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THE INFLUENCE OF TRADE ISSUES ON THE WORLD COTTON DEMAND

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ABSTRACT

For any business to be successful today, globalization is a trend and a key term one must become familiar. When evaluating the risks and benefits of becoming a global player, there are many factors that influence the business opportunities available. Historically, cotton has been traded globally. With the recent changes in trade agreements and the impact of global economic and political situations, keeping abreast of these developments are crucial. This report will review those changes in trade legislation, political and economic issues and the supply/demand situation for cotton as each continue to be a major factor in world trade.

KEYWORDS: cotton, world cotton demand, cotton fiber, cotton producers, cotton exporters

Introduction

Global opportunities are abundant, however the challenge is to identify and take advantage of those opportunities. Markets are opening and growth of those markets will continue. For the year 2000, the world consumption of textiles was placed at 4.8 million metric tons for a population of six billion[1]. That calculates to a per capita consumption of eight kilograms of fabric, which has doubled from 1950. There has been an increase in consumer spending worldwide. Since 1989, U.S. textile products have lost a full percentage of consumer disposable income expenditures, going from 5.9% to 4.9%[2]. For any manufacturer to grow their business, they must respond to these markets and know what the consumer is buying. Along with these opportunities there are obstacles, of which some are not so easy to analyze and overcome. The textile industry, as most other industries, has found itself attempting to embrace globalization, which is going to happen. The main challenge is to think on a global basis. Along with that, the industry must contend with consumer demand volatility, reduced customer lead times, new product introduction and increased margins and price pressure. Clearly other countries have done so as evident by more than 60% of apparel sold in the U.S. is now imported[3]. The increasing importance of cotton apparel imports into the U.S. market, combined with world textile trade that is rapidly moving in the direction of lower tariffs and the elimination of quotas, creates a dynamic sourcing environment. Like it or not, today's marketplace is global. Globalization is not new, and there are so many more resources available to day that process and standards are under constant pressure. The U.S. is setting the standard for what consumers want. Of the top 100 brands in the world, in terms of value added to their companies, the top ten were American and two-thirds of those 100 were American[4]. The U.S. needs to learn how to export and to establish manufacturing in other parts of the world.

<u>China's Admission into the World Trade Organization</u>

This is perhaps one of the most controversial trade issues facing the global textile industry of today and tomorrow. China is the world's largest textile producer with 24 billion square yards of fabric produced in 1998[5]. Since the United States has granted permanent normal trade relations with China and the expectation that China will enter the WTO, there have been more debates about the impact on the domestic textile industry than any other trade issue. This is an issue that has all the components of economic, political and moral questions that can lead to division among any industry segment. While many uncertainties still remain about the total impact, it is generally felt that China's accession to the WTO will accelerate the displacement of the textile industry in the United States. China may increase imports at the expense of other Asian countries. Some estimates put the loss of textile related jobs at 150,000 workers combined with $7.6 billion lost apparel sales and $4 billion lost in textile sales[6]. While it is expected the China will take advantage of this opportunity to import more textile products into the United States, it is predicted that their markets will not be open to trade with the U.S. and that the Chinese would not respect intellectual property rights. In addition, many expect the problem of transshipments and illegal smuggling of goods into the United States will continue.

Normal trade relations (NTR) refers to the general tariff treatment the United States extends to foreign nations in return for reciprocal tariff treatments for U.S. exports. The United States now extends normal trade relations to more than 130 countries with only six (Afghanistan, Cuba, Laos, North Korea, Serbia-Montenegro and Vietnam) countries not included. The United States suspended the normal trade relations with China in 1951. This was conditionally restored to China under the Trade Act of 1974. Since 1980, NTR is renewed annually based on having a bilateral trade agreement in place.

On the other hand, China sees this as a growth opportunity for their textile sector. Estimates suggest apparel exports will increase to $43 billion by 2005, an increase of $13 billion over 1999[7]. China is expected to increase their market share of the U.S. garment market to 30% as compared to the 12% market share it held in 1999. As the garment industry is one of China's biggest exporters at 15% of the nation's total exports for January through April 2000, the contribution to China's economy could be significant. Because of China's superior labor force and higher production standards, many importers are now looking back to China as a reliable and competitive source. Mexico recently surpassed China as the number one garment exporter to the United States because of the NAFTA benefits.

<u>North American Free Trade Agreement</u>

This is yet another controversial piece of trade legislation but, unlike China's admission into WTO, NAFTA has had time to establish a presence in the textile trade particularly with the United States, Canada and Mexico. Mexico has a labor rate of about $1.50 and the direct connection to the U.S. making transshipments easier than across water. The most significant influence is the increase in apparel manufacturing in Mexico for consumption in the United States. In 1992, the amount of apparel consumed in the U. S. of Mexican origin was about two percent. In 1999, that figure has grown to 15%, surpassing the amount of apparel consumed in the U. S. that is actually manufactured in the U.S[8]. Apparel imports from Mexico have grown from $1.3 billion in 1993 to more than $6.7 billion in 1998. There have been a total of 393 companies that have direct foreign investment in the Mexican textile and apparel industries. Of these, 70% have U.S. capital, 4% Spanish, 3% Korean, 2.5% Canadian and the remaining 20% from other countries[9]. Many U. S. firms have found refuge and established partnerships with companies in Mexico. While there have been and will continue to be obstacles, U. S. textile producers have found this as but one opportunity to meet the changing challenges that lie ahead. One such challenge to doing business in Mexico was very well illustrated in an article published in Women's Wear Daily on May 22, 2001. That article discussed the difficulty in allowing Mexican trucks greater access to U.S. highways. Trucks from Mexico are not allowed beyond ten miles past the border because the U.S. does not approve of Mexico's truck safety standards. This complicates the movement of textiles and apparel across the U.S.-Mexico border for many of the major retailers.

Trade and Development Act of 2000

As the most recently enacted trade legislation, the Trade and Development Act of 2000 holds the potential to enhance business opportunities for the U.S textile industry; but not without some risks. This act has two main provisions aimed at enhancing trade with countries of the Caribbean Basin and sub-Saharan Africa. The new law also includes duty and quota preferences to the U.S. market for certain textile and apparel products manufactured in the Caribbean Basin and sub-Saharan African regions.

Basically, the Caribbean Basin Initiative expands the North American trading block. Many mills look at the combination of establishing businesses in both Mexico and the Caribbean Basin as the best opportunities to combat cheap labor and imports from countries such as China and India. As well, the close proximity of those regions gives a strategic advantage for quicker response to the fashion seasons. As many companies in the Caribbean have not used U.S. fabrics, they are unfamiliar with the product offerings. Historically, they have bought Asian piece goods. Many mills are faced with the task of introducing their products, methods of operation and cost structures. Caribbean labor rates have been quoted at between $0.80 to $1.50 per hour, making the combination of wages and location an attractive alternative for sourcing and garment manufacturing. After the enactment of the CBI bill in October of 2000, U.S. fabric exports to that region increased 37% in the fourth quarter to reach a year-end record level of $1.24 billion[10]. Large increases in exports to CBI countries are in spun and filament yarns, cotton fabrics, synthetic and cotton broadwoven fabrics and knit fabrics. However, the largest increase has been in the exports of cut pieces. A recent reduction in exporting cut pieces to CBI is a result of shifting to cutting the pieces in the CBI; a provision as specified in the bill.

The other main provision of the act contains the African Growth and Opportunity Act (AGOA). This provides opportunities to increase trade and investments, economic development and increase access for U.S. investors in sub-Saharan Africa. Specifically for textiles, all existing quotas on textiles and apparel products made from U.S. yarn and fabric will be lifted from those qualifying countries. It also extends duty/quota free U.S. market access for sub-Saharan African apparel made from yarns and fabrics not available in the United States. Apparel made in Africa with African/regional fabric and yarn also qualifies for duty and quota free U.S. market access but is subject to a limit range (cap). While the AGOA legislation has the potential to benefit those countries in Sub-Saharan Africa, the following describes changes happening in the country of South Africa as reported from a recent trade mission indicative of what might occur throughout the region.

Because of the years of sanctions under the apartheid regime, the industry is in a state of flux. Management remaining from that era is struggling to adjust to new economy approaches while companies with younger or foreign management have a better understanding of globalization. The urban areas have strong unions with relatively higher wages as compared to the decentralized areas where wages are considerably lower. Those are the areas where the trans-national (Hong Kong/Chinese/Taiwanese) companies are building factories. The possibility of being a major textile supplier exists but a lot more investment is needed. The population of South Africa is 44 million but has a severe unemployment problem estimated at over 30% (realistically most recognized at 50-60%). Most textile workers receive wages between $200 to $250 per month. The unions in the urban areas closely monitor the wages and working conditions. The textile industry is the sixth largest employer in South Africa's manufacturing sector and the 11th largest exporter of manufactured goods. In total, from cotton farming to garment manufacturing approximately 300,000 persons are employed in the industry (140,000-apparel manufacturing; 60,000-textile industry; 100,000-cotton production). An industry survey estimates 300 apparel companies operating in South Africa with an additional 2,000 small emerging companies taking advantage of the low wages in the decentralized areas. Total apparel production was estimated at 200 million units in 1999[11].

The Global Landscape for Cotton

In order to better understand how all of these issues, including trade, economic, consumer, supply and demand, and market conditions, we must look first at a few fundamentals that apply to the cotton situation (see Table 1).

USDA estimates put 2000/2001 world cotton production at 87.2 million bales (480 pounds per bale). With a carryover of 41.1 million bales, this would give a supply of 128.3 million bales. Another strong year of consumption at 91.7 million bales leaves an ending stock of 37.1 million bales; or 4 million bales less that the previous year indicating a tightening of the supply.

Table 1. World cotton market in millions of bales comparing production years 1999/2000 and 2000/2001.

World Cotton Market

millions of bales	1999/2000	2000/2001
Beginning Stocks	44.9	41.1
Production	87.2	87.2
Consumption	91.8	91.7
Ending Stocks	41.1	37.1

Source: USDA

Figure 1. Major Cotton Producers

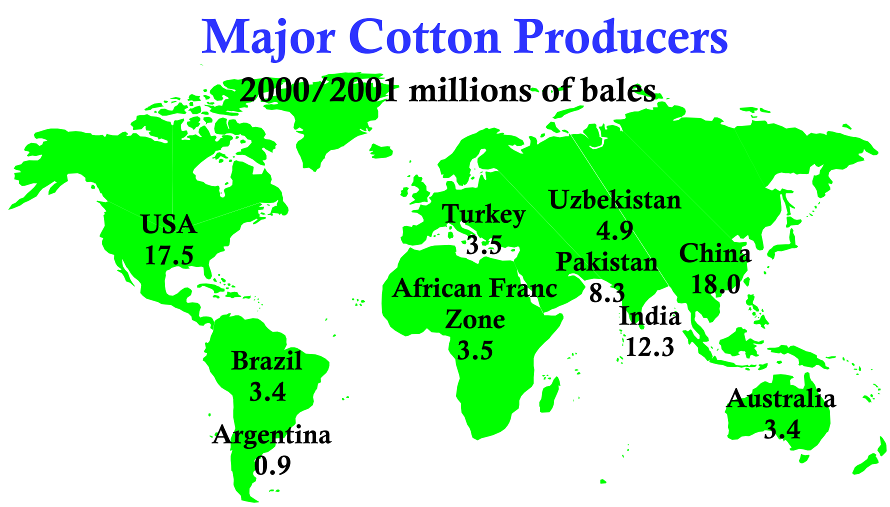


Table 2. U.S. cotton balance sheet for production years 1999/2000 and 2000/2001.

U.S. Cotton Balance Sheet

Millions of Bales	1999/2000	2000/2001
Beginning Stocks	3.9	3.9
Production	17.0	17.5
Imports	0.1	0.1
Total Supply	**21.0**	**21.5**
Domestic Use	10.2	10.1
Exports	6.8	7.6
Total Demand	**17.0**	**17.7**
Ending Stocks	3.9	3.8

Source: USDA

Worldwide cotton production by country is shown in Figure 1. The three leading producers are China, the United States and India. The outlook for world production for 2001/2002 estimates an increase in all countries except for Greece, Syria and Uzbekistan. Expectations are for higher production figures with consumption remaining at record levels. The gap between world consumption and production will continue to narrow. This will cause world stocks to continue to marginally decline.

Another important consideration is the supply and demand situation in the United States. The balance sheet for U.S. cotton is shown in Table 2. While exports are declining, the major factor contributing to higher ending stocks is the reduction in domestic consumption. Demand for U.S. cotton over the past decade is shown in Figure 2.

Figure 2. Ten-year trend for exports and domestic consumption of cotton in the U.S.

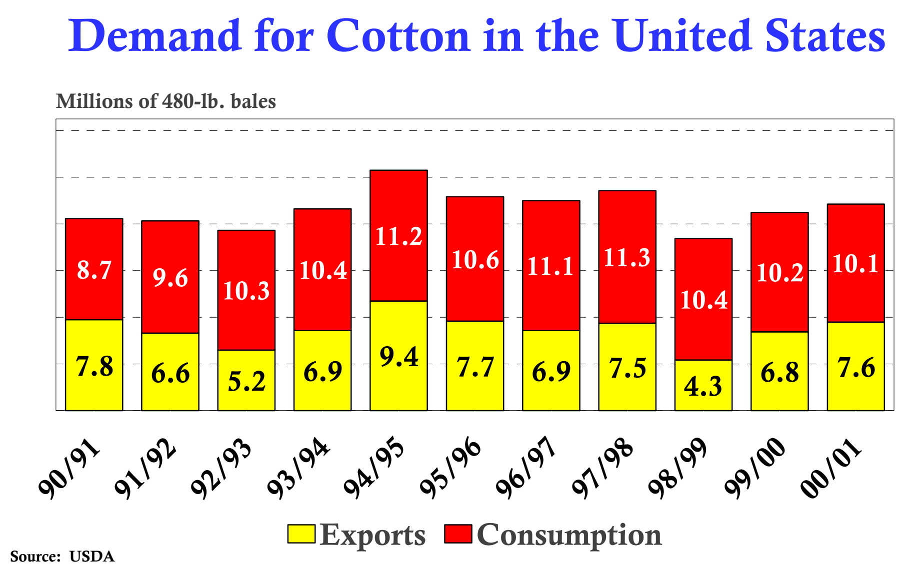
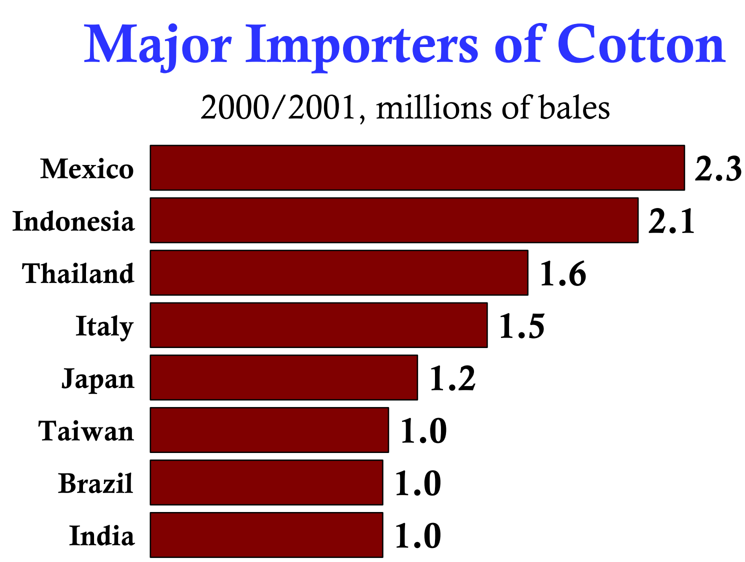


Figure 3. Major Importers of Cotton.



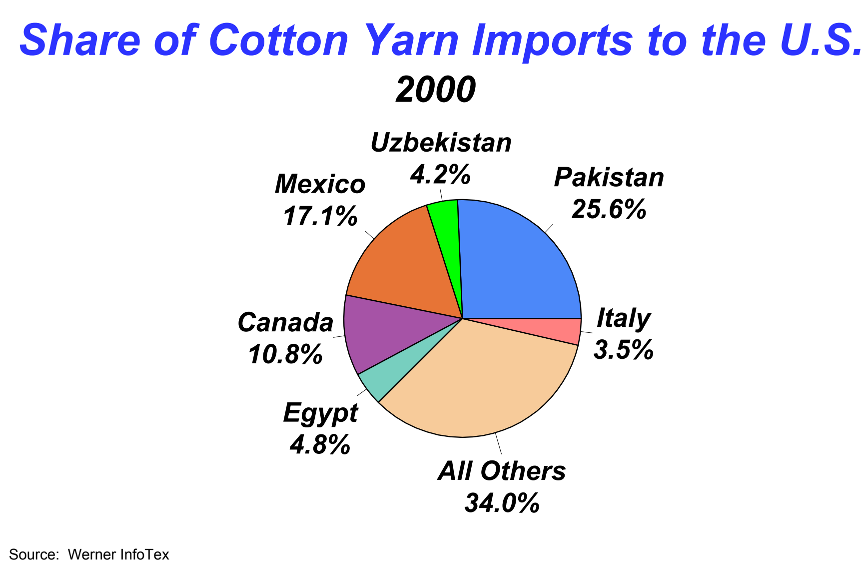
Source: USDA

The principal importers of cotton are listed in Figure 3. The top five export destinations for U.S. cotton are Mexico, Turkey, Indonesia, South Korea and surprisingly, Canada. Mexico will purchase nearly two million bales, most of which will return to the U.S. as finished apparel products. Mexico is the major supplier of cotton products to the U.S. followed by Pakistan, India, China and Honduras. If we compare the years of 1989 to 2000 of those major suppliers of cotton products to the U.S., we can see a changing scenario. As we look into the factors that influence such a change, quota fill rates and low labor costs are paramount in determining those sources of products. High quota fill rates combined with low labor costs indicate high potential suppliers. This has been the product of NAFTA, as seen in Mexico being the top supplier, and is expected to be major factors in the TDA of 2000. Of greater significance is the impact of high quota and low labor wages with China and the impact that will have on the source of apparel products coming into the United States after 2005. High export potential countries after 2004 also include Bangladesh, Sri Lanka, India and Mexico. A quota-free environment will accelerate the shift in suppliers already underway in the Asian region. Some countries such as Singapore, Jamaica, Korea, Taiwan and Hong Kong are likely to lose market share after the quota phase-out.

Major cotton product categories include underwear, sheets/pillowcases, towels, men's shirts, women's shirts, dresses and denim bottoms. Collectively, these categories represent 65% of the cotton fiber consumed in retail sales for home and apparel fabrics. For the years 1991-1998, there was a decrease in U.S. mill use for underwear and a high net import for that category. What was once a U.S. commodity product may not be considered such as imports represent a higher percentage at retail.

Yarn is now a globally sourced item. Pakistan has the single highest share of yarn imports into the U.S. followed by the NAFTA neighbors of Mexico and Canada (Figure 4). Pakistan has taken advantage of supplying a commodity ring spun yarn of good quality offered at a very reasonable price. Again, meeting the demands of quality and price that are necessary for today's sourcing options. Interesting enough is Canada's position to supply yarn to the U.S. New investments by the Chinese and the opening of a major spinning operation in Canada have made this possible.

Figure 4. Suppliers of Cotton Yarn to the U.S.



In conclusion, everyone will have to deal with the fact that all textile and apparel quotas will disappear as of 2005. The challenge is to find ways to adjust. There are opportunities to develop markets. For the U.S. this has been demonstrated by the positive influence of NAFTA whereby the high-tech, capital intensive textile industry has taken advantage of the labor intensive apparel industry south of the border. As the past two administrations have been in support of building international trade, each trade issue enacted has become a very complicated and often misinterpreted act. Expanding trade to some regions brings optimism for increasing sourcing options and meeting demand. The establishment of such a business arrangement can often be discouraging and frustrating. A cautious approach to understand all the issues related to international trade can only help in such arrangements. But as one can see from this very condensed report, there are many factors that must be researched prior to any such business transaction.

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