitted to impose safeguard mechanisms when it can be suitably demonstrated that Chinese textile imports threaten to or cause market disruption in that particular market segment.

In 2004, the US textile industry filed threat based petitions against seven imported products from China. These petitions have been accepted by the Committee for Implementation of Textile Agreements (CITA). This decision enables the United States to consult with China, after which textile import growth can be limited to 7.5 per cent a year in these categories (a rate still substantially higher than the growth rate of the US domestic market).

Over the outlook period, it is expected that further petitions will be lodged with CITA. Acceptance of such petitions is likely to slow the rate at which China gains market share of particular segments of the US textile market. However, over the medium term, China is still expected to substantially increase its export share to the United States.

Textile fibre price



account for an estimated 45 per cent of world textile fibre consumption). This will reduce growth in the derived demand for raw cotton. Partially offsetting this, however, are relatively low world cotton prices and an increase in synthetic prices (largely because of higher world oil prices), which are expected to stimulate cotton mill use.

Developing countries to benefit from expiry of Agreement on Textile and Clothing

The phasing out of the Multi Fibre Agreement (MFA) through the Agreement on Textiles and Clothing (ATC) on 1 January 2005 is expected to result in China, Pakistan and India gaining increased market share in world textile production (particularly in the production of labor intensive clothing and textiles) at the expense of developed countries. Approximately 60 per cent of the world's cotton is spun in China, India and Pakistan. Increases in consumption of raw cotton over the medium term, therefore, is expected to be predominantly determined by growth in textile production in developing countries.

Prior to the Agreement on Textiles and Clothing, trade in the textile sector was controlled by quotas specified under the various multifibre agreements. The ATC set a schedule for the progressive elimination of MFA quota restraints and the lowering of tariffs by 2005, with the aim of aligning trade in textiles and clothing with the rules of the World Trade Organisation (WTO). With the expiry of the ATC on 1 January 2005,

trade in the textile sector is now governed by the WTO.

The decline in textile and clothing production in the United States is expected to continue as the domestic clothing and textile industry faces increased competition from lower priced imports. A recent WTO report suggests that China's share of clothing imports to the United States over the longer term could rise to 50 per cent (from around 16 per cent currently) following the expiry of the MFA.

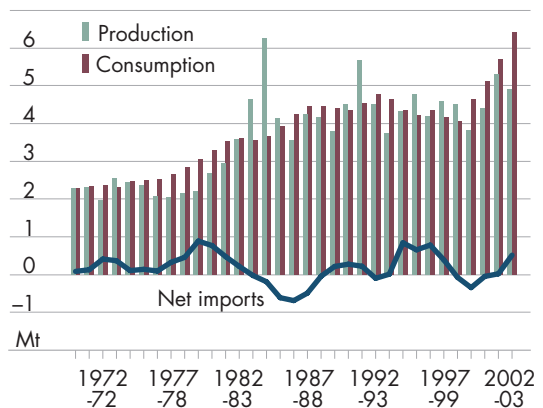
In addition, China's share of US textile imports could rise to 18 per cent (from around 11 per cent currently).

China to dominate world raw cotton consumption over the medium term

Raw cotton consumption growth in China will continue to be the most important determinant of raw cotton consumption over the outlook period. The US Department of Agriculture estimates that China will account for over 35 per cent of total world cotton consumption in 2004-05. China is expected to account for 90 per cent of the increase in world raw cotton consumption in 2004-05.

China's cotton lint (51 per cent increase) and cotton yarn production (110 per cent increase) has grown substantially over the past decade. Investment in China's textile industry is estimated to have grown by over 50 per cent over the four years ended 2004.

China's cotton



In 2005-06, China's consumption of raw cotton is projected to grow by 7 per cent to 8.4 million tonnes. With consumption expected to exceed production, net imports in China in 2005-06 are forecast to exceed 2.7 million tonnes.

Cotton's market share to decline over medium term

Over the medium term, cotton is expected to continue to lose market share to synthetic fibres. Ongoing technological improvements are expected to enhance the properties of synthetic fibres and reduce the cost of production.

China, for example, has substantially increased its chemical fibre yarn capacity in the past ten years. While production of cotton fabric and yarn is increasing strongly, production of chemical fibre yarn has increased by over 450 per cent in the past ten years.

World raw cotton consumption is expected to reach 24.7 million tonnes in 2009-10.

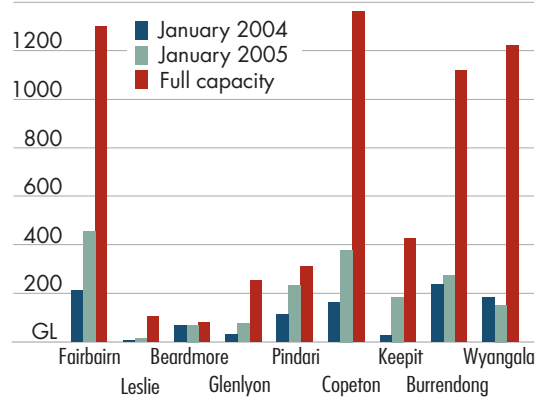
Australia

Improved water availability prior to planting of the 2004-05 cotton crop led to a 59 per cent increase in area planted to cotton. This increase can be attributed to improved seasonal conditions over the past twelve months in some areas of northern New South Wales and southern Queensland, with average rainfall exceeding historical averages in many areas. Corresponding with increased planted area, Australian cotton lint production is expected to rise by 58 per cent to 551 000 tonnes.

Above average rainfall in a number of areas of northern New South Wales and southern Queensland over the past three to six months has resulted in an improvement in water storage levels in key cotton growing regions. A continuation of these seasonal conditions in the leadup to the commencement of the 2005-06 season

Water storage and availability

southern Queensland and New South Wales



could result in a significant increase in the area planted to cotton.

Assuming average rainfall, the area of Australian cotton harvested in 2004-05 is forecast to be around 341 000 hectares, an 8 per cent increase on the current season.

Availability of water will continue to be a constraint on cotton plantings in Australia over the medium term. Water availability in the major cotton growing areas of northern New South Wales and southern Queensland will be constrained by the cap that applies to extractions within the Murray Darling Basin; new rules on the allocation of water between extractive and nonextractive uses contained in statutory water plans; and any restrictions on harvesting of overland flows contained in these plans.

Despite these restrictions, it may still be possible for the area planted to raw cotton to expand over the medium term if cotton growers purchase water on the market or increase the efficiency with which they use water. However, the potential to increase plantings will be largely contingent on a return to more average conditions.



Introduction:

Good afternoon Ladies & Gentlemen,

It is an honour to be able to share with you my thoughts on some of the features of international trade landscape and their potential impact on the Australian Cotton industry.

I would like to focus on 5 aspects of international trade that I believe will be influential on our profitability and sustainability in the coming years. They are

1. The current proliferation of bi-lateral and regional trade agreements
2. The emergence of non commodity issues in the trade debate
3. The importance of sound financial architecture for global trade
4. The need for relevant standards in various aspects of trade conduct and
5. The importance of a global cotton industry approach to marketing and promotion.

Commentary:

1. Bilateral Trade Agreements verses Multilateral Trade Reform

Australia has long been perceived globally, as a champion of multilateral trade reform. In virtually any trade related forum or discussion, our abandonment of any form of subsidies or government support for our agricultural industries in particular, is publicly acknowledged and lauded.

However, in recent times, Australia has engaged in several bilateral trade agreements. On 28 July 2003, we signed an FTA with Singapore, on the 5th of July 2004, with Thailand and



on January 1 2005 an FTA with the US came to life. We have embarked upon a feasibility study into an FTA with China, with hopes for completion of such an agreement by 2006.

Our actions mirror global activity in this area.

Since the creation of the WTO in 1995, 130 Regional Trade Agreements notifications have been lodged. This spaghetti bowl of Free Trade Agreements across the world adds enormous complexity to the international trade landscape. Australia is now very much a part of this spaghetti bowl.

So what are the implications for the Australian Cotton Industry?

Based on the FTA's to date, the Australian Cotton Industry has gained little. Our interests are best served by multilateral trade reform. Having said that, if we assume that practical expedience will continue to be a powerful motivator behind continued bilateral agreements, then it is critical for our industry that we engage in the process as early as possible. In this regard, the industry has engaged early in feasibility study being undertaken on an Australian China Free Trade Agreement.

The industry's position, in summary, on the Australian China Free Trade Agreement is as follows:

1. The industry sees tremendous potential benefit from a FTA with China.



2. Any Free Trade Agreement between our countries should be comprehensive, inclusive and timely.
3. The industry notes the concerns raised by our colleagues in the United States cotton industry regarding China's failure to fully comply with the commitments it gave in order to secure accession to the WTO. China must harmonise its domestic regulations with its bilateral ambitions.
4. The industry is concerned that the reform of China's financial markets is not progressing at a sufficiently rapid rate to efficiently facilitate the expanded trade possibilities that a Free Trade Agreement could present for both countries.

The central issue confronting the Australian cotton industry in any FTA is fair market access to the world's largest market for raw cotton.

2. Other Non-Tariff Trade Issues

Non-trade concerns have traditionally figured prominently in agricultural trade policy and in international negotiations to reduce trade barriers. In recent years the range of non-trade concerns has broadened. The list now appears to include a collection of attributes that are encapsulated in the term multifunctionality. While this term appears to have a range of interpretations, its primary intent is to characterise agricultural production as a multi-output activity, in which there are both commodity and non-commodity outputs. Specifically, these non-commodity outputs include environmental effects, landscape amenity, cultural heritage and social balance.



Here in Australia, over the past decade, growing public interest in the environmental health of our Nations' land, rivers, and vegetation has inspired a raft of State and Federal activity that have directly impacted on the way we approach our farm management decisions. Within the WTO, the EU has been a vocal campaigner for trade discrimination based upon their standards of environmental stewardship, and at the 2001 Doha round they got some real traction. The relationship between MEA's (Multilateral Environmental Agreements) and the WTO was then revisited at the World Summit on Sustainable Development in Johannesburg in 2002. So this issue is right on top of the current global trade agenda.

The potential for our markets to place as much emphasis on the methods we use to produce our cotton-as the actual cotton itself. In this regard, the Australian Cotton Industry, through BMP does indeed possess a capacity to measure and the attitude to manage, a sustainable cotton farming system. In fact I believe our industry is exceptionally well placed to secure real market leverage as a result of our commitment to sustainability. But to do so, we really will need to walk the talk. Markets that differentiate suppliers on the basis of specific performance attributes will be zealously diligent in monitoring conformance with those objectives.

3. Financial Market Maturity

The Australian Cotton Industry is almost totally dependant upon export markets. Our primary markets are in South East Asia, and over the past decade our industry has survived substantial financial upheaval in many of these countries. In the late 1990's, Japan and



South East Asia experienced a financial crisis that was as spectacular, as it was unexpected. \

In many economies, the after effects are still being felt. From January 1997 to February 1998, the Indonesian Rupia fell by 76%, the South Korean Won 43%, and the Thai Bart by 49%. In some cases, such as Indonesia, South Korea and Thailand, short-term sovereign debt actually exceeded holdings of foreign reserves making these countries technically insolvent.

Navigating our way through those troubled financial crisis diverted substantial Australian Cotton Industry resources away from conventional use. But that experience serves to highlight the sometimes fragile financial markets that confront many Australian companies seeking to sell their product offshore.

This lack of sophistication and depth leads to volatility in interest rates, it can constrain the availability of credit on commercial terms, and depending upon the exchange rate policy of the country and its microeconomic settings, can lead to significant volatility in international exchange rates. Despite the international push for trade globalisation, there are still a vast range of policy options which are being employed by many of our customers and competitors with regards to exchange rate settings. Each policy setting, be it fixed exchange rates, floating exchange rates or pegged or targeted exchange rates, has its inherent risks. However, it is clear that fixed exchange rate regimes will make countries more vulnerable to capital account crises which can in turn inflict catastrophic damage on the banking system.



Also, fixed exchange rate policy settings can create artificial competitiveness. Those countries that deliberately undervalue currencies, are provided with an unfair competitive advantage for exporters, in the same way that deliberately overvalued currencies provided an unfair advantage for importers. Whilst neither deliberately undervalued nor overvalued currencies are sustainable in the long-term, they can seriously alter the short term competitive dynamics confronting participants in international trade.

The United States has in recent times expressed the view that low currencies are a direct form of subsidisation. This has been perceived as nothing more than a self serving attempt to justify their own agricultural subsidy largesse. But there can be no doubting that the manipulation of exchange rates by central authorities has the potential to significantly alter natural competitive dynamics.

Interestingly, the United States has a long history of dissatisfaction with market exchange rates-particularly for their own currency.

The Bretton Woods Agreement collapsed in 1971 as global confidence in the US dollar evaporated, the Plaza Accord between the G5 (which led to a 30 percent decline in the value of the greenback) was struck in 1985 and more recent coordinated market intervention in 2001/2 devalued the dollar again.



Unfortunately, the USDLR remains the dominant global cotton currency so the industry's competitive dynamics it would seem are somewhat vulnerable to occasional interim shocks at the whim of G5/7 Finance ministers.

But what are the implications for the Australian Cotton Industry?

As previously mentioned, Australia has truly embraced the notion of a market economy. This embrace of a market economy makes exporting industries very vulnerable to exchange rate volatility and global capital availability. Unfortunately, the reality is, that exchange rates are now heavily influenced by capital flow intensity, and in the short term have very little to do with merchandise trade account surpluses or deficits, and even less with the comparative efficiency or productivity of a country's agricultural sector.

Furthermore, as Alan Greenspan, the former Chairman of the US Federal Reserve said, International capital markets are often subject to "irrational exuberance", and this irrationality often manifests itself in illogically volatile foreign exchange markets and capital markets.

So for the Australian Cotton Industry, exchange rate volatility and occasional capital availability crises are going to be a part of our future. Secondly, exchange rate volatility is going to have no relationship to the relative productivity of our agricultural sectors. (We may be the most productive producer of cotton in the world, but if we have an exchange rate that is more influenced by other sectors of our economy, then our world's most efficient Cotton



Industry might be confronted with unviable terms of trade.) Fortunately, enhancing the world's financial architecture is a priority for groups like the G7 and APEC.

4. International Standards

Because we are heavily focussed on export markets, and our product is a globally traded product, then our aspirations to have the market for that product operating as efficiently as possible are best served if we are able to promote a broad range of effective and enforceable standards governing those markets. This is the best way that we will be able to promote market liquidity, trade integrity and bipartisan confidence in that trading system.

These standards are already in place in some areas- as would be expected in an industry with the history of the Cotton Industry.

Specifically, the international cotton market has embraced standards for fibre quality, and this global standard is based on the US Department of Agriculture's Grade Classification System. This system has provided a universal language for the description of the technical characteristics of fibre. But it is an old system, and the challenge for the global industry is to ensure that our product description truly meets the customer needs. If we look at recent reports conducted, not just on Australian cotton, but on global cotton, our customers are expressing some displeasure at other fibre characteristics that are emerging. Specifically I refer to short fibre content, maturity, neps, and stickiness. As yet we have been unable to develop an effective high speed method of measuring these fibre characteristics.



A second area where the global cotton industry has achieved a certain degree of standardisation is in the matter of sales contracts. Unfortunately, as we have witnessed recently, contract sanctity continues to be a major challenge for all cotton exporters and importers around the world. While the majority of Australia's international cotton customers show the highest regard for cotton purchase contracts, it is disheartening that in times of significant price declines, there are customers who seek to exploit technical loopholes in sales agreements for their own advantage.

We also need to promote appropriate standards of corporate governance across the international cotton trade. In many of our customer markets, these systems are only just emerging, and it is in the best interests of our industry to promote standards of behaviour that inspire the confidence of all participants.

Finally, market efficiency is heavily dependant upon the accuracy, reliability, and the regularity of the disclosure of price sensitive information. Extreme price volatility can be best mitigated by promoting an informed market place. In this regard, the Australian Cotton Industry can improve. I think it is fair to say, that over the years we have developed a global reputation as an industry that continually and consistently underestimates the level of our own production. This creates a level of scepticism within the marketplace and the global cotton community about our intentions, and potentially about our integrity.

So what are the implications for the Australian Cotton Industry of promoting better global standards?



Well firstly, as one of the world's top 5 cotton exporters in a normal year, I think we have a legitimacy and responsibility to promote improved standards across a range of activities.

Secondly, I think we all have a very powerful vested interest in promoting contract sanctity. If our merchants lose confidence in the performance of their counterparties, markets will diminish, and / or prices will fall in order to compensate for the increased risk.

I think it is important, as an industry, that we are united in our commitment to ethical conduct in all of our commercial engagements. In this regard, the reputation of our entire industry is at the mercy of the conduct of every participant within it.

And finally, we must strive for more accurate crop information where the marketplace is sensitive to that information.

5. Global Fibre Industry as an uncoordinated collection of National Cotton Industries

My final theme today on trade related matters is the observation that the International Cotton Industry, is not really an international industry, but a international collection of fiercely independent national cotton industries. These national industries see other cotton exporters and producers as the competitor rather than see alternate fibres as the real threat. The consequence of this is that there is no true global approach to product promotion or research and development.



Organisations such as Cotton Inc, and ICAC are real pillars of our industry, and they have made concerted attempts at promoting cotton, or at creating a more globally unified approach to our wonderful fibre. But the reality is, that these initiatives have fallen by the wayside for a lack of multilateral support.

Over the past 20 years cottons share of total textile consumption has fallen significantly. Over this same period, total textile consumption has grown very strongly. By extension, this means that man-made fibres have enjoyed a period of growth that we can only envy. If cotton today had the same market share of total textile demand, as it had just 10 years ago, then total cotton consumption would be estimated at 112 million bales, which represents 107% of estimated production for the 04/05 year. Just imagine what this would do for the price of our commodity.

What are the implications for the Australian Cotton Industry?

I think we often see these global issues as either being hard, or too far away. At the same time, I am sure we all tire of hearing the cliché that the world is becoming a global village, and it is shrinking daily. If that is the case, then it critical that once again we as an industry take our seat at the table, and provide the appropriate financial and intellectual resources, and if necessary the leadership to promote the establishment of a well resourced, well managed International Cotton Body, that can restore cotton's rightful place in the global textile community.



6. Conclusion

Today I have identified five issues of influence.

1. We need good bilateral agreements.
2. Non-commodity issues are relevant.
3. We need a robust global financial architecture.
4. Efficient markets need standards.
5. Market share retention will solve price problems.

But these issues are NOT totally discreet.

“In fact, the five issues discussed today are converging; Free Trade exposes domestic policies to global markets. In that game of international trade we need common rules and courageous umpires to ensure a fair contest.”

AUSTRALIAN COTTON FARMING IN A CHANGING ENVIRONMENT

I've been given the opportunity today to outline how I see cotton's future in a changing environment. Like all other sectors of the Australian economy, cotton farming, has and will continue to adapt to change. In fact, I believe it is one of our industry's strengths and successes that we have been proactive in meeting change. For me and for most cotton growers, identifying the challenges that lay ahead, so that we may be prepared to meet them to the best of our ability, is the only way to manage a business in an ever-changing world.

Perhaps it's worth reflecting for a moment on where the cotton industry has come from. Our industry is emerging from a period of very rapid growth. In the 3 years from 1993-95, Australian cotton production averaged 1.5 million bales, compared to the 3 years from 1998-2000, where we averaged 3.2 million bales – an incredible 100% increase in production in the space of 6 years.

In the last few years however, drought has all but halted this rapid growth through development in established cotton regions last year producing a meagre 1.5 million bales. Promisingly, the crop that is just being harvested should see the industry's production return to the more healthy level of about 2.4 million bales.

So, what do I see as the industry's challenges and how will a changing environment affect the industry's future?

Certainly, there are still expansion opportunities through such things as purchase of existing properties and, to some degree, new production areas, for example, the Ord Stage 2 in W.A. and the Burdekin in North Queensland. But for most growers, we appear to be entering a new era, an era where there is opportunity to further secure our businesses, through a combination of consolidation, and on-farm efficiency gains. There are exciting new opportunities that offer greater efficiencies on our farms. Technologies such as GPS, precision farming and fertilizer application and sophisticated irrigation systems all combine to give us far greater efficiencies in our on-farm production.

One area in particular that offers huge opportunities is biotechnology. Biotechnology that delivers insect and weed resistant crops is changing inexorably our whole farming approach. For decades we have concentrated on pest and weed management. Today we are able to devote more of our attention to plant health and nutrition, and through this concentrate on increasing yields and maximising water use efficiency. This season, about 75% of the cotton crop is genetically modified and I expect next season this will increase to around 90%. As well as delivering real environmental benefits, the increasing use of biotechnology is allowing us to reduce our variable production costs, something we must continue to remain viable in an ever increasingly competitive world cotton market. In a broader context, I cannot understand how we see ourselves surviving as Australian farmers and being more efficient in an ever increasing competitive world trading environment if we deny ourselves the opportunities and benefits that biotechnology offers. To me it's like trying to compete globally

with one hand tied behind your back. There is no doubt that biotechnology is the future for global agriculture. To deny this is like arguing that the world is flat.

For 10 years the Australian cotton industry has shown Australian agriculture that biotechnology is safe, profitable and environmentally good. It is high time the wider community put aside their fears and prejudices and see this technology for what it really is.

Fortunately our industry usually enjoys Australian dollar prices that can deliver good profitability to good farmers. There is however, a concerning trend in long term cotton prices. This chart shows the downward trend of cotton prices over the last 10 years. We can expect this sort of price pressure to continue, particularly in the current global environment, where we have emerging nations making good use of the same biotechnology we are enjoying, and producing more and more cotton at lower prices. Brazil particularly emerges as a potential major competitor for Australian high quality cotton by growing in a very favourable natural environment with the added benefit of low labour costs. Brazil is currently producing good quality fibre for around A\$380 per bale compared to the Australian cost of production of A\$420 per bale.

An even greater threat to long-term cotton prices is competition from synthetics. This chart shows that in 1982, global raw cotton production equalled 14.7 million tonnes (or 49.9% of global fibre production in that year). 20 years on in 2002, whilst raw cotton production had increased to 20.6 million tonnes, it had slipped to only 39.6% of global fibre production. This loss of market share to synthetics can be expected to continue in the face of very stiff competition where today synthetic fibre manufacturers are producing top quality, highly consistent fibre at around US40 cents/lb. Again, adding further downward pressure on prices.

As if all this isn't daunting enough, today we are living in an era where we are bombarded by what we see as interference and red tape from government departments at all levels. In areas such as water allocation and access, water pricing, farm management systems, vegetation management, OH & S, greenhouse, GM regulation, and even access to basic inputs such as fertilizer, there seems to be no end to the challenges coming our way from government.

As you can see, I am acutely aware of the myriad of challenges facing us, but the threats and challenges only become real if you do nothing about them. Recognition is the first important step in preparing to deal with these challenges.

Australia's world leading cotton R & D effort has played a huge part in establishing the strong position Australian cotton enjoys in world markets. Our CSIRO and industry plant-breeding program has shown the world that very high yields and excellent fibre quality can be bred into the same plant, in varieties that also show good disease resistance. Our R & D effort has shown us a way through the chemical treadmill of the mid-90's and IPM is now an integral of cotton production. Our water use efficiency, nutrient management, soil management, and almost every other facet of cotton production you can mention, are where they are, as a result of our R and D. In short R&D has

provided our industry with the tools and knowledge to do what we do. We can be confident that this dedicated effort will continue to provide us with even better yielding varieties, with even better fibre characteristics than we are now growing.

I would like to take the opportunity here, to acknowledge the positive support we receive from governments, particularly in co-funding in different ways, industry research. It has been a good partnership to date and all indications are that this will continue. A good example is the recent announcement by the Commonwealth government of its funding support for a new cotton CRC. We appreciate the confidence demonstrated in the industry with the support of the new CRC and in so doing, enhance relationships in cotton growing communities and place the Australian cotton industry at the forefront of sustainable production systems.

The cotton industry has positioned itself very well with the development and adoption of its Best Management Practice Program (BMP). This program serves a multitude of purposes: for industry critics, it provides a clear demonstration of our industry's commitment to managing our production system in an environmentally responsible and safe manner. For governments, it provides an industry driven self-regulation alternative to mandatory regulation and policing. For growers, it is a voluntary, user-friendly and cost-effective means of managing risk on the farm, and recently our industry has identified a significant potential for using BMP to position Australian cotton as an environmentally friendly, eco-labelled, product. The combination of these factors results in tremendous value to growers who choose to adopt this comparatively simple program. The benefits from BMP are many and significant, but the biggest threat to BMP is our own complacency. After six years we can still only claim approximately 60% of our industry's production to be BMP accredited. Again I must acknowledge the federal government's support with funding assistance to develop the program's Land and Water module and extending BMP beyond the farm through to our overseas customers.

We will hear from Richard Haire shortly about the complexities of global trade reform. The gains to be had from the elimination or reduction in trade distorting farm subsidy programs are immense. In 2001 our Research and Development Corporation found the impact of trade barriers and subsidies on Australian cotton growers was a massive 19%, or \$42,000 for an average size grower. For a comparatively small industry like ours to tackle the might of the U.S. and EU farm programs seems too big a challenge to contemplate, but through our affiliation with the National Farmers Federation and in collaboration with the Department of Foreign Affairs and Trade, we are indeed having some degree of impact. There is strength in unity, and we must continue to support such effective organizations as NFF and a concerted whole of agriculture approach to world trade reform.

The national debate on natural resource management, and in particular, water reform is perhaps the biggest challenge facing the cotton industry currently, and whilst good progress has been made in this area over the last year or two, there is still much work to be done. Last July we saw COAG endorse the adoption of

the National Water Initiative, clear evidence of a national approach to better manage our precious water resources to the benefit of the environment and all consumptive users. Despite recent setbacks, we are extremely anxious that the federal and state governments reengage and get this critical initiative back on track. As major users of irrigation water, it is essential that we have security of entitlement if we are to make long-term investment decisions involving higher cost water efficient technologies and production systems. The industry has demonstrated the efficiencies and increased production that can be accrued by being active participants in the Queensland government's water use efficiency program. Practical programs such as this should be developed and promoted by other governments to provide the incentives needed to stimulate change in irrigation practices.

The cotton industry welcomes the federal government's intent to pursue further labour market reforms. As an industry that operates in two states under both state and federal awards and agreements, the industry finds it almost impossible to be able to be flexible and innovative as it is in most other areas of business. A national, uniform approach to human resource management where both employers and employees can benefit from a less regulated and prescriptive approach by better balancing enterprise needs and with those of workers and their families must result in more productive workplaces and assist in making Australian agriculture more competitive.

In the time available, I have outlined a number of challenges facing our industry in a changing domestic and international environment. In many respects the challenges are no greater than we have faced in the past. I have an absolute belief in the cotton industry's ability to manage its affairs. With the benefit of new technologies, water and labour market reform and working cooperatively, the future for the cotton industry is perhaps brighter now than it has ever been.

Thankyou

One apparent target for growing our premium lies further down the supply chain. There are obviously knitters and weavers who are prepared to pay a premium for yarn made from Australian cotton.

Yet as a result of the structure of the textile industry we don't know who these customers are!

Supply-push vs Demand-pull

Traditionally our target customer has been the cotton spinner. We regarded our cotton as a commodity. Our strategy was "supply-push" – sell the spinner of the quality of our product, but make sure it's priced competitively enough against its many substitutes.

The Australian Cotton Industry Council, Cotton Shippers Association, Cotton Australia and CRDC are now working on a new approach – creating "demand-pull".

Demand-pull for Australian cotton is about creating a point of difference, a reason for retailers or brand-owners at the end of the supply chain to demand garment and textile manufacturers, knitters, weavers and finally spinners to use Australian cotton ahead of other growths. Our point of difference must be meaningful and tangible – something that consumers will recognise - and ideally something that is difficult for our competitors to copy or replicate. Our industry is currently researching that point of differentiation which can then be branded and promoted.

We've taken note of the lessons of the past from that other Australian fibre industry – any branding effort must result in benefits which flow back to the Australian cotton industry, not elsewhere.

Global Cotton Branding

In the global cotton industry there are several examples of successful branding. Cotton Incorporated (CI), with a US\$62 million annual market promotion and R&D effort has increased cotton's US textile market share from 34% in 1975 to more than 60% today.

The US Cotton Council International develops, licenses and promotes a Cotton USA Mark for products made of 100% cotton and certified to contain at least 50% US cotton. This program has lifted garment manufacturers preference for US cotton – from 19% in 1989 to 43% in 1998. Cotton USA Mark has now reached an 84% brand recognition in its target markets in Asia, translating into increased retail sales. Another recent cotton branding success story is Fibermax.

Fibermax is a cotton seed brand, developed by Bayer Cropscience, using varieties derived from Australian cotton seed genetics.

Many US cotton growers have recently become certified Fibermax suppliers – and via this mechanism, Bayer and US cotton merchants are actively promoting Fibermax cotton directly to spinners.

The biggest selling point for Fibermax is that it is a substitute for Australian cotton. However it is offered five to eight cents per pound lower than our styles and spinners are making the switch in large numbers.

This has been a tremendous marketing coup by the Americans – particularly in Asian markets traditionally serviced by Australian cotton.

Regrettably for us, Australian growers are being beaten by our own genetics and a clever marketing campaign in our own backyard.

Our industry now agrees – we need to fight back with our own differentiation strategy!

BMP – unique to Australia

One of the unique aspects of Australian cotton production is the Best Management Practices program.

BMP represents one of the opportunities to differentiate ourselves in the supply chain and create demand pull for our fibre. The merits of the BMP system have been recognised beyond the farm gate by the likes of the Australian Government, International Cotton Advisory Committee and green groups like WWF. As an industry we're now moving to implement the disciplines of BMP across the post-farm gate supply chain. These efforts are being supported by the Federal Government under the EMS Pathways to Industry program.

BMP represents something unique about Australian cotton. The BMP approach – and its extension post-farm gate - is difficult for any other cotton producing country to replicate. The key to realising a greater benefit from BMP is to develop an effective marketing campaign.

Cotton Australia and the Australian Cotton Shippers Association have already conducted some research into BMP's market viability. The world's consumers are increasingly trending towards "clean and green" ideals. Consumers are demanding to know the origin of the products they are purchasing and they are genuinely concerned about the future of the planet.

Identity Preservation and environmental awareness are powerful influences on consumers today. And there is no reason why this should be limited to foodstuffs alone.

BMP appeals to this market niche - consumers are seeking environmentally friendly products, and perhaps more powerfully, retailers and brand-owners are seeking to demonstrate their environmental credentials by sourcing from clean, green suppliers. A number of international and Australian retailers and brand-owners have expressed interest in our ability to supply garments from BMP cotton in order to cater to a "green" market, and to help them meet their corporate social responsibilities. One of the challenges being addressed under the EMS Pathways project is developing relationships and partnerships at all stages of the supply chain, as well as with external groups such as WWF, who are able to provide the independent credibility required by the brand-owners when sourcing 'environmental' products.

Gowings in Australia is already using BMP cotton in a range of t-shirts and promotes this fact through swing tags in store. UK's Marks and Spencer, serving over 10 million customers each week and using over 60,000 metric tonnes of apparel fibre per year wants to source BMP cotton. Strong interest has also been expressed by a Japanese trading house in BMP cotton from Australia, as it has both the quality and environmental characteristics they need to underpin a niche product line.

Together with Marks & Spencer we've traced out the supply chain from gin-yards in Australia to spinners, knitters and weavers in Indonesia, Thailand or Korea, garment manufacturers in China, Vietnam, Bangladesh or Sri Lanka and from there to European stores. Marks and Spencer currently specify their product lines to each of the garment manufacturers, who in turn demand matching specifications right back to the spinner.

If we can convince M&S or other brand owners to add a specification for certified BMP cotton we believe this will quickly lead to a demand-pull for Australian cotton.

Developing a brand

Of course our industry does not have the funding of Cotton Incorporated or CCI. But we can leverage off the existing promotional budgets of the brand-owners and retailers. We just need to have a good brand and story to tell. There are three things we need to spend money on to make this happen: One - BMP needs a brand. Best Management Practices itself does not mean anything to a consumer in Europe, Japan or Australia for that matter - and it's difficult to see it conveying the resulting story. The term BMP could relate to any process in any industry in the world. To appeal to millions of global retail customers we need something catchy and conveying. Two - we need a verification system.

We need to capture the benefits of this program for accredited Australian BMP growers.

If this is going to lift the volume of BMP cotton in demand, the returns need to flow to Australian BMP growers in the form of increased sales, and hopefully increased prices as a result.

This could be as simple as an on-line database for licensed BMP suppliers which can generate certificates of authenticity that can be included in the documents which accompany any sale of Australian cotton. Third, to be successful we need to be clear on our objectives.

As an example - is this an environmental story or a Quality Assurance program or a combination of both? BMP is currently an on-farm environmental best practice regime, but in order to provide the tangible and meaningful difference critical for properly differentiating Australian cotton, 'BMP's for fibre quality may also be required. The challenge will be developing a credible, marketable process at minimal extra cost. Also, there will be 100% BMP accredited farms producing short-staple or high-micronaire or rained-on cotton - how is that cotton then best marketed?

BMP cotton is also not organic. Australian cotton producers simply cannot compete without biotechnology and high inputs to maintain high yields. However, there is scope for Australian cotton to fill a niche between 'organic' and 'conventional', particularly in view of some of the commercial issues - reliability of supply, quality, traceability and price - associated with organic cotton.

Finally, do we have the capacity to supply? We don't want to create a lot of hype and not be able to deliver.

Conclusion

In conclusion, Australia's cotton industry has a highly successful track record.

Thanks to world leading research programs and the competition borne of a free market system we've been able to position our cotton as a fibre of choice around the world. Yet competitors will continue to gain ground on us – and with today's pace of technology transfer will do so quicker than they have in the past. In order to continue to flourish as an industry, we need to stay one step ahead. In parallel with research to lift yields and quality, and increase water use efficiency, we need to reposition our product with a differentiation strategy. Evidence exists that several spinners are paid yarn price premiums to use Australian cotton. We need to tap into that demand pull.

BMP represents one great opportunity to expand on that demand pull and elevate us out of the "commodity" business.