

CATO INSTITUTE ECONOMIC DEVELOPMENT BULLETIN

CENTER FOR GLOBAL LIBERTY & PROSPERITY

No. 11 • July 10, 2007

The “Cotton Problem” in West and Central Africa: The Case for Domestic Reforms

by John Baffes

Cotton subsidies have received considerable attention during the past four years, primarily triggered by the excessive government support received by the cotton sectors in the United States and the European Union. In response to that support, four cotton-producing countries in West and Central Africa—Benin, Burkina Faso, Mali, and Chad—have requested that the Doha round of negotiations on trade liberalization contain financial compensation for WCA countries for as long as those Western subsidies remain in place. Brazil also brought a case to the World Trade Organization, claiming that the U.S. subsidies cause a reduction in the world prices of cotton, thus reducing the income of Brazilian cotton growers.

Western cotton subsidies should be abolished, but not much attention has been paid to another, perhaps more important, issue. Many African cotton-producing countries, especially in WCA, must reform their cotton sector in order to allow a greater share of the world price to reach the growers and must foster a policy environment that is conducive to the promotion of new technologies. For the most part, the cotton sectors of the WCA countries are managed by government-owned parastatals. Competition by private entities is limited—with deleterious consequences for the efficiency of the cotton sectors.

Basic Facts about the WCA Cotton Sectors

Cotton is the dominant cash crop in most of West and Central Africa, with respective cotton sectors sharing a num-

John Baffes is a senior economist with the World Bank's Development Prospects Group. This essay is a summary of a larger forthcoming paper entitled “Distortions to Cotton Sector Incentives in West and Central Africa.”

ber of similarities. The industries were pioneered during the 1960s and 1970s by the French state-owned company Compagnie Française de Développement des Fibres Textiles (CFDT)¹ in conjunction with national state-owned cotton companies. Those state-owned companies had a legally protected monopsony in cotton buying, and most also had a monopoly on primary processing, marketing, and supplying of inputs.²

Typically, the state-owned companies would announce a base buying price before farmers planted their cotton, sometimes supplementing that price with a second payment (payable in the following season as a bonus) based on those companies' financial health. Most cotton used to be marketed through Compagnie Cotonnière (COPACO), a CFDT subsidiary. The cotton industries also benefited from research carried out by the French Agricultural Research Institute or Centre de Cooperation Internationale en Recherche Agronomique pour le Développement (CIRAD).

The performance of the WCA cotton industries has been described as a success story.³ Indeed, between 1970 and 1988 WCA cotton yields per hectare grew at 6.1 percent per annum, which compared to 1.9 percent annual growth in world cotton yields per hectare and implied that, had trends continued, WCA yields would have been similar to world yields by the early 1990s.⁴ Moreover, between 1970 and 2005, cotton production in WCA increased tenfold, from a little over 100,000 tons in 1970 to one million tons in 2005. The sector's contribution to total merchandise exports in the WCA countries ranges from 25 to 45 percent, while its contribution to GDP ranges from 3 to 6 percent. Moreover, the cotton sector provides income to one million households in the region.

Yet, the seemingly successful performance of the industries masked a number of weaknesses that called into question their long-term sustainability or even their survival. First, the post-1980 production increases reflect solely expansion of the area under cultivation. In contrast, the pre-1980 production increases reflected yield increases per hectare, mainly in response to fertilizer use. A growth decomposition analysis for the 1980–2005 period shows that cotton yields in WCA countries remained stagnant. That compares unfavorably with the 1.7 percent annual growth rate of global cotton output, which is a reflection of yield increases only.

Second, growers in WCA countries received low prices even when world prices were high. For example, during the early 1980s, WCA cotton producers were receiving between 60 and 70 Communauté financière d’Afrique franc (CFAf) per kilogram for their seed cotton, while the world price of cotton ranged between the equivalent of 200 and 250 CFAf.⁵ Similarly, following the 1994 devaluation of the CFAf, producer prices paid by the cotton companies were adjusted upwards, but far less than the increase in world price, thus denying WCA cotton growers the high prices enjoyed by cotton producers elsewhere. Furthermore, econometric evidence shows that in none of the WCA countries did the pricing mechanism reflect movements in the world price of cotton.⁶ In other words, the price-setting mechanisms have entirely ignored world market signals in all WCA countries. That is ironic, considering that the various price formulas used to determine the price to be paid to WCA cotton growers use as their starting point the world price of cotton.

Third, while the panterritorial pricing mechanism (i.e., prices being the same in the entire country) common to all WCA countries is a convenient and socially popular income redistribution mechanism, in effect it transfers resources from efficient cotton growers (or growers with transportation and/or location advantages) to less efficient ones. Price controls within each country have thus constrained overall growth and innovation in the industry by penalizing the most productive entities (or areas) of the sector.

Fourth, in periods of price declines most cotton companies experienced financial difficulties, which in turn led to demands for fiscal transfers from state budgets, thus putting into jeopardy the fiscal position of those countries. For example, during the late 1990s the state-owned cotton company of Mali was in no position to manage the downturn in cotton prices, because the stabilization fund, created to set aside a portion of profits from earlier periods of high prices, turned out to be empty, resulting in financial losses of CFAf 56 billion (\$100 million) to the cotton company. Eventually, the cotton company was bailed out by the government through budgetary support. Similar bailouts took place in most WCA countries following the two cotton price collapses—in the mid-1980s, and in the late 1990s and early 2000s.

Fifth, because of their inefficient and inflexible structure, the cotton companies were not sufficiently prepared (in terms of improved sales strategies, risk management tools, and adoption of new technologies) to respond to the changing nature of the external environment, especially the down-

ward trend and volatile nature of world prices. Those price changes reflected technological changes, as well as, to some extent, subsidies by some developed countries (especially the United States and the European Union).⁷ For example, more than one third of global cotton output is now of genetically modified origin. Furthermore, China and India, two developing countries with high rates of adoption of genetically modified cotton have experienced considerable yield gains. Yet, with the exception of Burkina Faso, none of the WCA countries has allowed even field trials of genetically modified cotton to assess the likely risks and benefits of such technology. That is unfortunate, because recent research has shown that the benefits of fully utilizing biotechnology may be even higher than the benefits from the elimination of all cotton trade distortions.⁸

Finally, the CFAf is fixed against the euro (or the French franc, FF, prior to 1999). The CFAf exchange rate has been subjected to only one adjustment since 1948—from CFAf 50 to CFAf 100 per FF in 1994. That fixed exchange rate has often led to unintended consequences, which is not surprising, given the different structure of the eurozone economies compared to those of the WCA countries. For example, between 2002 and 2005, the world price of cotton increased by 20 percent in US\$ terms (from US\$1.02/kg to US\$1.22/kg) while it declined by 9 percent in CFAf terms (from CFAf 711/kg to CFAf 644/kg). Within the current political and macroeconomic setting, it is beyond the control of individual WCA governments to choose the exchange rate regime that is consistent with the structure of their economies. That makes the case for reforms even stronger.

Only Limited Reform Efforts

Faced with those constraints, a number of WCA countries began reassessing the structure of their cotton industries. With financial and technical assistance from the donor community, especially the International Monetary Fund and the World Bank, policy reforms were contemplated during the early 1990s to bring the cotton sector back to a sustainable development path and, ultimately, increase the welfare of the cotton growers.

However, because the reforms were portrayed as ideologically driven—that is, forced by the Bretton Woods Institutions—they were viewed with suspicion. Not surprisingly, they were subjected to considerable opposition from the WCA countries themselves as well as from bilateral donors.⁹ For example, in a survey of the cotton sectors of Mali, Burkina Faso, and Benin, Professor Yves Bourdet from the Lund University in Sweden described the reasons for such opposition as follows:

There are two reasons behind this limited ownership [of reforms by] home government. The first is the strong opposition on a part of the urban elite and some farmer associations in cotton-producing countries to the privatization of the state-owned ginning enterprises, which are at the centre of the network of institutions and actors composing the cotton sector. The second is the opposition of some bilateral

donors, in particular France as the main bilateral donor, to the deregulation of the sector. No doubt this “lack of enthusiasm” on the part of the home government of cotton-producing countries and some bilateral donors has contributed to the slow pace and mixed outcome of reforms.¹⁰

Following the cotton price collapse of the late-1990s, however, it became evident that reforming the cotton industries by eliminating the monopoly status of the cotton companies and introducing competition is probably the only feasible alternative. Yet, despite that understanding and “constructive dialogue,” policymakers have been reluctant to engage in serious reform efforts and hence the structure of the WCA cotton sectors is not very different from what it was 30 or 40 years ago. In Chad, for example, reforms are nonexistent. Although the government of Chad announced that it would disengage from the cotton sector in 1999, so far it has failed to act accordingly (with the single exception of the privatization of the company that makes cotton oil—one of the by-products of processing of the cotton seed). Factors behind the unwillingness to reform include fiscal difficulties of the cotton company, the lack of ownership of reform by the government and, more recently, the windfall revenue from crude oil that has practically absorbed all capacity and energy by officials who, otherwise, would have been in charge of the reform process.

Reforms in Benin consisted of three key elements: separation of the various links in the cotton supply chain according to the different functions—such as input provision, seed cotton production, transport, ginning, and trading; division of the responsibility for handling those functions—except for research and training—among a large number of actors; and organization of the key decisionmaking process (including issues such as the price setting mechanism and cotton delivery time) into horizontally organized entities, which must all agree before any sector-wide decision is made. Despite those, albeit limited, reform efforts, it appears that the performance of the sector has not improved. For example, there was a sharp decline in cotton production from 171,000 tons of cotton fiber in 2004–05 to 82,000 tons in 2005–06.

Some reforms took place in Burkina Faso when the government sold part of the state-owned monopoly to private investors. The market is currently structured into three regional monopsonies—a dominant state-owned company accounting for about 85 percent of cotton purchases and two private companies that account for the rest. On the positive side, it should be noted that Burkina Faso is the only country in sub-Saharan Africa (in addition to South Africa), which is in the process of introducing GM cotton. However, the drying up of the cotton stabilization fund and the recently revealed €100 million debt by the dominant state-owned company, calls into question the sector’s long-term sustainability.

Mali, which has contemplated reforms for quite some time, reconsidered its reform commitment in July 2004 and decided to start assessing the pros and cons of the reform process in Burkina Faso and Benin instead. In November 2005 the government increased its share in the capital of the

cotton company (from 60 to 70 percent) and publicly announced that reforms will be delayed for several years.

The Way Forward

Admittedly, the global cotton market reflects, in part, rich countries’ protectionism. Nevertheless, policymakers in the WCA countries (as well in other poor cotton-dependent countries) face a number of challenges.

Reform programs for restructuring the cotton sector to increase its efficiency remain largely incomplete. Reforms should become the immediate focus of policymakers. After all, even if cotton prices increase either as a result of elimination of subsidies or as a result of market forces, it will do no good to poor producers if such an increase is absorbed by bankrupt parastatals, debt-ridden cooperatives, or corrupt public officials unwilling to engage in serious reform efforts.

Moreover, cotton producers face competition from chemical fibers, especially since technological improvements of the early 1970s brought the prices of chemical fibers down to cotton price levels. In an era of globalization and intense competition, cotton producers in many developing countries may want to explore genetically modified seed technology in order to compete more effectively with their competitors who have already embraced such technologies. That, however, would entail extensive field trials to develop varieties suitable to local growing conditions as well as putting into place the appropriate legal and regulatory framework—both of which are challenging and time consuming processes.

It has often been argued that poor cotton-producing countries should engage in domestic value addition, specifically, textiles and clothing. While a successful textile industry is good to have, especially when it comes to employment generation, it is unlikely to improve the welfare of the cotton growers for a number of reasons. First, regardless of whether cotton is consumed domestically or exported, cotton growers will receive the same price that is determined by global supply and demand for cotton. Second, the argument that local cotton will be favored because domestically produced cotton does not incur transport costs may not be valid since producing textiles for export markets implies that other types of cotton and chemical fibers must be imported, thus subjecting the industry to the same bottlenecks that the cotton industry currently faces (i.e., high domestic transportation costs, delays at the ports, etc.). Third, producing textiles for local consumption may also not be profitable, given the proliferation of imports of second-hand clothing.

It is in the interests of the consumers in the rich countries and growers of cotton in West Africa that American and European cotton subsidies should end. However, the positive impact of the end of cotton subsidies on the welfare of West African cotton farmers will be limited unless it is accompanied by domestic reforms that should include privatization of the state-owned cotton companies and liberalization of the cotton trade.

Notes

1. CFDT was renamed Développement des Agro-Industries du Sud (DAGRIS) in 2001.

2. In addition to their core activity, which is ginning, the cotton companies engage in other pursuits, such as input distribution, provision of research and extension services, and maintenance of rural roads.
3. See Uma Lele, Nicholas Van de Walle, and Mathurin Gbetobouo, "Cotton in Africa: An Analysis of Differences in Performance," in *Managing Agricultural Development in Africa*, World Bank Discussion Paper no. 7, 1989.
4. For example, world yields during the late 1980s averaged 550 kilograms of cotton fiber per hectare, similar to the 460 kilograms per hectare average achieved by the WCA countries. However, by the early 2000s, their respective averages were 680 kilograms and 425 kilograms of cotton fiber per hectare.
5. The CFA Franc (CFAf) is the common currency of 14 West and Central African countries, also known as the Franc Zone. It was created in 1945, when France ratified the Bretton Woods agreement. Initially, convertibility with the French Franc (FF) was set at 0.59 CFAf/FF, becoming 0.50 CFAf/FF after the 1948 devaluation of the French Franc. In 1958 two zeros were added to the existing denomination, making it 50 CFAf/FF. In January 1994 it was pegged again to the French Franc at 100 CFAf/FF, and in 1999 it was linked to the euro at 656 CFAf/€.
6. More information on such evidence along with statistics can be found in John Baffes, "Distortions to Cotton Sector Incentives in West and Central Africa," World Bank Development Research Group, 2007 (preliminary draft).
7. For a discussion of cotton subsidies and their effect on the world market in cotton see John Baffes, "The Cotton Problem," *World Bank Research Observer* 20 (2005):109–44.
8. See discussion in Kym Anderson, Ernesto Valenzuela, and Lee Ann Jackson, "Recent and Prospective Adoption of Genetically Modified Cotton: A Global Computable General Equilibrium Analysis of Economic Impacts," World Bank Policy Research Working Paper 3717, 2006.
9. International Cotton Advisory Committee, "Statement of France" and "Statement of the World Bank," *Statements of the International Cotton Advisory Committee*, 1998, pp. 45–50, 50–52.
10. Yves Bourdet, "A Tale of Three Countries: Structure, Reform and Performance of the Cotton Sector in Mali, Burkina Faso and Benin," *Country Economic Report* no. 2, Swedish International Development Cooperative Agency, Stockholm, 2004, p. 41.

Other Relevant Studies from the Cato Institute

"Troubling Signs for South African Democracy under the ANC," by Marian L. Tupy, Development Briefing Paper no. 3, April 25, 2007.

"Kenya's Fight against Corruption: An Uneven Path to Political Accountability," by John Githongo, Development Briefing Paper no. 2, March 15, 2007.

"Leading the Way: How U.S. Trade Policy Can Overcome Doha's Failings," by Daniel J. Ikenson, Trade Policy Analysis no. 33, June 19, 2006.

"How the Loss of Property Rights Caused Zimbabwe's Collapse," by Craig Richardson, Economic Development Bulletin no. 4, November 14, 2005.