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**COMMUNICATION FROM THE COMMISSION TO THE COUNCIL AND THE
EUROPEAN PARLIAMENT**

Proposal for an EU-Africa partnership in support of cotton sector development

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1. THE COTTON SECTOR.

1.1. Challenges on the world cotton market.

The world cotton sector faces several major challenges. All of these affect also developing and least developed producers particularly in Africa. Indeed cotton plays in a number of African countries a key role in the economy and development efforts.

A general overview of the state and trends of the world cotton market allows for a better understanding of the specific challenges and situation within which the African cotton sector operates and needs to develop.

Although at global level, international cotton trade represents a limited share of production (approximately 30%) some developing countries are heavily dependent on it: for example, between 30 and 40% of export earnings in Benin, Burkina, Chad, and Mali, come from cotton. The West and Central African region, with about 12% of world exports, is an important player in the international cotton market, although well below the United States which accounts for 30%. Other important exporters comprise Uzbekistan (13%) and Australia (12%). China is the largest cotton producer as well as consumer, but only occasionally exports part of its production. On the other side, the European Union is a major importer of cotton, and about a third of its imports come from West and Central Africa. In addition South-East Asia, as well as Brazil, are becoming increasingly important importers due to their growing textile industries. This trend is expected to be amplified by the forthcoming liberalisation foreseen under the Agreement on Textiles and Clothing. Global cotton demand is only expected to grow moderately over the next decade, in line with population increase (1,8% annually).

Cotton prices as those for most agricultural commodities show a long-term decreasing price trend and strong short term fluctuations. These have been significantly influenced by China's sporadic entry in the world market, both for imports and for exports, which highlights the need for deeper analysis of the characteristics of the world cotton market in order to better understand its determinants. Prices of agricultural commodities are determined by several factors, in particular: the level of demand, which reflects changes in the economic situation of major importers, as well as substitution effects from other similar products; the level of supply, which derives from the commodity chain structures in place, agro-technical capacity and local unpredictable natural conditions; and the level of stocks. The long term decline of cotton prices has averaged 0,2% per annum between 1960 and 1984, and has accelerated thereafter to 0,9% per annum between 1985 and 2002. It has been closely linked to increases in productivity and reduction in production costs, as well as to the competition of synthetic fibres.

Subsidisation regimes in several producing countries, in particular in the industrialised world, add to the general downward pressure on prices. There are different types of subsidies applied to cotton in the United States and the European Union and the Union is spending only a fraction of the amount put at the disposal of cotton producers in the US (€ 0,8 billion in the EU vs € 2,9 billion in the US in 2001-02). Due to subsidisation, prices paid to domestic cotton farmers were 90% and 154% above world prices in 2001/02 in the US and EU respectively. This has direct impact on cotton production in both countries. Nevertheless, unlike the US, the EU is a minor player in terms of global production, accounting for just 2% of world output. Therefore the EU has only a marginal influence on price formation in international

markets. However in terms of volume, EU production represents approximately 70% of West and Central African exports.

The 2001-02 season witnessed particularly low prices, which, in West and Central Africa where there is no price support, have led to serious difficulties for the cotton sector. Prices have risen sharply again more recently illustrating the dramatic short-term volatility with which cotton producers have to cope.

1.2. Context and problems of the African cotton sector.

Cotton is a vital export commodity in a number of African countries. Two to three million producers and some 15 million people depend directly or indirectly on the cotton sector. Many of them belong to the poorest sectors of society. Price levels and stability directly affect their capacity to earn a living. Sudden recent fluctuations in price have highlighted the vulnerability of the African cotton sector.

While generally, cotton produced in Africa is competitive, in particular in West and Central Africa, there is potential for further strengthening its competitive position. In addition, the dynamic character of the domestic and international environment raises serious challenges for the future of the sector. In terms of external factors, as analysed above, the long term decline of prices and significant short term fluctuations, as well as heavy international competition influenced by trade distorting subsidies, are serious concerns, that deserve consideration both at domestic and international level. As to domestic challenges, limited flexibility of the sector in meeting changing demands, and a slow rate of technological innovation have to be addressed as a matter of priority. If these international and domestic threats are not adequately recognised and tackled, a decline of the sector could result. This would imply severe consequences in terms of impoverishment of rural areas, intensification of migrations and even risks for the stability of the cotton-dependent countries.

During the preparation process leading to the World Trade Organisation (WTO) Ministerial Conference of Cancún, four of the West and Central African countries¹ voiced concerns in WTO regarding the situation of their cotton sectors. The initiative put forward by these countries aims at obtaining specific negotiations within the Doha Development Agenda for cotton, focussing on two demands: 1) establishing a mechanism “for phasing out support for cotton production with a view to its total elimination”, and, 2) as a transitional measure “until cotton production support measures have been completely eliminated cotton producers in LDC should be offered financial compensation to offset the income they are losing, as an integral part of the rights and obligations resulting from the Doha Round”². This initiative has met a lot of sympathy across WTO membership.

2. OBJECTIVES FOR EU ACTION

The EU view is that concerns of West and Central African countries regarding their cotton sector should be addressed. The Council of 17th November 2003 “*recognised that this is a vital issue for those countries and invited the Commission to examine the situation in depth and to inform the Council accordingly*”.

¹ Benin, Burkina Faso, Chad and Mali

² WTO Document TN/AG/GEN/4 of 16 May 2003

Given the European Union's and its Member States' history of involvement with the cotton sector in Africa, its long standing relationship with the continent under the successive Lomé Conventions and now the Cotonou Agreement and its role as a major international trading partner, the European Commission proposes that the Union enter into a partnership with Africa with the aim of supporting the development of the cotton sector in a comprehensive, structural and sustainable manner. Although the four West and Central African countries Benin, Burkina, Mali and Chad have been most active on the international scene to highlight the challenges facing their cotton sector, the EU proposes to collaborate within this partnership with all African ACP countries where cotton is a key element of the economy. As the cotton situation and national priorities may differ across countries, involvement of each country will have to be discussed and agreed with each of them.

For the cotton initiative to succeed and have the desired impact, it should be both realistic and comprehensive and involve actions at all three levels - international, regional and domestic. It should build on the lessons of past cooperation, complement existing initiatives but also address new challenges faced by the sector. It aims to provide elements of a response to the problems impacting negatively at the micro level on producers and the sector as a whole, as well as at the macro level on the economies concerned. Considering the nature of the necessary improvements, the proposed partnership requires a long term perspective including regular assessments to ensure its continuing relevance in an evolving context.

In order to address the crisis faced by the cotton economies in Africa in a realistic, comprehensive and sustainable manner, the proposed partnership encompasses two main objectives:

- Obtaining fairer trade conditions on international cotton markets.
- Supporting cotton producing countries and regions in Africa.

The latter element goes beyond the specific WTO related request of the West and Central African countries but the European Commission believes that both elements proposed are essential, and form an integrated package that will permit us to tackle the issue in a comprehensive manner. In addition, the goal of modifying international market conditions through WTO negotiations can only be reached in the medium term, and additional partly more short term oriented activities to consolidate and improve the situation have to be launched in parallel. Moreover, countries will only be able to benefit from improved international trade conditions if present shortcomings of their cotton sectors are overcome.

This proposal represents a practical application of the principles and analyses put forward in the Commission communication "Agricultural Commodity Chains, Dependence and Poverty - A Proposal for an EU Action Plan", adopted in parallel to this one. Within this context the present proposal on cotton aims to focus efforts of the Commission and Member States as well as other important actors, the World Bank, the IMF and relevant other UN agencies and above all the countries concerned, around a set of approaches and activities to address the problems of the cotton sector.

3. OUTLINE OF A PARTNERSHIP IN FAVOUR OF THE COTTON ECONOMIES IN AFRICA.

3.1. Obtaining fairer international trade conditions on the cotton market.

3.1.1. Action within the agricultural negotiations of WTO

The European Commission (EC) supports an effective and specific solution within the WTO agricultural negotiations. Only within this framework will all WTO members be able to engage in negotiations on the basis of their respective interests and therefore be likely to find a balanced solution that will also do full justice to the cotton issue.

Being integrated within agricultural negotiations will however not mean that the specificity of the cotton issue is lost. On the contrary, the EC considers that cotton negotiations could be given the specific attention they deserve and the results could be made subject to specific time frames for implementation where appropriate.

The EC does not support the concept of financial compensation as put forward by Benin, Burkina Faso, Mali and Chad at WTO, because this is not foreseen under WTO rules. However, the EC proposes a comprehensive set of initiatives containing elements on market access, export competition and internal support.

3.1.2. Market access

Enhanced market access is the backbone of any trade related package of activities. Without unrestricted and complete market access to all major markets, the opportunities for existing and potentially expanded cotton production in Africa will remain limited. The European Commission considers that all developed countries should, as a minimum commitment, follow the example set by the EU under its “Everything but Arms” (EBA) scheme and fully open their markets to all products, including cotton and cotton based products, from all LDC. In fact the EU is one of the main import markets for African cotton. There can be no doubt that the future opening of other important developed markets to LDCs and others will provide significant additional market opportunities for cotton producing and exporting countries.

In addition it needs to be taken into account that the most dynamically growing markets are nowadays to be found in the more advanced developing countries. In fact the South and East Asian economies become increasingly important as cotton importers. Therefore, a contribution from these countries is also of utmost importance and they should as a minimum provide unrestricted access for cotton from the Least Developed Countries.

Tariff escalation, i.e. increasing tariffs with increasing degree of processing, makes the development of industrial processing chains in raw material producing countries more difficult. Tariff escalation hence negatively affects the opportunities to develop a textiles industry based on locally produced cotton. While the EU, under its preferential trade regime has granted fully unrestricted market access for all textiles and related products from ACP countries, the phenomenon of escalation still exists in other major markets. The European Commission will support efforts aimed at addressing the problem in the relevant non agricultural market access negotiations. At the same time, general liberalisation under WTO may erode the preferences where they are enjoyed by developing country cotton producers. In cases in which this will pose a challenge for African countries the European Commission will also support its consideration in the negotiations.

3.1.3. Export competition

Export subsidisation by powerful competitors can impair the competitiveness of products from developing countries such as African cotton and undermine their success in export markets. Within the negotiations in WTO all forms of subsidies granted for the export of cotton have to be put on the table for reduction, be they applied within explicit and easily recognizable schemes or be they implicitly integrated within the framework of other mechanisms such as subsidised export credits. The European Union does not apply any forms of export subsidies to cotton, but other major producers such as the United States do. The Commission believes that all of them have to be eliminated for products of interest to developing countries like cotton. It will work towards this goal within the DDA to create as much as possible a level playing field for African cotton exporters.

3.1.4. Domestic support

As regards domestic support to the sector, subsidies linked to production can have a distorting effect on markets since they can lead to increased production and exports. These effects are to the potential disadvantage of those producers in poorer countries that do not benefit from equivalent levels of support. Therefore, an effective package of activities in favour of African cotton producers should also focus on the substantial reduction of those components of domestic support for cotton that distort markets and trade. The European Commission intends to work towards that goal within the agricultural negotiations of the DDA.

As has been mentioned, the EU accounts just for 2% of global production and has hence only a marginal influence on the formation on world prices. Nevertheless, in order to reduce any impact, the European Commission has recently proposed to de-couple 60% of its domestic support from production, i.e. grant it as direct income payment to farmers, that is, unrelated to production levels. The European Commission urges the Council and Parliament to lend their full support to the measures proposed with a view to securing their rapid approval and faithful implementation. Within DDA, the European Commission will work towards securing a commitment from major cotton producing countries currently applying production distorting support to undertake reforms similar to those enacted by the EU.

In addition, the European Commission will establish a mechanism that will allow it to monitor the impact of its subsidy schemes and reform measures on cotton production and trade and invites all major players in cotton markets granting domestic support to follow the idea. This will help to increase the transparency of any effects on international markets and trade and will assist in assessing the need for further reform measures.

3.1.5. Trade related technical assistance – helping developing cotton producers to defend their interests.

Finally, it is obviously important to support African countries in identifying, presenting and defending their cotton related interests in the multilateral trade context. The EC therefore intends to allocate appropriate resources to these issues. Funding for trade related technical assistance and capacity building is currently available under the €10 million WTO Support Facility and the €20 million EPA Support Facility. In addition, a new €50 million trade related assistance facility has been recently approved and can also be used to contribute in this regard. Furthermore, various activities undertaken by the EU Member States have also assisted in strengthening the trade related capacity of the African cotton producing countries and will continue to do so.

3.2. Supporting cotton producing countries and regions in Africa

As outlined in the Commission Communication on “Agricultural Commodity Chains, Dependence and Poverty”, the overall objectives of a plan to support commodity dependent developing countries should be to improve income for producers and reduce income vulnerability, at both producer and macro level. The main lines of action for that purpose emphasise developing national and international commodity strategies, coping with long term price decline, managing commodity risks and accessing finance, diversifying around traditional commodities, successfully integrating with the international trading system, and enhancing sustainable corporate practices and investments in commodity dependent developing countries.

3.2.1. Consolidating the competitiveness of African cotton economies

3.2.1.1. Main elements for supporting cotton producing regions.

Improvements in the cotton economies of African countries are part of wider developmental issues and should as such be anchored in development plans of countries and regions (and in particular linked to the fight against poverty and the related Poverty Reduction Strategy). In this framework, there is an essential need for national ownership of any programme to consolidate the cotton sector.

The main aims of such a programme are presented hereafter. These elements apply more or less to different countries and regions, depending on their specific conditions. They are not necessarily exhaustive, and should be adapted on a national basis. In particular in terms of timing, the state of advancement of the sectoral reforms, which most countries are engaged in, means priorities among interventions may vary.

- At the level of cotton growing regions and countries: update and actively stimulate the implementation of comprehensive **plans for sustainable development of cotton areas**. This requires considering the more general framework of regional as well as local development, with due respect for environmental, social and health issues. Essential elements of that framework include appropriate infrastructure, as well as decentralised administrative and management capacity, but above all strengthened governance at all levels.

In addition, as the rural economies in which the cotton sector is inserted are made vulnerable, in some cases, by excessive dependency on a single commodity, a comprehensive approach to the development of such regions should include supporting options for **diversification** around the cotton sector in the medium and long term. Diversification options relevant for poverty reduction could be researched both in staple crops and in emerging or more traditional cash crop sectors, which would complement cotton production. Support to diversification can take place in particular in the fields of private sector support, technological innovation, and strategy development at government level.

- At the level of the cotton specific policy and institutional environment (at in-country regional, national and regional scale): strengthen the development of **cotton related policies and institutions**, which enable sectoral reforms aiming notably at securing farmers’ interests and at stimulating private sector development, while ensuring complementarity of involvement of the public sector. Policies (amongst which price policies) should be based on a thorough knowledge of the sector and its national

specificities. There is a general recognition that removing the remaining institutional bottlenecks in the cotton sector in several countries could bring about important efficiency gains. This refers to institutions at all levels of the chain (strong producer organisations, an efficient industrial sector, focussed public sector interventions), as well as, at a general level, effective labour market institutions. Functional institutional arrangements are needed to ensure the provision of essential services to the sector (financing, advice, inputs, marketing, etc.). Interprofessional bodies, with a balanced representation of all parts of the chain, have an important role to play in the development of the sector; their functioning should therefore be strengthened.

- At the level of the cotton chain: encourage investments in **chain integration activities**. This includes the development of vertical diversification and industrial processing, to increase the added value of cotton products from the African region, ensuring adequate sharing of benefits across the chain. The opportunities for the latter should be explored and developed in a regional perspective, building on comparative advantages of the different countries. Potential developments should also take into account the trends of the international trading environment of textiles, and focus on specific regional and export markets. Specific markets (such as fair trade and organic cotton), which open opportunities for added value on the cotton market, also need to be approached from a chain perspective.
- At the level of cotton producers: favour **technological innovation and adaptation** in the African cotton sector, including at small holder level. Maintaining competitiveness will require, in line with major international producers, reducing production costs, limiting environmental impacts and upgrading quality of output and work. Developing specific products, such as organic and fair trade cotton, also requires specific technical and managerial skills. Research has an important role to play in this perspective, as well as regulatory developments, training, and the efficient supply of services and inputs to producers.
- At the level of the international cotton market: promote the consolidation of international market shares of African cotton, notably through **quality recognition**. This requires in particular, to differentiate fibre qualities, supporting the establishment of a Universal Cotton Classification System, with participation of the African cotton sector, as well as ensuring implementation capacity of such a scheme in Africa.

3.2.1.2. Valorising the EPAs for the development of the cotton economies

The EU is currently engaging in negotiations with ACP regions on the establishment of Economic Partnership Agreements (EPAs). These negotiations are meant to instrumentalise trade for development. They hence provide an ideal opportunity to also support the development of the cotton sector within the framework of these negotiations. EPAs combine market access issues with provisions on all relevant trade related areas, regional integration and complementary development co-operation activities. Since there is already full market access in the EU for cotton and textiles from the ACP, the EPA process can not add any further opportunities in this respect, although it can offer wider market access in other products which should support diversification. Furthermore as regards trade related areas and regional integration, the EPA process can be instrumentalised to assist in enhancing the competitiveness and prospects of the cotton sector.

Thus attention will be devoted to identifying and agreeing on appropriate solutions in the area of trade facilitation and investment clauses. Landlocked cotton producing countries for example stand to benefit from regional solutions on transit within the context of trade facilitation arrangements, while greater predictability and credibility of investment protection in conjunction with harmonised regional markets will help to attract direct investment, foreign or local. Using the mechanism of regional preparatory task forces, it is foreseen to link and support the actual establishment and utilisation of these provisions through related development co-operation activities.

3.2.2. Elaborating a framework to mitigate the effects of price volatility.

Price volatility is recognised to be one of the main causes of difficulties for cotton producers and cotton dependent economies. The proposed partnership in support of the development of the cotton sector should thus provide an innovative framework to address the consequences of this problem, in particular by means of:

- Providing support to **access market-based mechanisms to manage the revenue risk** of cotton producers, notably via the ginners. A first line of support includes capacity building and technical assistance and should take into account the experience of the World Bank Commodity Risk Management initiative, which aims at bringing the potential buyers of the risk instruments into contact with international providers, with a focus on commodities with a clear link to poverty reduction. A second line of support could be explored, namely the potential for a regional insurance fund to back the market based instruments.
- Mobilising the **international financial institutions** (IMF, World Bank, etc.) to integrate commodity shock provisions into their current mechanisms (e.g. Poverty Reduction Growth Facility, Poverty Reduction Strategy Credit, Compensatory Finance Facility). These should consider the type of possibility included in the Highly Indebted Poor Countries Initiative, which foresees additional debt alleviations in case of external shocks leading to a degradation of exports earnings.
- Revising the **FLEX** instrument, in order to facilitate the access of ACP countries to this mechanism, in support of national budgets, in case of significant losses in government revenues due to a shortfall in export earnings. The Commission intends to propose in May 2004 to the ACP-EC Council of Ministers the appropriate amendments to Annex II of the Cotonou Agreement, so as to allow for applicability of the new conditions already for cases corresponding to 2003.

4. IMPLEMENTATION CONSIDERATIONS AND SOURCES OF FUNDING

The process of defining the scope and measures of the partnership will require the input of Member States and especially of the concerned cotton producing African countries themselves. The EC will pay special attention to co-ordinating its activities closely with Member States and other actors such as the World Bank and the IMF, thereby seeking synergies and complementarities of action. In this perspective, appropriate consultation and coordination actions will be carried out. Amongst other things in the first half of 2004 the European Commission intends to organise a seminar on the issues concerned involving all stakeholders together with interested Member States.

As a concrete step towards implementation of the above programme in particular as it relates to its development co-operation elements, the European Commission proposes to establish cotton task forces for the regions concerned consisting of representatives of governments, the Commission and other relevant stakeholders with a view to discussing, encouraging and co-ordinating activities taking into account the existing processes and interventions. These task forces could meet as subgroups of the Regional Preparatory Task Forces currently being set up in the various ACP regions to ensure the linkage between the EPA process and development co-operation.

As the present initiative is proposed in the form of a partnership between the EU and the concerned countries and regions of Africa, the concept of joint efforts in favour of the cotton sector is at the heart of the scheme. This means that the concerned countries concretely demonstrate their commitment to the development of their cotton sector, in particular in the framework of national policies, budget allocations and aid programming exercises.

As regards the funding of activities in support of African cotton, the partnership relies on important instruments and facilities already in place. Together with the countries concerned, these can be re-focussed and used towards supporting cotton producing regions. As regards directly trade related assistance needs concerning the cotton issue (consultation, definition of positions, advice, negotiations etc.), as mentioned above, the € 10 million WTO support facility, the € 20 million EPA support facility and the forthcoming € 50 million Trade.Com facility are available.

With regard to wider development support for cotton, the existing funding from national and regional indicative programmes under the European Development Fund (EDF) can be used. The mid-term review of the different ACP country strategies and programmed allocations will take place in 2004. It will be an important opportunity for the concerned countries, in partnership with the European Commission, to revisit the currently existing funding priorities (under the so called "A envelope") and where necessary attach greater priority to cotton related themes such as agriculture and rural development taking into account that the overall envelope for particularly performing countries will be increased. If these funds are not sufficient, a further possibility, under circumstances still to be discussed and agreed, could involve drawing on the additional envelope allocated to each country for unforeseen needs ("B envelope"), beyond the use of FLEX.

At regional level, the Regional Indicative Programmes foresee allocations for regional integration, including trade, as focal sectors, which can be used in favour of the cotton sector. This could be done in particular in close co-ordination with the related activities under EPA and, of course, the national actions. The Commission intends to propose securing additional funding for cotton under the so called "intra ACP Co-operation" facility.

As regards the issue of price volatility, the foreseen revision of conditions for the applicability of the FLEX mechanism will lead to additional budgetary support to help countries face the consequences, at the level of State budget, of a fall in export earnings.

Member States and other donors' contributions can also be expected and will be part of the co-ordination exercise.

Annex: Facts and Figures on World Trade in Cotton

2001-2002	Production		Exports	Imports	Net Exporter
	000 T	% world production			
World	21414				
West and Central Africa	1098	5,1%	801	16	785
Other ACPs	283	1,3%	183	5	178
EU	563	2,6%	295	784	-489
Brazil	766	3,6%	147	55	92
China	5313	24,8%	74	98	-24
USA	4421	20,6%	2395	5	2390
India	2678	12,5%	13	381	-368
Pakistan	1807	8,4%	35	218	-183
Uzbekistan	1067	5%	740	0	740
Australia	697	3,3%	664	0	664
Rest of World	2721	12,7%	966	4850	-3884

Source: Foreign Agriculture Service (FAS)-online

Importance of cotton to West and Central Africa

- In 2001-2, West and Central Africa produced 1.1m tonnes, representing 5.1% of world production and exported 801 000 tonnes of cotton, representing 12.7% of world trade.
- During the period 1998-99, cotton represented 30% of Mali's total exports, 40% of Benin's, 33% of Chad's and 44% of Burkina Faso's.

EU market

- In 2001-2, EU production accounted for 2.6% of world production and EU exports account for 4.7% of world cotton exports.
- The EU is a net cotton importer *and the world largest importer of cotton*. About a third of its imports came from West and Central Africa in 2002.
- Between 20% and 80% of cotton exports from Mali, Benin, Burkina Faso and Chad reach the EU