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Cotton Policy

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A quarterly newsletter of the World Bank on cotton sector policy reform and implementation issues

The cotton sector in West and Central Africa is currently undergoing a process of reform that will have a significant impact on its long-term growth. As individual countries are designing and implementing these reforms, the World Bank, through the current publication, is seeking to provide a forum to (i) exchange views among interested stakeholders, and (ii) disseminate experiences and lessons across countries. The views expressed here are those of the author(s) and do not necessarily reflect the views of the World Bank Group, its member countries, or the other groups mentioned.

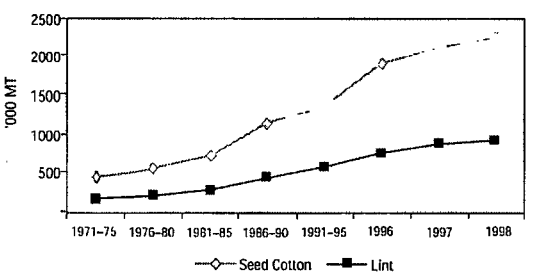
The Cotton Sector in West and Central Africa[1]

Sector Overview and Future Prospects

The modern cotton industry in West and Central Africa was pioneered by the Compagnie Française pour le Développement des Fibres Textiles (CFDT), a French parastatal. As each of these countries achieved independence, CFDT retained minority shareholdings in most of the national cotton companies. It has also maintained partial or controlling interest in cotton processing firms (cotton seed oil, oilseed cakes and pellets, soap in certain cases, and lint marketing) in most of these countries. In turn, CFDT provides services such as extension, credit, and input supply to the parastatals.

Cotton has proved to be an economically efficient crop that has had a significant impact on export and economic growth, and on the development of rural areas. Cotton production in the region has increased five-fold over the last thirty years, from around 445,000 tons in the early 1970s, to nearly 2.3 million tons currently (see Figure 1), thereby increasing income for over 2 million farmers. In 1996/97, the region produced nearly 900,000 tons of cotton lint, equivalent to 5 percent of the world's production. The combined exports of the West and Central African countries, accounting for almost 15% of world cotton trade in 1996/97, are exceeded only by those of the US and Uzbekistan.

Figure 1. Seed Cotton and Lint Production West and Central Africa, 1971–1998



Source: FAOSTAT 1999

Several factors have contributed to making cotton production a success:

- broad application of technical packages that include effective measures for soil nutrient replenishment, pest management, and seed varieties well adapted to local conditions;
- the provision, by governments and/or the cotton companies, of good support services and infrastructure;
- guaranteed output markets at stable prices;
- high input-credit recovery rates; and
- well organized village-level farmer associations.

Tremendous potential exists for regional integration through the West African Economic and Monetary Union (UEMOA) and the Central African Economic and Monetary Community (CEMAC). Effective regional integration would not only allow West and Central African countries to enlarge their internal markets, but could also turn the region into a world cotton powerhouse. The resulting competitive environment would, in turn, attract additional investments by multinational agro-industrial firms, and lead to new export markets.

The Strategic Issues Ahead

While the development of the sector has resulted in consistent good-quality cotton, high average crop yields (by international standards), and high average ginning ratios, it has also led to numerous inefficiencies and considerable scope for improvement. The lack of transparency creates oppor-

[1]The cotton-producing countries in West and Central Africa are Benin, Burkina Faso, Cameroon, Central African Republic, Chad, Côte d'Ivoire, Mali, Senegal, and Togo.

tunities for rent seeking and mismanagement of resources, generally at the cost of the farmers, the national budget, and the national economy as a whole. The sector's contribution to poverty alleviation and to the establishment of a modern, highly articulated, and rapidly growing agricultural sector could be greatly increased, provided that a number of critical issues are addressed

The administered pricing system

The cotton parastatals hold a monopoly on the provision of production inputs to farmers, giving farmers limited control over the types and quantities of the seeds and other inputs they use Downstream, the parastatals control purchases of seed cotton and, for the most part, ginning, marketing, and exports of lint and seed. Typically, a single producer price for seed cotton is established annually before planting, and supplemented by a second payment (ristourne) based on the difference in weight at purchase and factory, and on primary marketing activities performed by farmers' organizations. In recent years, additional payments have been made in some countries, based on the actual lint export price, or if the parastatal's profits were higher than expected for the season The guaranteed producer price applies throughout the year and in all growing areas, and reflects the relative bargaining power of farmers, governments, cotton parastatals, and CFDT Credit for the acquisition of modern inputs is deducted directly by the cotton parastatals from the price that it pays to farmers for seed cotton.

The current pricing system provides some stability to farmers, but at a fairly high cost in terms of income forgone and long-term growth potential. These costs are to be expected, however, given that governments have every incentive to keep guaranteed prices low in order to avoid the possibility of having to subsidize producers during falling world prices, and that farmers have no effective influence on decision making in the sector.

Table 1 illustrates the impact of the current system on cotton pricing in individual countries in West and Central Africa. It compares prices in individual countries to international prices and to prices in other exporting countries such as Zimbabwe and India. For the sake of comparability, domestic prices of seed cotton are converted to lint-equivalent prices The figures show that, before the devaluation of the CFA Franc in 1994, producer prices were a little over one-half of their international levels, similar to the observed levels in Zimbabwe before the reform of the cotton sector in that country. In contrast, in India, where the system has been more competitive, domestic prices were less than 10 percent below international price levels Despite their low starting base, domestic prices in West and Central African countries fell dramatically after the devaluation of the CFA Franc, due to the parastatals' reluctance to transmit the effects of the change in parity to producer prices. In contrast, the ratio of domestic to international prices rose by more than one-third in Zimbabwe, following that country's decision to open the sector to greater competition.

Only a small portion of the noted difference in price ratios can be explained by factors such as road infrastructure or the cost of support services that are provided by the parastatals to the farming communities in most countries in West and Central Africa

The gap between the domestic producer price and export lint-equivalent price of the seed cotton is explained primarily by (i) subsidies to other areas of the sector such as ginneries, and the domestic oil and meal processing companies, (ii) excessive operating costs of inefficient parastatals, and (iii) implicit taxes and payments

Monopolistic/monopsonistic nature of the cotton sector

The highly monopolistic and monopsonistic nature of the cotton sector is impeding broader economic development in several ways.

- The low prices that are paid to cotton farmers reduce their income levels and hence their ability to invest in productivity-increasing technologies.
- The lost income leads to forgone multiplier effects that would generate additional income and employment in other parts of the rural economy and the country as a whole.

Table 1 – Ratio of Domestic (*) to International Prices (%)

	Benin	Burkina Faso	Cameroon	Chad	Côte d'Ivoire	Mali	Togo	Average 7 countries	Zimbabwe	India
1990-1993	58	59	48	59	54	52	56	55	58	91
1994-1997	36	35	40	35	37	35	39	37	79	93

Source: "Cotton Policies in Francophone Africa". World Bank. Background paper prepared for the meeting on the cotton sector, held in Dakar, June 4-6, 1998.
(*) Domestic prices are lint-equivalent of seed cotton producer prices

- The potential of cotton production to support investment in other rural economic activities is underutilized, since seed cotton can only be used as collateral to borrow for cotton inputs.
- Entrepreneurial opportunities are denied to potential investors who could build on the momentum generated by such a successful sector to provide a wide range of agricultural support services.
- The monopsonies and export monopolies are incompatible with the establishment of the customs unions in West and Central Africa.

The Ensuing Debate and Options for Reform

In 1998, intensive discussions took place among the stakeholders in the cotton sector in West and Central Africa. These discussions included government representatives, the cotton parastatals, CFDT, representatives of cotton farmers, representatives of the French Ministry of Cooperation and Agence Française de Développement, and the World Bank. The objective of these consultations was to evaluate the options available to reform the sector and improve and sustain its performance. In the course of these discussions, two alternative approaches emerged. The West and Central African countries could retain, but reform, the current system, or they could establish free entry and increased competition in the sector.

Retaining but reforming the seed cotton monopolies/monopsonies

The key components of reform would include:

- setting the purchase price for seed cotton at levels closer to world prices;
- giving cotton farmers more influence over key decisions, especially the pricing of seed cotton, the organization of credit and input supply, and the design and implementation of price-stabilization schemes;
- increasing the extent to which activities such as input supply and transport are subcontracted to private firms, and
- eliminating subsidies of the sale of cotton lint and cotton seed to domestic textile firms and oil mills.

One of the main advantages of limited reform is that it reduces the risk that more far-reaching reforms might lead to the deterioration or breakdown of some of the strengths of the present system. Those strengths include the compulsory contract farming that ensures research and extension cost recovery, and the high recovery rates of input credit. Another advantage of this approach is that seed cotton prices would be aligned more closely with world cotton-lint prices. But this is precisely why there is some resistance to reform, since such large shares of national income are at stake. The base purchase price would remain inherently political and negotiated among the various interest groups.

With limited reform, parastatals would continue to have greater access to political power and patronage as compared to farmers. This would, in turn, assure them a higher share of the profits. Governments would be likely to continue holding guaranteed prices low, to avoid having to subsidize cotton marketing. Consequently, seed cotton prices would remain well below world levels. Finally, this option would be incompatible with the recent decision to liberalize trade in the member countries of UEMOA and CEMAC.

Free entry and competitive markets

The key components of market liberalization include

- competitive free entry at all levels of the cotton sector,
- higher producer prices, more closely aligned with world prices,
- more efficient pricing of inputs and agricultural support services;

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- strengthening of related public activities, especially research, extension, and phytosanitary controls;
- strengthening farmer groups and facilitating their participation in voluntary contract-farming arrangements; and
- a reduction in the implicit taxation of the cotton industry (except in certain cases of temporary fiscal difficulty, in which case a small excise tax on ginned cotton might be employed for a limited time)

With liberalization, seed cotton prices in the region would rapidly approach equivalent world prices. Higher seed cotton prices would generate extra government revenue indirectly through the resulting increase in cotton production and exports. In some countries, free entry may be sufficient to generate a competitive system, but in most others, restructuring and privatization of existing public companies would be required in order to signal the government's commitment to free entry.

The competitive model would eliminate the negative aspects of a monopoly system (low prices and incomes, barriers to entry, constraints to growth in marketing, transport, processing, and the export sector, and the negative fiscal effects of world market downturns). Measures would have to be taken, however, to ensure that input distribution and credit provision systems function adequately and equitably.

The World Bank's Position

Both the competitive and reformed-monopoly models can work, and both would require specific conditions and safeguards. From the point of view of the Bank, the best option would be a model of competitive contract farming. Such a model would allow competition among several firms based on an inter-professional agreement, or a "code de conduit", that would ensure that contracts are enforceable, and that would link credit repayment to seed cotton marketing. The Bank does not believe that it would be productive to privatize the cotton parastatals unless the minimum conditions for competition exist.

The World Bank's view is that the discipline and responsibility that a free-entry competitive system imposes on market participants will make for a more resilient, flexible, self-reliant, and innovative national cotton sector in the long run. Improved competition through market liberalization offers important opportunities for regional trade and cooperation, the latter in areas such as research, phytosanitary controls, and seed development and certification. Most importantly, an improved sector performance will contribute to alleviating poverty, by raising farm cotton revenues to levels enjoyed by farmers elsewhere in the world

Where governments cannot be convinced to move quickly to a competitive model, a reformed and regulated monopoly is an acceptable option. In such cases, the Bank would seek to help ensure that (i) the regulated monopoly is functioning properly, (ii) the parastatal is under strong pressure to perform adequately, (iii) the cotton company generates fiscal resources and transfers them to the treasury, and (iv) the producer price is set by a formula which is less taxing and much more favorable to producers than in the past. Moreover, producer organizations need to be strengthened so that they acquire improved negotiating capacity.

The responsibility for cotton policy reform and implementation rests with the national governments and the other stakeholders in the sector. The Bank stands ready to assist all interested parties in ensuring that the policies chosen contribute to the welfare of the rural populations in the region, and in maximizing the economic development potential of the region's cotton sector.

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