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Cotton

Production and Market Reform Update

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Report Highlights:

Post's estimate for MY 1999 cotton planted area has been reduced by 200,000 MT to 4 million MT, based on information from the Ministry of Agriculture. The estimate for production has also been revised to reflect lower planted area. Trade estimates for MY 1998 and MY 1999 have also been revised to reflect policy changes that promote increased use of domestic cotton. Though there have been several delays, reforms to both procurement pricing and quality standards continue to move forward.

Includes PSD changes: Yes

Includes Trade Matrix: No

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Summary

Post's estimate for cotton planted area for MY 99/00 has been reduced by 200,000 MT to 4 MMT, based on information from the Ministry of Agriculture. The production estimate has also been reduced to reflect the lower planted area, with a corresponding decline in production. Trade estimates for both MY 98/99 and 99/00 have also been revised to reflect the effects of China's drive to increase consumption of domestic cotton. Despite these efforts, production continues to outstrip consumption, and stocks will continue to grow. Though the cotton spot market in Beijing has yet to open, procurement prices have dropped substantially, and officials in some provinces claim that procurement prices are now being determined by international market prices. China's efforts to improve cotton quality have run into a number of delays, and many of the new quality standards declared in July will not go into effect until next year.

Production

Current estimates for cotton MY 99 planted area vary widely. Recent press releases by the National Statistical Bureau (NSB) put planted area at 3.78 million hectares (MHa), a decline of roughly 15% over from last year. Sources within the Ministry of Agriculture and the private sector, however, estimate planted area at between 4 and 4.15 MHa. As a result, Post's estimate for planted area has been reduced to 4 MHa, a decline of roughly 10% from MY 98/99. Production has also been reduced to reflect the fall in planted area. The decline in area is likely to accelerate next year because procurement prices for this year's crop will be much lower than last year.

The Xinjiang Autonomous Region is attempting to eliminate cotton production in less productive areas, even while fighting to preserve prices. In 1998, Xinjiang's total cotton production amounted to 1.4 MMT, more than 1/3 of the national total. The Regional government has demanded that all areas in Xinjiang grow only fine varieties of cotton and minimize the number of different seed varieties, promoting only those with a yield of 120 kg/mu (1,800 kg/ha).

In an effort to reduce handling costs, the Regional government has eliminated secondary cotton procurement stations. The government has also further opened procurement of Xinjiang cotton, by allowing authorized processing companies, state farms, foreign trade enterprises and other approved textile enterprises nationwide, to purchase Xinjiang cotton directly. The immediate effect of this may be limited, since most of China's cotton ginning capacity continues to reside in the hands of the Cotton and Jute Corporation.

A recent government survey has confirmed suspicions that seed quality is a particular problem for Xinjiang. In August, the State Bureau of Quality and Technical Supervision conducted a random sample of cotton planting seed in major cotton producing provinces. The survey found that cotton seed quality was lowest in Xinjiang, where seed varieties are often mixed. Seven seed companies out of 40 failed to meet government standards, of which four were from Xinjiang. Seed quality was found to be highest in Shandong and Hebei.

Declining prices for standard grade cotton have led provincial governments to promote production of special types of cotton. Xinjiang's production of Pima cotton is now in excess of 50,000 MT, and authorities are actively promoting increased production. Xinjiang is also now encouraging the production of color cotton in an effort to boost incomes.

Color cotton prices are reported to be as high as 2 to 8 times that of regular cotton. Area planted to color cotton is extremely limited, but the large military-managed cotton farms in southern Xinjiang are now investing 5% of their income from cotton in the further development of color cotton. They are particularly interested in developing new colors and developing mid and long fiber-length color cotton.

Hebei province has invested heavily in the production of BT cotton, which in 1999 accounted for 94% of the 267,000 hectares of cotton planted, according to Chinese press reports. Hebei began promoting BT cotton in 1994, developing its own variety as well as importing U.S. varieties. In 1998 Hebei planted roughly 204,000 hectares of BT cotton. Although the province has reduced cotton planted area by 67,000 hectares, most of the reduction was of scattered, low-yielding fields. Henan province also plants BT cotton, which comprises about 1/5 of cotton planted area in that province. Provincial officials in Henan are reluctant to increase BT planted area any further, since they believe the yields are lower than for standard varieties, and pest control can be accomplished by other means.

Pricing

Procurement prices have fallen sharply in 1999. Though procurement of the current crop has just begun, government sources estimate the current price at \$915 - 964/MT for standard (average grade) ginned cotton. Prices in Sichuan (\$964-1,015/MT) are higher due to transportation costs. Henan province reports that the procurement price is now being based on international market prices, though the cost of production is also taken into account. Rough estimates place production costs in Henan at over \$963/kg., including labor. The farmer's own labor, however, accounts for nearly two-thirds of the cost. (According to provincial officials, labor costs are RMB 4,500/ha., and input costs are RMB 2,700/ha.). Nationwide, prices for other grades range from \$1,204/MT for top grade to \$722/MT for lower grades. By comparison, 98/99 crop cotton was purchased at an average price of \$1,488/MT. By June of this year, market prices for cotton had fallen to \$1,250/MT, and cotton enterprises could no longer sell without incurring a loss. In August the National Cotton Conference indicated that the central government will subsidize cotton sales in the future. As a result, enterprises have been unwilling to sell their high-priced stocks until the subsidy becomes available, and mills such as the Hubei Tianmen Jintien Cotton Corp., reported that they could not find cotton to buy at market prices.

The procurement price for Xinjiang ginned upland cotton is currently \$894.80/MT, while Pima (Bony) cotton is priced at \$1,074/MT. The price differential between low, middle and high grades of Xinjiang cotton has been increased from 1% to 5% to encourage production of high quality cotton. These prices were set independently by the Xinjiang Regional government. The central government has insisted that these prices are too high, however the Regional government stated that they can not risk political stability by lowering the cotton price further. On Sept. 24, the government also decided to remove the land fee for cotton production, thereby reducing the farmers' tax burden. Income from cotton is estimated to have accounted for 30% of Xinjiang's total income in 1998.

Marketing Reforms

The National Cotton Exchange Center, which was scheduled to open on September 1, has had its opening postponed indefinitely. The Exchange will have a total of twenty branches, including Shanghai, Tianjin, Wuhan, Chengdu, Guangzhou, Hangzhou, Nanjing, Jinan, Changsha, Qingdao, Zhengzhou, Taiyuan and Nanchang. Of these, fifteen are subordinate to the All China Federation of Supply and Marketing Cooperatives (ACFSMC, Cotton and Jute Corporation's parent organization), and the other five will be subordinate to the China Textile Industry Association.

The Center will not set prices, but will merely provide a clearinghouse for buyers and sellers.

The first Xinjiang Southern Cotton Exchange Center opened in Aksu. This cotton exchange is an independent spot market, unconnected with the Beijing market. The center is capable of accommodating 50,000 MT of cotton at a time and can handle 200,000 MT in business annually. Though currently only a spot market, the center claims that it will develop a futures market, and even hopes to offer online sales. Aksu is one of the largest cotton producing areas in China, producing roughly 1/9 of all of China's cotton.

Quality

China's efforts to improve quality are proceeding, but at a slower pace than originally envisioned. The revisions announced in July included four of the six quality factors in the U.S. "Universal Classification" (grade, fiber length, Micronaire and trash). Since then, Cotton and Jute has acknowledged that the implementation of one of these standards (micronaire) will be delayed until next year, due to a lack of adequate testing equipment. Government contacts have further indicated that the implementation of the other standards is likely to be uneven during the current year, due to the short lead time between the announcement of the new standards in July and the start of procurement in October. Other reforms are expected to go forward, including revision of China's 10% moisture regain to 8.5%, and change from a 2 mm fiber length increment between grades to a 1 mm increment.

Another element of the campaign to improve quality has been the drive to reduce contamination from synthetic bags and strings by requiring farmers to collect cotton in cotton bags tied with cotton string. Cotton and Jute Corp. has made it clear that they are very serious about this, providing cotton purchasing stations with the right to discount or refuse to purchase cotton presented in any other manner. Xinjiang has taken this one step further, stipulating that only white cotton bags and strings may be used. Although some officials remain confident that the campaign will be successful, anecdotal evidence indicates that word of the change has yet to reach farmers. When questioned about the change, most farmers interviewed either did not know or did not care about the change. Some local officials are aware of this problem, but they believe that, once farmers see their payments drop due to improper collection or high trash content, they will comply with the policy.

Textile Industry

China's textile industry is in the midst of a reform campaign to cut excess production capacity. The campaign resulted in the elimination of as many as 5.12 million cotton spindles and the layoff or transfer to other businesses of 662,000 employees in 1998. During the first six months of 1999 another 1.8 million spindles were destroyed and 215,000 more employees were laid off or transferred. Despite this, according to the State Administration of Textile Industry, production of cotton textiles increased by 10% during the first seven months of 1999, compared with the same period in 1998.

Textile trade continues to remain depressed, though exports posted their first gain in 15 months during July. Textile exports during the first seven months of 1999 fell by 17.87% in value, though a 7.6% percent drop in sales prices for garments and other textiles accounts for part of this decline. Trade in cotton textiles has done quite well however, posting a 14.2% increase in exports during the first 6 months of 1999. Processing trade (importing fabric for processing into products that are re-exported) now constitutes over half of China's textile exports. According to the

China Textile News, general trade (export of textiles made from domestically produced fiber) accounted for 46.9% of all sales, while processing of imported fiber and textiles for export accounted for 31.4%. Labor-adding trade, import of textiles which are then processed and exported back to the exporter for further processing, accounted for 20.6%. The distribution of textile exports has shifted, as exports to Japan and South Korea have risen, while the sharp decline in exports to Hong Kong and Southeast Asia appears to have bottomed out. Given Hong Kong's dominant role in textile exports, however, continued poor sales pose a major problem for the Chinese industry.

Beginning July 1, the State Council approved a 100% rebate on the VAT for garment exports. Textile products other than garments are entitled to a 15% rebate, increased from 11% to 13%, depending on the product. This is the sixth time in six years that the rebate has been increased. The increase in the VAT exemption was triggered by a \$482 million fall in garment exports. This will also narrow the gap between general trade (export of garments made from domestic materials) and the processing trade (export of garment manufactured from imported materials), which already benefits from a VAT exemption.

Table 1. China's Textile Industry

ITEM	UNIT	1978	1990	1997	1998
Total Revenue	US\$10 million	74.687	410.964	861.325	835.301
Employees	10 thousand	396.3	1,203.8	1,064.9	--
Share of Nat'l Revenue	Percentage	10.0%	7.82%	3.28%	--
Total Exports	US\$100 million	24.3	138.5	455.8	428.9
Shares of Total Exports	%	25.0%	22.3%	24.9%	23.3%
Cotton Spindles	10 thousand	1,561.9	3,882.0	4,245.6	--
Cotton Yarn Production	10,000 mt	238.2	462.6	559.8	542
Cotton Fabric	100 mill. meters	110.3	188.8	248.8	241
Wool Textile	10,000 spindles	47.8	265.9	387.0	--
Staple Production	10 thousand MT	2.97	5.66	8.3	--
Textiles	100 mill. meters	6.11	17.12	65.3	--
Chemical Fiber Prod.	10,000 MT	28.5	165.42	471.6	510.0
Garment Production	100 mill. pieces	6.73	31.75	96	97
Source: China International Business Daily					

Trade

Post's estimate for MY98 imports was reduced by 12,000 MT to 78,000 MT, while estimated exports have been increased by 18,000 MT to 148,000 MT. The decline in imports largely reflects increased substitution of domestic cotton, due to tax rebates and export subsidies for both raw cotton and finished textiles. The MY99 export forecast remains unchanged at 160,000 MT, based on the assumption that declining world prices will partially offset the effects of China's export promotion policies.

One method being used to promote both cotton and textile exports is a complex system of VAT rebates. Direct exports of Xinjiang cotton now receive a 100% rebate on the VAT. A rebate is also available to enterprises purchasing Xinjiang cotton for use in products that will be exported. A 100% rebate is also now available on garment exports (see Textiles section, above). Thus, a manufacturer exporting garments made from Xinjiang cotton pays no VAT on raw materials, and no VAT on the final product.

The other method being used to promote exports is an export subsidy. In early 1999, the State Council approved a subsidy of 2,500 RMB/MT (\$301/MT) on direct exports of 400,000 MT of Xinjiang cotton. Another subsidy was approved for 3,000 RMB/MT on 350,000 MT Xinjiang cotton purchased for use in manufacturing exported products. Thus, the same garment manufacturer who received a 100% VAT rebate for both raw materials and the final product for using Xinjiang cotton, also could receive a subsidy of 3,500 RMB/MT off the cost of the cotton. This subsidy was sufficient to bring the price of Xinjiang cotton close to world market prices, and allow much higher exports than in previous years: exports for the first 9 months of CY 1999 reached 154,000 MT, compared to 20,000 MT for the same period in 1998. Despite the increase, exports have not even come close to exhausting the 400,000 MT earmarked for direct exports of Xinjiang cotton, and Xinjiang officials are now requesting that the remaining balance be applied to subsidize MY99 crop cotton.

Production, Supply and Distribution Tables

Table 2. PS&D: Metric Tons

PSD Table						
Country:	China, Peoples Republic of					
Commodity:	Cotton					
		1997		1998		1999
	Old	New	Old	New	Old	New
Market Year Begin		08/1997		08/1998		08/1999
Area Planted	4491000	4491000	4459000	4459000	4200000	4000000
Area Harvested	4491000	4491000	4250000	4250000	4200000	4000000
Beginning Stocks	3378199	3378199	4074483	4074483	4710483	4680483
Production	4603000	4603000	4501000	4501000	4300000	4120000
Imports	399321	399321	90000	78000	100000	100000
TOTAL SUPPLY	8380520	8380520	8665483	8653483	9110483	8900483
Exports	6037	6037	130000	148000	160000	160000
USE Dom. Consumption	4300000	4300000	3825000	3825000	3676800	3676800
Loss Dom. Consumption	0	0	0	0	0	0
TOTAL Dom. Consumption	4300000	4300000	3825000	3825000	3676800	3676800
Ending Stocks	4074483	4074483	4710483	4680483	5273683	5063683
TOTAL DISTRIBUTION	8380520	8380520	8665483	8653483	9110483	8900483

Table 3. PS&D: Bales

PSD Table						
Country:	China, People's Republic				Conversion	0.004593
Commodity:	Cotton					
		1997		1998		1999
	Old	New	Old	New	Old	New
Market Year Begin						
Area Planted	4491000	4491000	4459000	4459000	4200000	4000000
Area Harvested	4491000	4491000	4250000	4250000	4200000	4000000
Beginning Stocks	15516	15516	18714	18714	21635	21497
Production	21141	21141	20673	20673	19750	18923
Imports	1834	1834	413	358	459	459
TOTAL SUPPLY	38491	38491	39800	39745	41844	40879
Exports	28	28	597	680	735	735
USE Dom. Consumption	19750	19750	17568	17568	16887	16887
Loss Dom. Consumption	0	0	0	0	0	0
TOTAL Dom. Consumption	19750	19750	17568	17568	16887	16887
Ending Stocks	18714	18714	21635	21497	24222	23257
TOTAL DISTRIBUTION	38491	38491	39800	39745	41844	40879

Trade Tables

Table 4. Monthly Cotton Imports

CHINA'S MONTHLY COTTON IMPORTS					
(Metric Tons)					
	1994	1996	1997	1998	1999
January	485	44,234	94,204	34,185	6,036
February	2,323	52,709	68,760	23,333	6,842
March	9,129	118,153	71,475	32,658	7,925
April	17,209	125,847	83,855	32,390	7,574
May	14,156	37,567	77,539	24,136	2,918
June	75,599	40,056	73,566	14,974	5,616
July	65,962	27,400	81,682	11,375	4,864
August	93,220	34,567	52,698	7,532	3,556
September	78,669	38,354	40,474	7,953	1,779
October	62,554	57,097	43,390	10,883	
November	46,706	41,819	38,300	3,055	
December	58,972	63,648	53,601	6,964	
JAN-DEC TOTAL	524,984	681,451	779,544	209,438	47,110
MY TOTAL	(94/95)	(96/97)	(97/98)	(98/99)	(99/00)
AUG-JUL TOTAL	786,087	786,566	401,514	78,162	5,335
Source: China Customs Data					

Table 5. Calendar Year Cotton Imports by Origin

CHINA'S COTTON IMPORTS BY ORIGIN, 1999						
(Metric Tons)						
	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	Total	Share of
Country	1999	1999	1999	1999	1999	Total
U.S.	5,852	4,605	1,731		12,188	25.9%
Australia	5,043	4,631	5,407		15,081	32.0%
Uzbekistan	3,172	1,408	164		4,744	10.1%
Mexico	1,969	1,238	0		3,207	6.8%
Cameroon	1,270	495	500		2,265	4.8%
Burkina Faso	930	260	0		1,190	2.5%
Mali	600	200	0		800	1.7%
Argentina	593	648	499		1,740	3.7%
Cote d'Ivoire	410	380	578		1,368	2.9%
Benin	97	789	787		1,673	3.6%
Other	889	1,454	533		2,876	6.1%
TOTAL	20,825	16,108	10,199	0	47,132	100.0%
Source: PRC Customs						

Table 6. Marketing Year Cotton Imports by Origin

CHINA'S COTTON IMPORTS BY ORIGIN							
July/June 1998/99 (Metric Tons)							
Country		Jul-Sep	Oct-Dec	Jan-Mar	Apr-Jun	MY 1998/99	Share of
		1998	1998	1999	1999	To Date	Total MT
U.S.	502	8,795	6,546	5,852	4,605	25,798	30.2%
Australia	601	10,441	3,328	5,043	4,631	23,443	27.4%
Uzbekistan	348	2,433	3,057	3,172	1,408	10,070	11.8%
Togo		900	40	40	0	980	1.1%
Mexico	341	0	1,381	1,969	1,238	4,588	5.4%
Argentina		648	1,337	593	648	3,226	3.8%
Burkina Faso		394	738	930	260	2,322	2.7%
Cameroon		0	150	1,270	495	1,915	2.2%
Tajikistan		297	1,444	0	0	1,741	2.0%
Mali		296	503	600	200	1,599	1.9%
Cote d'Ivoire		400	0	410	380	1,190	1.4%
Kazakhstan		345	931	0	0	1,276	1.5%
Benin		511	202	97	789	1,599	1.9%

Syria		605	444	48	0	1,097	1.3%
Other		1,196	841	781	1,805	4,623	5.4%
TOTAL		27,261	20,942	20,805	16,459	85,467	100.0%
Source: PRC Customs							
Total volume is only up to the end of the first quarter of 1999.							

Table 7. Monthly Cotton Exports

CHINA'S MONTHLY COTTON EXPORTS					
(Metric Tons)					
	1995	1996	1997	1998	1999
January	1,089	470	0	11	10,291
February	10,021	0	0	0	20,821
March	1,206	5	11	513	12,613
April	0	410	10	293	15,811
May	2,106	274	0	0	19,130
June	4,874	910	182	472	14,451
July	1,075	1,113	620	4,080	15,285
August	692	701	234	10,336	22,181
September	0	262	142	4,642	23,619
October	5	477	120	3,473	
November	0	0	172	8,266	
December	670	0	0	13,175	
JAN-DEC TOTAL	21,738	4,622	1,491	45,261	154,202
	(95/96)	(96/97)	(97/98)	(98/99)	(99/00)
AUG-JUL TOTAL	4,549	2,263	6,037	148,294	49,880
01/1/ to date	Source: China Customs				
HS Code: 5201.0000, 5203.0000					

Table 7. Calendar Year Exports by Destination

CHINA COTTON EXPORTS BY DESTINATION, 1999						
(Metric Tons)						
	Jan-Mar	Apr-Jun	Jul-Sep	Oct-Dec	TOTAL	Share of
Country	1999	1999	1999	1999	1999	Total
Hong Kong	8,278	5,359	2,883		16,520	10.7%
Indonesia	7,001	6,751	11,800		25,552	16.6%
South Korea	4,139	16,349	25,514		46,002	29.8%
U.S.	12,770	7,153	294		20,217	13.1%
Thailand	4,256	2,930	3,848		11,034	7.2%

Taiwan	2,121	3,414	2,895		8,430	5.5%
Peru	2,198	5,622	4,294		12,114	7.9%
Brazil	1,999	0	0		1,999	1.3%
Japan	365	477	654		1,496	1.0%
Pakistan	0	100	2,854		2,954	1.9%
Russia	0	0	2,001		2,001	1.3%
N. Korea	0	118	1,487		1,605	1.0%
Others	597	1,229	2,561		4,387	2.8%
TOTAL	43,724	49,502	61,085	0	154,311	100.0%
Source: PRC Customs						

Table 8. Marketing Year Exports by Destination

CHINA COTTON EXPORTS BY DESTINATION						
July - June 1998/99 (Metric Tons)						
	Jul-Sep	Oct-Dec	Jan-Mch	Apr-Jun	TOTAL	Share of
Country	1998	1998	1999	1999		Total
Hong Kong	9,098	8,517	8,278	5,359	31,252	22.8%
Indonesia	1,851	6,203	7,001	6,751	21,806	15.9%
South Korea	572	435	4,139	16,349	21,495	15.7%
U.S.	0	37	12,770	7,153	19,960	14.6%
Thailand	2,058	3,953	4,256	2,930	13,197	9.6%
Taiwan	3,130	4,083	2,121	3,414	12,748	9.3%
Peru	0	60	2,198	5,622	7,880	5.8%
Brazil	1,077	0	1,999	0	3,076	2.2%
Japan	364	217	365	477	1,423	1.0%
Others	908	1,232	597	1,447	4,184	3.1%
TOTAL	19,058	24,737	43,724	49,502	137,021	100.0%
Source: PRC Customs						