



DIRECTOR-GENERAL'S CONSULTATIVE FRAMEWORK MECHANISM ON COTTON

MARKET ENTRY CONSTRAINTS FOR AFRICAN COTTON

Communication from the International Trade Centre (ITC)

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1 BACKGROUND

1.1. WTO negotiations on trade in relation to cotton fall under the three pillars of Market Access, Domestic Support and Export Competition and are addressed under the Committee on Agriculture in Special Session. Two of the pillars are well advanced. That includes duty-free and quota-free market access, under which "developed countries and developing countries in a position to do so have committed to grant, to the extent provided for in their respective preferential trade arrangements, duty-free and quote-free market access for exports of cotton and cotton-related agricultural products from least-developed countries (LDCs)" (WTO). Countries also agreed to abolish agricultural export subsidies. However, with regard to domestic cotton policies, more efforts are needed.

1.2. This paper will not look at these three pillars of cotton-related WTO negotiations. It will instead identify and analyse internal as well as external market entry constraints faced by African cotton producers and ginneries. These difficulties have their origin in the country(ies) themselves or are related to business practices that pose challenges to African cotton producers/ginneries.

1.3. Sub-Saharan African (SSA) cotton is usually sold out, of which 86%¹ is exported. Hence, there have been no difficulties in selling it. That being said, there could be improvements made to market and brand it more effectively. That could influence market penetration, prices and engagement in long-term client (spinner) relationships that are presently missing but necessary to attract foreign investment in fibre value addition.

1.4. Below please find a number of identified obstacles that hinder a more effective market entry for African cotton as well as recommendations to overcome them.²

¹ SSA mill use was 230 tonnes against a production of 1,655 tonnes in 2017/18.

² For the purpose of this short paper, specific differences among the differing cotton systems in Africa (the World Bank classified four systems in Africa, namely national monopolies, local monopolies (in concession zones), competitive system and concentrated system) could not be elaborated.

2 MARKET DEVELOPMENTS THAT REQUIRE AFRICAN STAKEHOLDERS TO REACT AND ADAPT

2.1 Voluntary standards ("identity cottons") are here to stay but presently do not cover two thirds of African cotton despite its relatively low environmental footprint

2.1. There is a clear movement towards using more and more sustainable (social and environmental) cotton. The share of "identity cottons" is rapidly increasing, driven by the final consumer demand for more sustainable and traceable textile products. While organic and fair-trade cottons remain niche products, Better Cotton Initiative (BCI) and Cotton made in Africa (CmiA), both launched in 2005, are successfully expanding market opportunities for more sustainable cottons; increasing transparency along the value chain to better connect supply and demand. BCI production rose to 12% of global production in 2015, and aims to reach 30% of global production in 2020. BCI is growing in importance and is likely to impose its standards at the expense of conventional cotton. While not foreseen by BCI, some textile buyers accept to pay a premium for BCI certified cotton to showcase their environmental sensitivity and in order to provide a green image.

2.2. Approximately one third of all African cotton production has been certified as sustainable in the season 2017/18. While this is higher than the world average, it does not take into account the fact that Sub-Saharan African (SSA) African cotton's environmental footprint is much lower than that of large mechanised cotton producing countries. A study by Cotton made in Africa (CmiA) concluded that "the carbon footprint of CmiA cotton (1.92 kg CO₂-eq) is significantly better than average conventional cotton (4.64 kg CO₂-eq)". With regard to the water footprint of CmiA cotton, the study found that it was slightly higher (14.2 cubic metres, 99 green water) than that of conventional cotton (13.1 cubic metres, 40% green water). However, due to the fact that SSA cotton production is rain-fed, "the production of CmiA has no environmental impact on blue water resources, the consumption of which is potentially harmful, while conventional cotton consumes about five cubic metres of this (blue) water per kilogramme of lint cotton" (M. Nill and K. Wick, 2013).

2.3. Despite its better environmental footprint compared to mechanized cotton producers, the latter can use BCI certification and the BCI standard as a marketing tool to sell their cotton as "better", while two thirds of the African production cannot.

2.2 The cotton trade is moving towards instrument-tested cotton (bale by bale) and hand-classed cotton is being discounted

2.4. African cotton is classed through visual and manual inspections and manual grading is still used in African countries. This practice is maintained despite an industry-wide trend towards instrument testing. Cotton instrument testing has been accepted on a wide-scale basis since the USDA implemented instrument classification on 100% of the United States crop in 1991. Major producing countries followed and instrument testing has become the commercial standard. Consequently, the trade penalizes all non-instrument-tested cotton, i.e. hand-classed cotton, with a de-facto price discount.

2.5. While African cotton standards have been developed for West and Central Africa (WCA) under the African Cotton Association (A.C.A.), they are not recognized by the market and steps need to be taken to increase instrument testing of bales. That, however, requires a new quality assurance system, as presently quality is not very homogeneous as even within bales variances can be found.

2.3 Clear bale-marking required to allow the market price function to work properly, bringing demand and supply into equilibrium

2.6. Direct trade between African ginners and end-users of lint remains marginal as both find it easier and less risky to sell and buy through international merchants, who have the ability to manage counterparty and price risks. While a few ginners in ESA have been able to establish close relationships with spinners in Asia, most SSA African cotton is sold through international merchants. They know that African cotton and especially WCA cotton is very conservatively classed i.e. classers often under-class rather than over-class the cotton. Knowing that and the fact that the type and the grade is usually not marked on the bale, some intermediaries sell bales at a higher grade than those they have actually bought. If the assumption of "over-classing" turned out to be wrong and spinners

find out and make a claim, traders honour their contracts and compensate but the image and reputation of the African origin is damaged.

2.7. Some African exporters have already taken action. Three WCA companies, namely the Compagnie malienne pour la développement du textile (CMDT, Mali), Société de développement du coton du Cameroun (SODECOTON, Cameroon), and Société de développement et des fibres textiles (SODEFITEX, Senegal) have introduced bale markings, clearly indicating the grade contained in the bale to address this. This change results directly from feedback provided by spinning mills on the quality through feedback loops created with the support of ITC. This change in bale marking policy ensures that cotton delivered to the spinners (by traders) is according to the actual contract as spinners can now verify the actual bale content. Moreover, importing spinners can provide feedback more easily on the cotton quality received. Also refer to the success story of CMDT on page 5.

2.4 Hand-picked cotton is traded at a discount compared to machine-picked cotton

2.8. Handpicked cotton has higher intrinsic cotton qualities as the handpicking exposes the fibre to lower stress levels than machine picked and mechanised harvesting. Notwithstanding, machine picked cotton gained a strong reputation as a cotton of better quality as it contains lower contamination levels. While contamination levels might be high for some African (or handpicked) cotton origins it is not the case for all origins, and especially not from most west and central African origins. Hence, policy needs to focus at the one hand on regulations to further reducing contamination originating at farm and/or gin level but also needs to address an erroneous perception that hand-picked cotton origins suffer from a contamination problem. To some extent, this perception was created by extensive marketing efforts of machine-harvested cotton countries marketing their cotton as clean cotton. Particularly in WCA, the reputation is more contaminated than the actual cotton. Thus, counterbalancing branding efforts from highly mechanised cotton origins and building strong quality images of African handpicked cotton could have positive effects in the market.

3 INTERNAL CONSTRAINTS THAT NEED TO BE OVERCOME

3.1 Very few links with cotton-consuming spinning mills

3.1. Cotton is sold to international merchants without any influence of the producer/ginner on the final destination/consumer. Thus, feedback on the cotton quality and characteristics is sporadic and cannot help in improving operations. The low domestic transformation of fibre (in many African cotton-producing countries no spinning mills are operating) does not allow for a regular feedback on quality either.

3.2 Marketing approaches in WCA that do not match the practices of their main (Asian) markets

3.2. In many cases, francophone African cotton companies follow a business model that is not easily compatible with the Anglo-Saxon model followed by the cotton trade. This hinders a closer involvement in trade as well as developing a closer relationship with spinning mills in Asia, which consume around 85% of the world's cotton. The following aspects contribute as obstacles:

- French language versus English as the trading language:
Most sales directors of francophone cotton companies are not fluent enough in English to actively negotiate or promote cotton.
- Cotton is sold in CFA francs (pegged to the Euro) whereas the USD is used by the cotton trade.
Therefore, cotton from WCA countries is effectively sold in Euros, i.e. the same currency as farmers are paid for their seed cotton and the credits that are obtained to finance the cotton crop. This avoids the need for risk management against currency fluctuation. While in the past a strong Euro had negative impacts on the remuneration obtained, the presently relatively strong USD has positive effects.

In addition, cotton prices are relatively volatile and need price risk management solutions adapted to Africa.

- WCA cotton sold in kg as against lb used by the trade.
While this is mainly a mechanical exercise, cultural customs need to be overcome in order to internalize the requirements of the trading community.
- Cotton sales contracts are based on the Règlement Général Européen (RGE) as opposed to the International Cotton Association (ICA) bylaws and rules.
While the RGE used by WCA cotton companies and merchants that are members of the Association Française Cotonnière (AFCOT) are in the French language³, the ICA bylaws and rules used by non-francophone cotton companies and spinners in Asia are in English. Differences not only refer to the language but to details of arbitration and mediation, among others.
- Cost & Freight demand versus FOB offer:
Finally, WCA cotton companies sell their cotton on a FOB basis at a port in West or Central Africa only, i.e. they do not cover the sea shipment to the port of destination. That way additional L/C charges and delays in receiving the final payment are avoided. This, however, is against the purchasing policy of most spinning mills that request delivery at the port of destination (CFR terms).

3.3 The business model of small ginners in various Eastern and Southern African countries hinder more direct engagement with spinners.

3.3. Small, atomised ginners as can be found in Tanzania, Malawi, Uganda and to some extent in Zambia and Zimbabwe do not have the trade finance in place to directly market their cotton and engage on long-term relationships with spinners. Under the customary business model, short-term finance is obtained from banks to finance the buying of seed-cotton. Once ginned, the lint is sold quickly to traders, often ex-gin. With the revenue obtained new seed-cotton is bought. Therefore, ginners find it difficult to engage in more direct sales relationships as they have no access to competitive trade finance. Faced with substantially higher interest rates as e.g. international merchants, higher margin of direct sales are equalled out by higher capital costs. In addition, ginners do not have price risk management knowledge and tools at hand.

4 COTTON-RELATED POLICIES TO INCREASE FIBRE AND SEED-COTTON VALUE ADDITION IN AFRICA

4.1 Stimulating artisanal cotton consumption while increasing farmer resilience against shocks

4.1. A first step to increase fibre value-addition in Africa is to promote handloom development, including among farmers. While Ethiopia and a number of West and Central African countries have a vibrant handloom sector, most East and Southern African countries have not. Thus, creating an understanding of fibre value addition and supplying basic fabrics for domestic use is the first step towards creating a textile industry.

4.2. Additionally, providing farmers with the opportunity to add value to their cotton by engaging them in hand-spinning and weaving operations creates resilience against price and weather shocks as farmers will be able to compensate income losses due to bad prices or lower harvests with additional income from selling cotton-based products. Moreover, these additional earnings will be available during the entire year. Farmers will therefore not-so-easily switch to another crop in case the price or output during the previous season was below their expectations. That contributes to long-term stability in the cotton sector in the respective countries, improved quality and predictability for ginners and the textile industry as well as the government for eventual support measures.

4.3. ITC pilot activities in Zambia have shown that empowering cotton farmers to add value to their own cotton enables farmers to build resilience to shocks as it diversifies farmers' income earning opportunities. In addition, this could also contribute to a more stable and sustainable engagement in cotton farming, including higher yields. In the past, cotton farmers have often moved out of cotton

³ An English version ("European Cotton Rules") was also adopted by the Belgian Cotton Association.

if the price or the crop output in the previous season was below their expectations. This has led to an erroneous in-and-out of the cotton sector. As a result, yield increasing programmes and training did not bear fruit, as farmers had no opportunity to apply learnings. As Terry Townsend pointed out "despite all the spending and all the efforts, all well-conceived and executed, yields in Sub-Saharan Africa did not rise during the past decade" (T. Townsend, 2017).

4.4. In order for the above to be successful, a sector-wide approach is required that encompasses all relevant stakeholders at public and private sector level as outlined in the Zambia case.

4.2 Attracting investors into fibre value addition

4.5. Cotton marketing and branding is closely related to attracting investors into fibre value addition. The necessary condition to attract foreign investment relates to the economic and political stability of the host country as well as the input costs for spinning and textile production such as electricity, water, labour, land, etc.

4.6. However, stability and low input costs are not sufficient to attract investors. The sufficient condition relates to the need to develop the trust and loyalty of a potential investor. In every likelihood, a potential investor would be an existing textile enterprise, likely operating in Asia, who is presently using African cotton. Thus, existing potential investors are at arm's length away, but most of them are unknown to African governments and cotton companies. The reason is that cotton is not promoted among spinning factories and no relationship exists with existing users and thus potential future investors.

4.7. ITC supported first steps in that direction by promoting African cotton in target markets. This had positive effects on cotton quality by establishing feedback loops and partnerships with spinners. A better knowledge of each other, the intrinsic cotton quality available and the way of operations will lead to a better understanding and ultimately trust among the parties. Trust and loyalty will help attract foreign investors into spinning operations in Sub Saharan Africa.

4.8. Moreover, one other aspect that is often overlooked needs attention and solutions, namely the need of spinning mills of continuous and regular supply during the entire year versus a local offer that is only available during a limited period of time. Thus, using only local origin cotton poses price risk management challenges as cotton would need to be stocked over a relative long period of time in commercial terms. An alternative solution could be to engage in pan-African collaboration between northern and southern hemisphere producers to ensure a more or less regular cotton supply. That would require liberal trade regimes between the hosting country and the supplying country. In addition, quality parameters of the cotton would need to be harmonized in order to ensure a homogenous yarn supply during the entire year.

Success Story: Changing the reputation of cotton from Mali

4.9. A decade ago, the quality of the cotton from Mali had an unfavourable reputation and the national cotton company (CMDT) was considered an unreliable shipper, which translated into a price discount versus the other WCA origins.

4.10. Considerable efforts were undertaken to improve the quality of cotton and the logistics efficiency and ITC assisted CMDT in effectively promoting their cotton. The export-focused promotion programme presented transparent information to cotton consuming spinning mills, differentiated Malian cotton against other origins and increased demand, particularly in Bangladesh, the largest importer of lint.

4.11. ITC facilitated visits of cotton producers/ginners to Asia, including Bangladesh and customers from Asia to West Africa. This was an eye-opener for Bangladeshi customers, who realized that the so-called top quality sold by merchants was in fact a lower quality. CMDT then decided to clearly mark the quality type name on the bales, despite the merchants' counter-arguments.

4.12. As a result of these efforts, Mali has been able to reverse its reputation and change its market positioning. CMDT is now recognized by the international cotton merchants as being the most reliable and efficient shipper in Africa. There is a strong demand for Mali cotton in Bangladesh, where it

started replacing cotton from Uzbekistan. Cotton from Mali now fetches a price premium over the other WCA origins (for the same staple length and equivalent type).

4.13. Building on this reversed positive image, Mali could now also start attracting foreign investment, subject to fulfilling also the necessary condition mentioned above.

4.3 Investing into cotton by-products

4.14. Cotton by-products in general have a growing market in Africa and are potentially an important complementary source of revenue for cotton growers. However, cotton by-products have not received much attention so far. The potential of cotton by-products is far from being fully exploited and the respective markets are not well developed in SSA.

4.15. Cottonseed is a source of many useful products such as:

- Cottonseed oil, which competes with other vegetable oils, is typically used for human consumption (sometimes for soap manufacturing and other industrial uses such as plastics and pharmaceuticals);
- Cottonseed hulls are either used to generate energy for the processing facility or are blended with meal for animal feed and less often as fertilizer;
- Cottonseed cake, which competes with other meals, is typically used as animal feed;
- Linters are a source of cellulose used in various products, including yarn, plastics, and filling material;
- Cottonseed is sometimes also used unprocessed, directly for animal feed.

4.16. Apart from cottonseeds, which are a by-product of the ginning process, cotton stalks constitute another important and under-utilized by-product of cotton production. Cotton stalks can be used for boiler energy fuel (briquettes, pellets), compost, particleboards, preparation of pulp and craft paper, hard boards, etc. Edible mushrooms can be grown on cotton stalks too.

4.17. There is a strong demand for edible oil in Africa but none of the countries is self-sufficient in edible oil production. The use of expeller-press method for oil extraction limits volume and quality of cottonseed oil. Cottonseed oil and other edible oils produced locally are facing a huge competition from imported palm oil. Cottonseed oil is healthier as it consists of 70% unsaturated fatty acids, whereas palm oil is highly saturated in fatty acids.

4.18. There is plenty of scope for value addition to cotton by-products. By-products have the potential to compete with lint as sources of income to numerous stakeholders and to significantly contribute to the overall cotton subsector profitability and contribution to income generation, employment and poverty reduction.

4.19. The relative value of cotton by-products to the price of lint has increased, and the upward trend is likely to continue as demand for edible oil and livestock & poultry feeds is growing in Africa, exceeding domestic production.

4.20. To develop the cotton by-product value chain in Africa, there is need for:

- identification and promotion of value addition activities, including processing and marketing of cottonseed by-products;
 - capacity building and knowledge sharing / raising awareness on the potential of cotton by-products for value addition;
 - clear national policy guidance on the development of both the edible oil and meal production industry with a conducive tax regime;
 - policy incentives to encourage investment in or adoption of technologies to add value to cotton stalks.
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SOURCES

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