TESTIMONY
Presented to the
U.S Senate Committee on Agriculture, Nutrition and Forestry
by
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Introduction

I would like to thank the Chairwoman Stabenow, Ranking Member Roberts, and Members of the Committee for the opportunity to offer the views of the National Cotton Council regarding U.S. farm policy. My name is Chuck Coley, and I am a third generation cotton and peanut farmer from Vienna, Georgia. I am also President of Coley Gin and Fertilizer which includes a cotton gin and warehouse; a peanut buying point and warehouse; and, a fertilizer and crop protection product distribution company. I am currently serving as Chairman of the National Cotton Council.

The National Cotton Council is the central organization of the United States cotton industry. Its members include producers, ginners, cottonseed processors and merchandisers, merchants, cooperatives, warehousemen and textile manufacturers. Cotton is a cornerstone of the rural economy in the 17 cotton-producing states stretching from the Carolinas to California. The scope and economic impact extends well beyond the approximately 19 thousand farmers that plant between 9 and 12 million acres of cotton each year. Taking into account diversified cropping patterns, cotton farmers cultivate more than 30 million acres of land each year. Processors and distributors of cotton fiber and downstream manufacturers of cotton apparel and home furnishings are located in virtually every state. Nationally, farms and businesses directly involved in the production, distribution and processing of cotton employ almost 200 thousand workers and produce direct business revenue of more than $27 billion. Accounting for the ripple effect of cotton through the broader economy, direct and indirect employment surpasses 420 thousand workers with economic activity well in excess of $100 billion.

The National Cotton Council believes that sound farm policy is essential to the economic viability of the cotton industry. We appreciate the dedication and diligent work of this Committee during last fall's attempt at a joint deficit reduction package. While that effort did not advance a farm bill to conclusion, the U.S. cotton industry supports the Committee's commitment to conclude a farm bill in 2012. It is critically important to provide certainty to those involved in production agriculture since they make long-term investment decisions based on federal farm policy. The National Cotton Council also strongly supports farm programs specific to the needs of individual commodities versus a one-size-fits-all approach.

The combination of the marketing loan, Direct Payments (DP) and Counter-cyclical Payments (CCP), as structured in the 2008 Farm Bill, has served the cotton industry extraordinarily well and, in recent years, has required minimal federal outlays. However, deficit reduction efforts are placing unprecedented pressure on the existing structure of farm programs. Deficit reduction will lower the baseline funds available to upland cotton. Yet simply downsizing the current program structure would undermine the effectiveness of the programs to the extent that alternatives need to be evaluated to ensure growers have access to an effective safety net.

The cotton industry faces another unique challenge. In developing new farm legislation, the U.S. cotton industry must work with Congress and the Administration to resolve the longstanding Brazil WTO case and remove the imminent threat of retaliation against exports of U.S. goods, services and intellectual property.

In order to respond to the challenge of designing the most effective safety net with reduced funding and to make modifications that will lead to the resolution of the Brazil case, the industry recommends a revenue-based crop insurance program available for voluntary purchase which will result in strengthening growers' ability to manage risk. By complementing existing products, the program would provide a tool for growers to manage that portion of their risks for which affordable options are not currently available.

The revenue-based crop insurance safety net would be complemented by a modified marketing loan that is adjusted to satisfy the Brazil WTO case. In the opinion of the U.S. cotton industry, this structure will best utilize reduced budget resources, respond to public criticism by directing benefits to growers who suffer losses resulting from factors beyond their control, and build on the existing crop insurance program, thus ensuring no duplication of coverage and allowing for program simplification. The revisions will provide confidence to lenders and ensure market-oriented production decisions that ultimately serve the long-term financial health of merchandizers, processors, related businesses and rural economies.

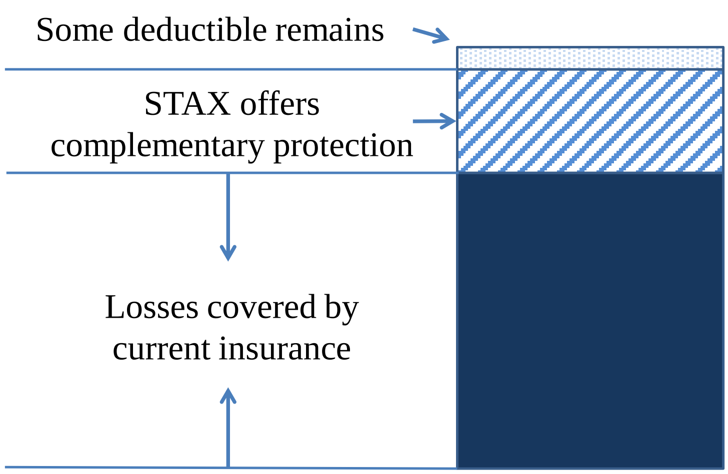
Stacked Income Protection Plan

The recent cotton market has been characterized by extremes. Cotton prices exhibited unprecedented volatility, essentially tripling between April 2010 and April 2011. However, the exorbitant surge in prices, which was in part fueled by unexpected cotton export restrictions by India, placed tremendous pressure on textile manufacturers, and cotton demand suffered as a result. By the end of 2011, cotton prices had retreated, losing much of the gains of the earlier rally. As market prices experienced greater turbulence, portions of the U.S. Cotton Belt faced extreme weather conditions. The Southwestern region, most notably Texas and Oklahoma, suffered the worst drought conditions on record in 2011. Based on USDA data, the percent of planted acres that were un-harvested reached an all-time high. Unfortunately, those dry conditions persist in many areas. Last year, portions of the Mississippi Delta region lost crops due to spring-time floods, while areas in the Southeast faced drought conditions. Unfortunately, the extreme market and weather events have come at a time when overall input costs are at an all-time high. As a result, operating margins are volatile and extremely tight.

Farmers understand that agriculture is an extremely risky endeavor, but they also understand that effective risk management is the key to long-term viability. While the goal of farm programs is not to completely remove the risk associated with farming, farm programs should strive to provide opportunities for effective risk management. The Stacked Income Protection Plan, or STAX for short, accomplishes that goal. STAX is designed to provide a fiscally responsible and effective safety net for upland cotton producers. The program will be administered in a manner consistent with current crop insurance delivery systems and is designed to complement existing crop insurance programs. This proposal does not change any features of existing insurance products.

The STAX plan is designed to address revenue losses on an area-wide basis, with a county being the designated area of coverage. In counties lacking sufficient data, larger geographical areas such as county groupings may be necessary in order to preserve the integrity of the program. The "stacked" feature of the program implies that the coverage would sit on top of the producer's individual crop insurance product (Figure 1). While designed to complement an individual's buy-up coverage, a producer would not be required to purchase an individual buy-up policy in order to be eligible to purchase a STAX policy.

Figure 1. Stacked Income Protection Plan (STAX)



The STAX revenue product would be funded using available upland cotton baseline spending related to the CCP, DP and Average Crop Revenue Election (ACRE) programs. In addition, producers would bear a portion of the cost of the program by paying some level of premium. However, producer premiums would be offset to the maximum extent possible through the use of available upland cotton spending authority for the CCP, DP and ACRE programs. The cotton industry believes that the premium offset should be no less than 80%, which is the current subsidy level for all enterprise unit policies.

The basic design of the STAX program is similar to current Group Risk Income Protection (GRIP) plans offered through the Risk Management Agency (RMA). Two notable changes relative to the current GRIP plan would be the introduction of a reference price in the formula determining reference income, and the proposed STAX plan would cover only those losses at the upper end of the producer's risk profile. Indemnities under the STAX plan would be paid on upland cotton planted acres purchasing the plan.

The following table highlights the basic design of the Stacked Income Protection Plan. The description in Table 1 is not an exhaustive list of the possible features of the program, but rather a general overview. Specific parameters and features of the program will in part be determined by budget considerations.

Table 1. Basic STAX Overview

Relevant market prices for crop insurance products are determined based on futures markets	Projected Price	Use same procedure as current insurance products. (For much of the Cotton Belt, the Projected Price is determined as the average closing value of the December contract for a relevant pre-planting period.)
	Harvest Price	Use same procedure as current insurance products. (For much of the Cotton Belt, the Harvest Price is determined as the average closing value of the December contract for a relevant harvest period.)
Determine level of price and income protection under STAX policy	Preliminary Price Protection	Higher of the Projected Price and a **<u>Fixed Reference Price</u>**
	Area-wide Projected Income	Preliminary Price Protection multiplied by the Expected County Yield
	Area-wide Reference Income	The higher of the Preliminary Price Protection and the Harvest Price multiplied by the Expected County Yield
Determine if indemnity is paid under the policy	Area-wide Realized Income	The Harvest Price multiplied by the Actual County Yield
	Area-wide Indemnity	If the Realized Income falls below an **<u>Elected Percentage</u>** of the Reference Income, then an Indemnity equal to the difference is triggered. However, the Indemnity may not exceed a **<u>Defined Percentage</u>** of the Reference Income.

The U.S. cotton industry proposes that growers should have the ability to purchase STAX coverage up to a 95% level. However, producers also should have the ability to adjust their upper coverage level depending on their risk profile and their ability and willingness to pay the associated premium. Producers will have the flexibility to adjust the width of the STAX coverage by selecting a lower bound of coverage, thus establishing a maximum indemnity. Furthermore, if a producer purchases an individual or traditional area-wide buy-up policy, the STAX lower bound must be a number at least as large as the coverage level selected in the buy-up policy. For example, a producer who purchases an individual revenue or yield product at an 80% coverage level and also chooses to purchase a STAX policy, the lower bound of the STAX policy can be no lower than 80%. STAX is designed to complement current insurance coverage and not overlap with that coverage.

As previously mentioned, the STAX proposal includes a reference price in the determination of the county reference income. In a manner consistent with other crop insurance products, price protection under the STAX plan is based on cotton's December futures contract during a relevant pre-planting period. Currently, the December 2012 contract is trading between $0.90 and $0.95 per pound, and the nearby December contract has averaged $0.82 between 2008 and 2012. Price projections by USDA and the Congressional Budget Office (CBO) are consistent with futures markets continuing to trade in the 80-cent range. However, the industry understands the volatility of commodity markets and the importance of downside protection during times of low prices. As a result, the U.S. cotton industry believes that a reference price of $0.65 per pound provides important protection during those times of low prices, but this should trigger on an infrequent basis given current projections for commodity markets. Also, it is important to remember that even with a reference price of $0.65, indemnities are not triggered until actual income falls below the selected trigger level. If a grower has purchased a 90% STAX policy, then futures must trade below $0.585 (i.e. 90% of $0.65) before indemnification occurs, assuming actual yields are in line with expectations.

Other Crop Insurance Issues

Across the Cotton Belt, crop insurance is an essential risk management tool for cotton producers, and the STAX plan will provide another viable option for producers to effectively address their risk profile. Given the diversity of weather and production practices, the menu of insurance choices should be diverse and customizable, thus allowing for the fullest participation and most effective coverage.

In 2008, the introduction of enterprise unit pricing gave producers one more option for insuring against those risks that are beyond their control. The U.S. cotton industry strongly supports the continuation of that option in the 2012 farm bill.

Upland Cotton Marketing Loan

The findings of the WTO Brazil case and the subsequent Framework Agreement between the U.S. and Brazilian governments require that changes be made to the marketing loan for upland cotton as part of the development of the 2012 Farm Bill. To address that requirement, the National Cotton Council proposes that the level of the upland cotton marketing loan be changed based on the historical Adjusted World Price (AWP).

The loan rate for a crop will be determined in the fall prior to planting the crop and be set equal to the average of the AWP for the two most recently completed marketing years provided the 2-year moving average falls within a set maximum and minimum loan level. If the 2-year moving average exceeds $0.52, the loan rate is set at a maximum level of $0.52. If the 2-year moving average falls below $0.47, the loan rate is set at a minimum level of $0.47. All other features of marketing loan remain unchanged from current law.

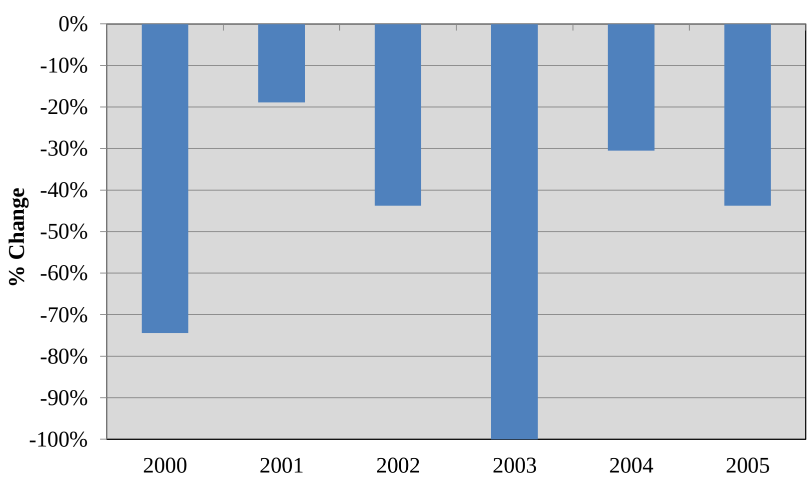
As an illustration, the loan rate for the 2013 crop would be announced in the fall of 2012 based on the average AWP prevailing over the 2010 and 2011 marketing years, which represent the two most recently completed marketing years. Once announced, the level of the loan remains fixed for the duration of the marketing year.

The WTO dispute with Brazil focused on data and market developments during the early 2000's, which was a time of chronically weak prices with the AWP below the marketing loan for extended periods. Had the proposed formula been in place during those years, the marketing loan for upland cotton would have declined to $0.47 for much of the period. With a loan rate of $0.47, any marketing loan gains would have been substantially lower than actual levels – with reductions generally above 20% and in some cases, more than 70% lower than actual levels (Figure 2).

As previously mentioned, existing features of the upland cotton marketing loan should be retained in the 2012 farm bill. These include an effective determination of the Adjusted World Price for purposes of loan redemption in times of low prices, as well as the provision of storage credits should the loan redemption price fall below the loan rate.

In order to be eligible for a marketing assistance loan, upland cotton must be stored in an approved warehouse. Unlike most bulk commodities, upland cotton cannot be farm stored, so to utilize the loan a producer has no option other than to enter cotton in a warehouse where storage and handling charges accrue until the cotton is marketed. Since cotton is stored in identity preserved units (each bale has a distinct identity), storage and shipment require more time, effort and expense than other crops. Storage credits allow the U.S. to remain competitive in times of low prices and should be maintained in new farm legislation.

Figure 2. % Change in Marketing Loan Gains with $0.47 Loan Rate



Resolution of the Brazil Dispute

The National Cotton Council understands the importance of resolving the Brazil WTO dispute within the 2012 Farm Bill. In the longstanding trade dispute between Brazil and the United States, a WTO panel previously concluded that the combination of the marketing loan, target price and former Step 2 provision of the marketing loan combined to cause significant price suppression and serious prejudice to Brazil's cotton industry.

The Step 2 provision of the upland cotton marketing loan was eliminated in 2006. In the context of the current farm program, the only remaining provisions relevant to the Brazil dispute are the marketing loan and the target price. NCC's farm policy proposal addresses both of those programs by eliminating the upland cotton target price and introducing a formula that would lower the marketing loan in times of low prices. Further, after assuming a 30% reduction in available support, the NCC proposal redirects remaining baseline funding for the target price-based countercyclical payment program and direct payment into an area-wide insurance program.

Moving upland cotton's support into an insurance program is consistent with the findings of the WTO panel that found no trade distortion or price suppression related to insurance programs. The WTO panel essentially treated insurance programs in the same light as direct payments in terms of production and price impacts. Under the NCC's proposed changes, coupled with past program eliminations, total trade-distorting support to upland cotton would have declined by 60% over the period 1999 to 2005, which is the period on which the Panel's findings are based. The NCC believes the combination of STAX and a modified marketing loan significantly reduce U.S. trade-distorting support.

Revenue triggers under STAX or any insurance program are directly related to the current level of futures markets. Fortunately, cotton prices have increased over the last two years, and as a result, price elections under crop insurance are higher. However, when the market moves lower, support under STAX and insurance programs will move lower as well. STAX does not "lock-in' high revenues through artificial means such as moving averages of prices or limits on annual changes. STAX simply looks to the market and allows growers to buy a level of coverage based on market signals. Furthermore, the higher coverage levels are not based on individual experience but rather area-wide triggers. There is no guarantee for the producer's individual income.

The industry understands that Brazil has raised concerns about the proposed changes to the upland cotton program. We look forward to the opportunity to address and clarify those concerns.

Provisions of the upland cotton program are just one aspect of the WTO dispute with Brazil. Brazil also successfully challenged export credit programs for cotton and a number of other agricultural commodities. NCC remains committed to working with the Agriculture Committees, the Administration and other commodity organizations in an effort to resolve all aspects of the case.

Economic Adjustment Assistance Program
NCC supports the continuation of the Economic Adjustment Assistance Program (EAAP) for domestic textile manufacturers. The EAAP, authorized in the 2008 Farm Bill, is a success story that is revitalizing the U.S. textile manufacturing sector and adding jobs to the U.S. economy. The program provides a payment to U.S. textile manufacturers for all upland cotton consumed, whether U.S. grown or imported. The payment rate from August 1, 2008 through July 31, 2012, is 4 cents per pound of cotton used, and will be adjusted to 3 cents per pound beginning on August 1, 2012.

Recipients must agree to invest the proceeds in equipment and manufacturing plants, including construction of new facilities as well as modernization and expansion of existing facilities. The assistance program, which is consistent with WTO commitments, is modeled after trade adjustment assistance programs and is not designed to affect the price or competitiveness of raw cotton.

The EAAP has led to higher employment and increased cotton consumption by US textile mills. Over the past 18 months, the Bureau of Labor Statistics reports that U.S. textile mills have added more than 6 thousand jobs. Based on a recent survey of EAAP recipients, 70% of respondents cited increases in the number of employees while the remaining 30% noted that labor requirements had either stabilized or more hours were required of existing employees.

The EAAP has allowed investments in new equipment and new technology. Survey responses indicated that companies had constructed new buildings, improved existing buildings, and invested in new spinning equipment and new technology for the purpose of expanding capacity and adding new product lines.

The EAAP has also allowed companies to reduce costs, increase efficiency and increase competitiveness. U.S. textile companies cited an increased ability to be more competitive against foreign competition and opportunities to reclaim market share from Asian competitors were also noted by survey respondents. Other benefits include lower energy costs, greater efficiency in style changes enabling faster adaptability to market conditions, improved quality control, increased capacity, reduced water use and more flexibility to meet customers' needs.

Future investments funded by a continuation of the EAAP will allow further recovery by the US textile industry. Companies have expressed their intent to build new plants, add additional spinning and weaving technology, and replace existing equipment with more efficient machinery.

Payment Limits and Eligibility
The National Cotton Council has always maintained that effective farm policy must maximize participation without regard to size or farm income. Artificially limiting benefits is a disincentive to economic efficiency and undermines the ability to compete with heavily subsidized foreign agricultural products. Artificially limited benefits are also incompatible with a market-oriented farm policy.

While the cotton industry understands the pressures from some in Congress for even more restrictive limits, we would like to remind the Committee that the 2008 farm bill contained significant changes with respect to payment limitations and payment eligibility. In fact, the 2008 farm law included the most comprehensive and far-reaching reform to payment limitations in 20 years. The limitations were made more restrictive, and the adjusted gross income test was substantially tightened. As part of the 2012 farm bill, the National Cotton Council would oppose any further restrictions on payment eligibility including lower limits or income means tests.

Extra-Long Staple Cotton
Pima cotton producers support continuation of a loan program with a competitiveness provision to ensure U.S. extra-long staple cotton, also known as Pima cotton, remains competitive in international markets. The balance between the upland and pima programs is important to ensure that acreage is planted in response to market signals and not program benefits.

Export Promotion Programs
Continuation of an adequately funded export promotion program, including the Market Access Program (MAP) and Foreign Market Development (FMD) Program, are important in an export-dependent agricultural economy. Individual farmers and exporters do not have the necessary resources to operate effective promotion programs which maintain and expand markets – but the public-private partnerships facilitated by the MAP and FMD programs, using a cost-share approach, have proven highly effective and have the added advantage of being WTO-compliant.

We appreciate the opportunity to provide these comments and look forward to working with this Committee in the development on a 2012 farm law that effectively meets the needs of cotton producers while addressing the challenges posed by budget constraints and trade concerns.