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China, Peoples Republic of

Cotton and Products

Annual

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Report Highlights:

Planted area and production are forecast to fall sharply in MY 02 due to low prices.

This, combined with continued growth in demand from the textile sector are forecast to drive imports as high as 475 TMT in MY 02. Tariff rate quotas for cotton have been issued, and trade under these quotas has already begun.

Includes PSD changes: Yes

Includes Trade Matrix: No

Annual Report

Beijing [CH1], CH

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Situation and Outlook

Estimates for MY 02 planted area vary, but all agree that area will fall by 13% to 20%. Post has adopted a conservative estimate of a 16% reduction in planted area, with a corresponding decline in production, down to 4.45 MMT. Declines are forecast for all major cotton producing areas. Yields are forecast to be slightly lower than MY 01, based on poor weather conditions at planting time. Heavy rains have delayed planting and destroyed emerging crops in several areas including parts of Xinjiang and the Yangtze river valley. Although most of these crops are likely to be replanted, yields and quality may suffer. The rapid spread of biotech cotton may keep yields from slipping very far, however. The decline in production this year is directly linked to the sharp drop in cotton prices at harvest last year. By the end of 2001 prices had fallen by 19% compared to the same time in 2000. Since then, prices have begun to increase. This situation may be short-lived, however, as the Chinese government is already preparing to resume sales of cotton from national stocks.

Low cotton prices have helped to improve conditions for the textile industry. During MY 01 high cotton prices resulted in the accumulation of large stocks of yarn manufactured from domestic cotton, as mills found it cheaper to import yarn from overseas. This situation changed when the large MY 01 cotton crop brought domestic prices down, and industry sources report that mills have worked through most of the surplus stocks of domestic yarn. Prospects for MY 02 are less certain, however: without a massive increase in cotton imports, the smaller domestic crop forecast for MY 02 could cause prices to rise again. Chinese industry sources estimate total cotton consumption by the textile industry for CY 2002 at 5.1 MMT.

Cotton exports are falling despite low domestic prices, and are likely to continue falling. The main reason for the reduction in exports is the loss of export subsidies. As part of its WTO accession package, China agreed to eliminate export subsidies for a range of commodities including cotton. Exports have continued during early CY 2002, however some of these sales may date back prior to China's entry into the WTO. In lieu of subsidies, China is offering full rebates on the VAT for cotton and a reduction in the transportation tax for cotton from Xinjiang. Other tax rebates and incentive schemes are rumored to be in the works. The VAT rebate may prove controversial, as some domestic sources claim that this rebate is being paid on a tax that was never charged, in effect making it an export subsidy.

Based on falling cotton production and growing demand from the textile industry, cotton imports now seem likely to jump in MY 02. Post forecasts imports of 475,000 MT, compared to a paltry 55,000 MT forecast for MY 01. This forecast assumes that China is able to use the shortfall to market over 500 TMT of reserve cotton, and that the Chinese government allows at least enough cotton imports to meet industry demand without driving up prices. The quantity and quality of cotton stocks are uncertain, but it seems unlikely that sales will exceed 500 TMT. Should they fall short, further increases in imports are likely. On the other hand, should the government attempt to slow cotton imports, limited supplies could cause cotton prices to rise. High prices could undermine the textile industry's competitiveness, causing demand for cotton to fall. One factor that will help to support increased imports are the tariff rate quotas (TRQs) that China has opened for cotton. For CY 2001, China has agreed to TRQs totaling 818 TMT. However, 500 TMT of this TRQ has been reserved for reprocessing trade (cotton that is imported, processed into textiles and then re-exported). Since the cotton does not remain in domestic markets, this may be interpreted as a possible violation of China's WTO agreement. Of the remaining amount, 270 TMT is reserved for state-owned enterprises and 48 TMT for general trade.

Statistical Tables

Table 1. Cotton Production, Supply and Distribution (MT)

PSD Table						
Country:	China, Peoples Republic of					
Commodity:	Cotton					
		2000		2001		2002
	Old	New	Old	New	Old	New
Market Year Begin		08/2000		08/2001		08/2002
Area Planted	4026000	4041000	4786000	4800000		4032000
Area Harvested	4026000	4041000	4786000	4800000		4032000
Beginning Stocks	3259260	3259260	2514161	2514161	2525054	2514161
Production	4422660	4417000	5315904	5320000		4450000
Imports	50110	52400	87146	55000		475000
TOTAL SUPPLY	7732030	7728660	7917211	7889161	2525054	7439161
Exports	98039	97480	54466	35000		20000
USE Dom. Consumption	5119830	5117019	5337691	5340000		5500000
Loss Dom. Consumption	0	0	0	0		0
TOTAL Dom. Consumption	5119830	5117019	5337691	5340000	0	5500000
Ending Stocks	2514161	2514161	2525054	2514161		1919161
TOTAL DISTRIBUTION	7732030	7728660	7917211	7889161	0	7439161

Table 2. Cotton Production, Supply and Distribution (Bales)

PSD Table						
Country:					Conversion	0.004593
Commodity:						
		2000		2001		2002
	Old	New	Old	New	Old	New
Market Year Begin						
Area Planted	4026000	4041000	4786000	4800000	0	4032000
Area Harvested	4026000	4041000	4786000	4800000	0	4032000
Beginning Stocks	14970	14970	11547	11547	11597	11547
Production	20313	20287	24416	24434	0	20438
Imports	230	241	400	253	0	2182
TOTAL SUPPLY	35513	35497	36363	36234	11597	34167
Exports	450	448	250	161	0	92
USE Dom. Consumption	23515	23502	24516	24526	0	25261
Loss Dom. Consumption	0	0	0	0	0	0
TOTAL Dom. Consumption	23515	23502	24516	24526	0	25261
Ending Stocks	11547	11547	11597	11547	0	8815
TOTAL DISTRIBUTION	35513	35497	36363	36234	0	34167

Table 3. China's Monthly Cotton Imports

MONTHLY COTTON IMPORTS (MT)				
Month	1999	2000	2001	2002
January	6,036	4,904	2,318	1,265
February	6,842	2,154	2,868	672
March	7,925	3,244	5,911	50
April	7,574	44	354	2,183
May	2,918	206	1,297	
June	5,616	3,296	3,999	
July	4,864	5,600	2,946	
August	3,556	10,610	4,416	
September	1,779	7,454	1,327	
October	1,543	2,835	8,907	
November	1,339	3,924	4,809	
December	2,214	7,884	7,392	
TOTAL	52,207	52,155	46,545	4,169
Marketing Year	Aug/99 - Jul/00	Aug/00 - Jul/01	Aug/01 - Jul/02	Aug/02 - Jul/03
MY Total	29,879	52,400	31,020	0
MONTHLY COTTON IMPORTS (480 lb. bales)				
Month	1999	2000	2001	2002
January	27,724	22,524	10,645	5,808
February	31,424	9,894	13,173	3,085
March	36,401	14,898	27,148	229
April	34,786	201	1,627	10,027
May	13,403	944	5,958	
June	25,796	15,139	18,370	
July	22,339	25,723	13,531	
August	16,334	48,730	20,283	
September	8,173	34,237	6,096	
October	7,086	13,023	40,911	
November	6,149	18,023	22,087	
December	10,171	36,211	33,953	
TOTAL	239,786	239,549	213,782	19,149
Marketing Year	Aug/99 - Jul/00	Aug/00 - Jul/01	Aug/01 - Jul/02	Aug/02 - Jul/03
MY Total	137,234	240,673	142,480	0

Source: PRC Customs Statistics		
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Table 4. China's Cotton Imports by Country of Origin

CHINA QUARTERLY COTTON IMPORTS BY COUNTRY OF ORIGIN (MT)					
Marketing Year: 2000/2001					
Country	Jul-Sep /00	Oct-Dec /00	Jan-Mar /01	Apr-Jun /01	TOTAL
United States	13,205	4,951	7,776	3,496	29,428
Australia	5,538	6,334	1,141	2,125	15,138
Egypt	2,329	322	146	0	2,797
Pakistan	793	832	798	0	2,423
Mali	0	300	698	0	998
Uzbekistan	347	513	0	0	860
Uganda	203	150	466	0	819
Tanzania	0	751	0	0	751
Peru	599	0	0	0	599
Benin	200	248	0	0	448
Other	450	244	71	29	794
TOTAL	23,664	14,644	11,096	5,651	55,055
Marketing Year: 2001/2002					
Country	Jul-Sep /01	Oct-Dec /01	Jan-Mar /02	Apr-Jun /02	TOTAL
United States	9,565	13,634	616		23,815
Australia	11,019	6,023	294		17,336
Egypt	925	993	1,005		2,924
Tanzania	0	270	0		270
Uganda	224	0	0		224
South Korea	58	54	70		182
Turkmenistan	0	74	0		74
Israel	0	50	0		50
Japan	0	10	0		10
China	0	0	0		0
Other	0	0	0		0
TOTAL	21,791	21,108	1,986	0	44,885
Source: PRC Customs Statistics					

Table 5. China's Monthly Cotton Exports

MONTHLY COTTON EXPORTS (MT)				
Month	1999	2000	2001	2002
January	10,291	28,427	7,574	1,933
February	20,821	21,552	8,668	2,614
March	12,613	43,517	10,014	3,299
April	15,811	43,767	7,683	7,915
May	19,130	27,233	4,700	
June	14,451	44,568	4,778	
July	15,285	31,296	1,869	
August	22,181	20,017	2,414	
September	23,619	11,859	46	
October	17,379	12,490	1,008	
November	31,183	2,916	835	
December	34,676	4,912	1,447	
TOTAL	237,440	292,554	51,035	15,761
Marketing Year	Aug/99 - Jul/00	Aug/00 - Jul/01	Aug/01 - Jul/02	Aug/02 - Jul/03
MY Total	369,398	97,480	21,511	0
MONTHLY COTTON EXPORTS (480 lb. bales)				
Month	1999	2000	2001	2002
January	47,268	130,565	34,786	8,878
February	95,629	98,987	39,811	12,006
March	57,930	199,874	45,993	15,152
April	72,622	201,022	35,287	36,354
May	87,862	125,081	21,586	
June	66,373	204,702	21,945	
July	70,205	143,742	8,583	
August	101,879	91,939	11,089	
September	108,483	54,468	212	
October	79,823	57,367	4,629	
November	143,222	13,392	3,835	
December	159,266	22,561	6,647	
TOTAL	1,090,561	1,343,701	234,403	72,389
Marketing Year	Aug/99 - Jul/00	Aug/00 - Jul/01	Aug/01 - Jul/02	Aug/02 - Jul/03
MY Total	1,696,645	447,726	98,800	0

Source: PRC Customs Statistics		
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Table 6. China's Cotton Exports by Destination

CHINA QUARTERLY COTTON EXPORTS BY DESTINATION (MT)					
Marketing Year: 2000/2001					
Country	Jul-Sep /00	Oct-Dec /00	Jan-Mar /01	Apr-Jun /01	TOTAL
South Korea	21,779	12,417	11,001	8,504	53,702
Indonesia	14,880	4,655	3,780	1,529	24,845
Taiwan	1,302	195	4,283	3,971	9,751
Malaysia	7,877	194	571	0	8,642
Thailand	5,153	1,426	1,141	176	7,895
India	5,516	405	457	200	6,578
Italy	0	0	2,829	1,588	4,417
Japan	1,450	143	599	911	3,103
Philippines	1,188	101	758	0	2,047
Vietnam	1,218	260	0	0	1,478
Other	2,810	522	835	281	4,448
TOTAL	63,172	20,318	26,255	17,161	126,906
Marketing Year: 2001/2002					
Country	Jul-Sep /01	Oct-Dec /01	Jan-Mar /02	Apr-Jun /02	TOTAL
South Korea	4,411	705	2,038		7,154
Taiwan	28	31	2,378		2,437
Italy	616	644	929		2,188
Indonesia	382	903	692		1,977
Japan	1,148	109	252		1,508
Myanmar(Burma)	145	658	0		803
Pakistan	0	44	375		420
Thailand	0	0	415		415
India	61	140	125		326
Bangladesh	0	45	251		297
Other	21	10	390		421
TOTAL	6,811	3,290	7,845	0	17,947
Source: PRC Customs Statistics					

Table 7. China's Cotton Yarn and Thread Imports by Country of Origin

QUARTERLY COTTON YARN & THREAD IMPORTS BY COUNTRY OF ORIGIN (MT)					
Calendar Year: 2001					
Country	Jan - Mar	Apr - Jun	Jul - Sep	Oct - Dec	TOTAL
Pakistan	43,979	54,089	49,700	42,057	189,825
China	26,064	33,402	31,381	32,911	123,759
India	22,022	22,600	17,725	14,648	76,995
Hong Kong	9,473	12,978	12,864	11,331	46,646
Indonesia	7,996	7,059	6,894	6,936	28,885
Taiwan	5,196	4,414	5,363	3,798	18,771
South Korea	2,886	3,784	3,310	3,176	13,156
Thailand	1,873	1,443	2,138	1,964	7,418
Malaysia	901	1,001	751	658	3,311
Japan	790	465	644	937	2,837
Other	2,700	1,381	1,543	2,030	7,654
TOTAL	123,881	142,616	132,313	120,445	519,256
Calendar Year: 2002					
Country	Jan - Mar	Apr - Jun	Jul - Sep	Oct - Dec	TOTAL
Pakistan	37,531				37,531
China	35,583				35,583
India	17,216				17,216
Hong Kong	12,411				12,411
Indonesia	6,878				6,878
Taiwan	3,778				3,778
South Korea	3,493				3,493
Thailand	1,579				1,579
Japan	946				946
Malaysia	677				677
Other	1,788				1,788
TOTAL	121,881	0	0	0	121,881
Source: PRC Customs Statistics					

Table 8. China's Cotton Yarn and Threads Exports by Destination

CHINA QUARTERLY COTTON YARN & THREAD EXPORTS BY DESTINATION (MT)					
Calendar Year: 2001					
Country	Jan - Mar	Apr - Jun	Jul - Sep	Oct - Dec	TOTAL
Hong Kong	41,190	52,050	49,592	50,021	192,853
South Korea	1,758	2,908	2,815	1,955	9,436
Japan	2,049	1,813	1,876	1,947	7,684
Myanmar(Burma)	1,200	1,429	1,980	1,838	6,447
United States	465	544	131	355	1,495
Macau	419	418	396	197	1,430
Bangladesh	362	479	414	111	1,365
Malaysia	232	689	161	87	1,169
Indonesia	100	112	103	183	497
Mauritius	54	72	240	71	438
Other	558	920	991	824	3,293
TOTAL	48,386	61,434	58,700	57,588	226,107
Calendar Year: 2002					
Country	Jan - Mar	Apr - Jun	Jul - Sep	Oct - Dec	TOTAL
Hong Kong	57,383				57,383
South Korea	2,415				2,415
Myanmar(Burma)	2,225				2,225
Japan	1,735				1,735
Indonesia	650				650
Bangladesh	587				587
Macau	480				480
Malaysia	471				471
Thailand	423				423
United States	260				260
Other	1,225				1,225
TOTAL	67,853	0	0	0	67,853
Source: PRC Customs Statistics					

Table 9. China's Cotton Fabrics Imports by Country of Origin

QUARTERLY COTTON FABRICS IMPORTS BY COUNTRY OF ORIGIN (1,000 sq. meters)					
Calendar Year: 2001					
Country	Jan - Mar	Apr - Jun	Jul - Sep	Oct - Dec	TOTAL
Hong Kong	77,277	102,276	89,451	99,297	368,302
China	65,836	82,269	76,643	84,648	309,396
Pakistan	36,388	33,243	40,774	47,726	158,132
Japan	42,039	39,794	27,731	30,867	140,431
Taiwan	27,330	34,648	33,349	34,403	129,730
India	12,644	17,617	13,042	14,930	58,234
South Korea	9,323	11,234	8,271	7,447	36,274
Macau	3,414	4,603	4,092	4,104	16,213
Indonesia	2,359	2,820	3,228	2,365	10,772
Thailand	1,583	1,150	1,255	1,070	5,059
Other	2,915	6,310	4,468	5,712	19,405
TOTAL	281,109	335,964	302,304	332,570	1,251,947
Calendar Year: 2002					
Country	Jan - Mar	Apr - Jun	Jul - Sep	Oct - Dec	TOTAL
Hong Kong	78,880				78,880
China	66,882				66,882
Pakistan	40,766				40,766
Japan	35,628				35,628
Taiwan	29,661				29,661
India	8,733				8,733
South Korea	6,443				6,443
Macau	3,039				3,039
Indonesia	2,768				2,768
Thailand	1,143				1,143
Other	3,251				3,251
TOTAL	277,194	0	0	0	277,194
Source: PRC Customs Statistics					

Table 10. China's Cotton Fabrics Exports by Destination

QUARTERLY COTTON FABRICS EXPORTS BY DESTINATION (1,000 sq. meters)					
Calendar Year: 2001					
Country	Jan - Mar	Apr - Jun	Jul - Sep	Oct - Dec	TOTAL
Hong Kong	220,308	235,980	227,818	251,681	935,786
South Korea	50,013	60,531	75,803	73,883	260,230
Japan	52,835	32,846	32,439	40,991	159,111
Bangladesh	35,870	48,209	35,316	39,364	158,759
United States	40,145	43,208	28,542	42,184	154,080
Benin	12,960	19,089	33,281	36,299	101,628
Thailand	14,810	11,533	21,293	14,442	62,077
Indonesia	7,437	11,858	14,452	12,915	46,661
Sri Lanka	9,639	8,100	10,674	13,906	42,319
Gambia	5,170	11,099	8,538	15,226	40,032
Other	174,046	221,678	206,013	238,025	839,762
TOTAL	623,232	704,129	694,167	778,916	2,800,445
Calendar Year: 2002					
Country	Jan - Mar	Apr - Jun	Jul - Sep	Oct - Dec	TOTAL
Hong Kong	208,071				208,071
South Korea	93,604				93,604
Japan	38,956				38,956
United States	33,957				33,957
Bangladesh	31,358				31,358
Benin	28,490				28,490
Sri Lanka	15,209				15,209
Thailand	11,856				11,856
Mexico	11,483				11,483
Guatemala	11,264				11,264
Other	241,115				241,115
TOTAL	725,365	0	0	0	725,365
Source: PRC Customs Statistics					

Table 11. Cotton Planted Area and Production by Province

Planted Area (1,000 hectares)				
	1999	2000	2001	2002*
Total	3,726	4,041	4,810	4,077
Xinjiang	996	1,012	1,130	889
Henan	733	779	858	773
Shandong	358	569	720	580
Hubei	311	318	347	300
Anhui	303	308	310	244
Hebei	267	307	419	406
Jiangsu	262	295	384	
Hunan	158	146	149	
Sichuan	94	70	66	74
Jiangxi	69	69		
* Unofficial government estimates published in newsletters and newspapers.				
Production (1,000 MT)				
	1999	2000	2001	2002
Total	3,829	4,417	5,324	
Xinjiang	1,354	1,456	1,458	
Henan	707	704	828	
Shandong	339	590	781	
Hubei	282	304	374	
Anhui	195	274	357	
Hebei	223	300	419	
Jiangsu	246	314	461	
Hunan	177	158	190	
Sichuan	76	59	30	
Jiangxi	63	68	81	
Source: PRC State Statistical Bureau				
Note: 2001 and 2002 official planted area estimates are still incomplete.				

Table 12. Cotton Tariffs as of January 1, 2002

Description	HS Code	In Quota Duty	Out-of-Quota M. F. N.	V. A. T.
Cotton, not carded or combed	5201-0000	1	54.4	13
Cotton, carded or combed	5203-0000	1	54.4	17
Cotton sewing thread, containing 85% or more by weight of cotton	5204-1100	n/a	5	17
Cotton yarn, containing 85% or more by weight of cotton, not for retail sale	5205-1100 to 5205-4800	n/a	5	17
Cotton yarn, containing 85% or more by weight of cotton, for retail sale	5207-1000	n/a	6	17
Cotton yarn, other	5207-9000	n/a	7.8	17
Woven fabrics of cotton, containing 85% or more by weight of cotton, weighing not more than 200 g/square meter	5208-1100 to 5208-5900*	n/a	12.3	17
	* Except: 5208-2300	n/a	13.8	17
Woven fabrics of cotton, containing 85% or more by weight of cotton, weighing more than 200 g/square meter	5209-1100 5209-1200 5209-1900 5209-3100 5209-3200 5209-3900 5209-4100 5209-4300 5209-4900 5209-5100 5209-5200 5209-5900	n/a	13.6	17
	5209-2100 5209-2200 5209-2900	n/a	13.8	17
	5209-4200	n/a	12	17
Source: PRC Customs Import & Export Tariff, 2002				

Table 13. Cotton Tariff Rate Quotas

China's Cotton TRQ:				
Description	HS Code	Initial Quota and Tariff Rate	Final Quota and Tariff Rate	Implementation of Final Quota
Cotton		780,750 mt	894,000 mt	2004
	5201- 0000	1%	1%	2004
	5203 - 0000	1%	1%	2004
<p>Other terms and conditions:</p> <p>1) STE share = 33% (See Note)</p> <p>2) Staging of TRQ for cotton:</p> <p>Year TRQ quantity:</p> <p>2002 818,500 mt</p> <p>2003 856,250 mt</p> <p>2004 894,000 mt</p> <p>Note:</p> <p>Tariff quotas indicated in the third column are volumes for calendar year 2001. Tariff quota concessions will be implemented according to the date specified in the "Implementation" column. The implementation column indicates the date (referring to 1 January of the year indicated) when the final quota quantity will be achieved. The tariff quota concessions are subject to equal annual adjustments (occurring on 1 January of each year), unless otherwise specified in the "Other terms and conditions".</p>				

Production

Planted Area

Current estimates for MY 02 cotton planted area vary widely, but all point in the same direction: planted area will drop. Estimates of the amount of the reduction range from 14% for the government-owned Cotton and Jute Corporation (CJC) to 17% by the Ministry of Agriculture, to almost 20% by some cotton traders. CJC notes that provincial level statistics are proving exceptionally difficult to come by this year. Post is adopting a relatively conservative 16% decline in planted area, bringing the total down to 4.032 million hectares. The drop in cotton area is a direct consequence of low prices last year. At the end of 2001 cotton prices had fallen by over 19% compared to the end of 2000. The Shandong Provincial Agriculture Bureau estimates that profits from cotton production in that province fell by 67% in MY 01. Trade sources also report that farmers in the Yellow River Valley experienced difficulties in finding buyers for their cotton. Domestic cotton prices have recently shown some sign of recovery, but remain relatively low. Differing estimates for this year's planted area are linked to differing opinions over the impact of the recent upturn in prices. CJC sources believe that this increase will encourage farmers to plant more cotton, but trade sources believe that planting decisions are made based on the price that farmers received at the previous harvest time, rather than on prices at the time of planting. Another factor may be the lack of alternative cash crops, which continues to make cotton production desirable, even when returns are low. A final factor is uncertainty over the impact of rainy weather in several cotton producing areas. Several sources claim that this has prevented cotton planting or destroyed emerging crops. CJC, however, expects that most of this land will be replanted, and that while late planting will affect both quality and yields, the impact on the overall crop will not be very large.

China's National Statistical Bureau (NSB) estimates that planted area in Xinjiang may fall by over 17% in 2001. Preliminary statistics from the Xinjiang Bureau of Agriculture support this estimate, stating that most of the land previously planted to cotton is now being planted to grain and sugar beets. This situation could easily reverse itself next year as the favorable market conditions for sugar beets have already disappeared. According to the Xinjiang Bureau of Agriculture, profits from cotton production in Xinjiang fell by roughly 30 percent, due to lower yields and falling prices. The reduction in yields may be associated with the 7.4% increase in planted area, which is believed to have brought a certain amount of marginal land into production, as well as to weather problems.

Biotech cotton, mostly BT (pest resistant), continues to gain ground rapidly. The use of BT cotton has played an important role in the return of cotton to the provinces of the Yellow River and Yangtze River, where persistent bollworm problems had made cotton production unprofitable. Despite the importance of BT in China's cotton production, the government has recently undertaken efforts to limit the development of this industry by prohibiting foreign investment in biotechnology. This change in the rules has placed existing biotech joint ventures in jeopardy. The dominant varieties of BT cotton in China currently include varieties developed by Monsanto and by the Chinese Academy of Agricultural Sciences (CAAS). CAAS has a Cotton Institute in Henan Province which has developed several varieties of BT cotton, and which produces a large proportion of the planting seed used in Xinjiang. Although earlier domestically developed varieties of BT cotton were inferior, more recent types are reportedly quite effective.

The exact amount of BT cotton being planted is difficult to estimate. Officially, BT is only approved for use in a handful of provinces. However, anecdotal evidence indicates that its use has spread rapidly throughout cotton growing regions. The spread of BT cotton has been aided by common practices, such as borrowing planting seed from neighboring

farmers, crossing provincial boundaries to purchase seed and purchasing seed from traveling salesmen. Many of the farmers interviewed are unaware that the seed they are planting is of biotech origin, merely referring to it as 'pest resistant.' CAAS estimates biotech cotton acreage in China during MY 01 at 1.5 million hectares, over 1/3 of total cotton planted area. Biotech cotton appears to have been largely unaffected by China's new biotech management regulations. Although the regulations were carefully phrased to exclude biotech fibers, most of the cottonseed is processed into oil and meal, which are used for food and feed. Failure to apply the same regulations on domestic cottonseed products as are being imposed on imported oilseeds may be interpreted as a violation of the national treatment principle of the WTO. There is also little evidence that domestically developed biotech cotton planting seeds are being held to the same testing and approval standards set by Ministry of Agriculture's biotech regulations. In an obscure sidenote, China's 'rabbit hair' biotech cotton made headlines once again as the local press reported the manufacture of a test batch of garments made from the cotton. This cotton contains a gene for keratin that is taken from rabbits, and is claimed to produce a stronger, shinier and softer fiber. The "rabbit hair cotton" was first developed in 1998, and is still in testing.

Production

Total cotton production for MY 01 has finally been confirmed at 5.32 MMT. Yields are forecast to remain relatively low, as cotton production got off to a poor start. Rainy and cold weather in the Yangtze and in parts of Xinjiang destroyed a number of seedlings. Though some of this area may be replanted, quality and yields are likely to suffer. Some areas are reporting a shortage of planting seed as well, which is likely to result in continued use of inferior varieties. Balancing this, the reduction in overall cotton planted area is likely to remove marginal land from production, which could strengthen yields.

Cotton quality continues to be a problem. Separation of cotton by grade has always presented difficulties in China, but the current breakdown in the marketing system has made matters worse. In the past, cotton was procured exclusively by CJC procurement stations, which either required farmers to separate the cotton by grade, or offered a lower price for sorting the cotton at the station. As CJC has lost its monopoly on cotton procurement, however, separation of cotton by grade frequently is not done at all. Foreign fiber content also continues to be a problem, reflecting the extremely small scale of cotton production and the practice of air-drying cotton outdoors. Other foreign material content, however, remains relatively low.

Complaints about declining fiber strength in Xinjiang cotton are having some impact, as provincial authorities seek to improve seed varieties. This problem is rooted in the fact that Chinese cotton standards and procurement prices provide price incentives for higher grades and fiber length, but do not account for fiber strength. Each increase in grade or each 2mm in length beyond standard produces a 6% increase in the procurement price. As a result, all efforts have been focused on improving color and length, but have accomplished this at the expense of fiber strength. It is still too early to tell how effective current efforts to improve fiber strength will be, since this is still not a part of the cotton standards and there is as yet no financial incentive for farmers to produce higher-strength cotton. Another problem for Xinjiang cotton has been the high sugar content. Few complaints have been heard on this count recently, perhaps indicating that past efforts to reduce sugar content and control aphids have been effective.

Reductions in cotton production have been welcomed in most provinces, as most authorities seem to recognize that domestic markets could not support last year's high levels of production. The exception in this area is Xinjiang, which remains the only province to offer a floor price for cotton. Last year the Xinjiang regional government issued a

'guidance' price of RMB 400/dan (\$968/MT) for standard cotton with a minimum price of RMB 360/dan (\$871/MT). As a result, Xinjiang continues to hold large stocks of cotton which it is unable to market at current prices without suffering a loss. Regional authorities finally seem to be looking beyond floor prices for additional means to support cotton producers. In March, they announced that the railroad tax levied on cotton would be eliminated as of April 1, reducing the shipping price of cotton by roughly RMB 100/MT (roughly \$12/MT).

Procurement

CJC estimates that, as of the end of March, total cotton procurement by CJC cooperatives amounted to 3.27 MMT out of an estimated total of 5.32 MMT. This is an increase of slightly over 17%, as compared to an increase of 20% in total production. In Xinjiang, by contrast, procurement by Xinjiang CJC amounted to 1.52 MMT, accounting for the bulk of production. Of this amount, however, only some 519 TMT had found a buyer by mid April. CJC procurement as a percentage of total production is continuing to fall. Filling the gap is a large number of independent procurement agents, who are sometimes competing directly with CJC enterprises and sometimes working with them by collecting cotton for sale to the CJC enterprises.

Consumption

According to the China National Cotton Textile Industry Association (CNCTIA), total cotton consumption by the textile industry is forecast to reach 5.1 MMT in 2002, while the China National Cotton Exchange estimates consumption at slightly over 4.9 MMT. The current situation for the textile and spinning industry represents a reversal of fortune over last year. At that time, high prices for domestic cotton relative to imports placed the textile industry in a difficult position relative to overseas competitors. Part of this difficulty was passed on to spinners as many textile mills sought to evade cotton quotas by importing cheap yarn from India and Pakistan. This caused a substantial accumulation of yarn manufactured from relatively expensive domestic cotton. The large MY 01 crop, however, put an end to that, causing cotton prices to fall sharply. Industry sources report that most of the surplus yarn stocks have been used. Future prospects are uncertain, however, as a much smaller crop is forecast for MY 02. Unless tariff rate quotas allow significant cotton imports, prices are likely to rise again, once again placing the textile industry in a difficult position.

Trade

Exports of Chinese cotton have fallen sharply, due primarily to the sharp decline in international cotton prices last year, while domestic prices remained relatively high. Although domestic prices have since fallen, massive exports are unlikely to begin again. This is due in part to the structure of Chinese cotton supply and demand. At present, China produces more high-quality long-staple cotton than it needs, and less low-quality cotton than it uses. As a result, there is a tendency to import low quality cotton and export high quality. China's primary producing area for high quality cotton, however, is in the remote western region of Xinjiang. Xinjiang cotton has gained favor among some millers in East and Southeast Asia, particularly Korea. Xinjiang is a remote, largely muslim region with a long history of unrest. This has made central government officials extremely sensitive to any changes that may increase unrest, including a drop in the price of the region's main cash crop, cotton. As a result, Xinjiang is now the only place in China to maintain a floor price for cotton. This, however, along with high transportation costs has made Xinjiang cotton less competitive in

international markets, despite the relatively low current price for Chinese cotton.

In the past, China has compensated for Xinjiang's lack of competitiveness by offering large export subsidies, and by offering refunds on the value added tax for exports of Xinjiang cotton and textiles produced with it. As part of its WTO accession package, China agreed to eliminate export subsidies. This does not, however, mean that government support to exports has ended. In March the government announced a plan to eliminate one of the taxes charged for rail transportation of Xinjiang cotton. The reduction amounts to roughly 100 RMB/MT (\$12/MT). More important is the impact of VAT rebates. In order to improve the competitiveness, the Chinese government offers a rebate on the value added tax for cotton to mills that export their products. The rebate is available on both imported and domestic cotton, and only applies to the value of the cotton, not the value added during processing. An industry source reports, however, that the VAT on cotton is never actually collected at the production level when cotton is procured from farmers. When the cotton is resold to a mill, the value of the VAT is included in the receipt for that sale. Thus the rebate is paid on a tax that was never charged. By contrast, imported cotton is invariably charged the full VAT. Since this rebate is only available on exports, it effectively becomes an export subsidy.

Cotton imports remain low, and do not appear likely to improve much before the end of the marketing year. China has issued the TRQs for cotton that it committed to under its WTO accession agreement, albeit rather late, and trade under the TRQ has already begun. There are, however, several catches that may limit the usefulness of the TRQs in the near term. Under the system established by China, a total of 818 TMT of TRQs have been announced. Of this, however, only 48 TMT is reserved for general trade. Another 270 TMT is reserved for state-owned enterprises, while 500 TMT has been reserved exclusively for the reprocessing trade. Reprocessing trade refers to the import of cotton for manufacture into textiles that are then exported overseas. Reservation of most of China's TRQ for reprocessing trade may be interpreted as a violation of China's WTO agreement, since the cotton does not actually enter domestic markets. In addition to problems with the TRQ system, imports are likely to suffer due to relatively low current domestic prices, and from competition from sales of reserve cotton by the China National Cotton Exchange, which are scheduled to begin in late May. In addition, control of the bulk of the remaining quota by SOEs may provide the Chinese government with the ability to unofficially limit imports by pressuring these companies not to use their quotas. A final catch is that many of the general trade quotas were issued for extremely small quantities that cannot be considered commercially viable. For the near term imports are expected to continue to favor low quality cotton, as this is in relatively short supply.

For MY 02, the import picture is likely to be quite different. Most sources expect a drop of between 14% and 20% in domestic production. If consumption remains reasonably stable, imports are forecast to reach 350 TMT. This assumes several things, however. Sales of domestic stocks are assumed to be very strong, amounting to a total of over 500 TMT. While this is a large amount, it should be noted that much larger reductions were made during MY 99 and 00. This also assumes that the textile industry has sufficient influence over policy to allow at least enough imports to keep cotton prices from rising high enough to cause problems for textile exports. While often true, this is far from certain.

Net imports of cotton yarn and thread increased during MY 00, but now appear to be falling. The increase was the result of high domestic cotton prices, coupled with low import quotas that limited access to cheap foreign cotton. The difference in prices between domestic and international cotton markets was large enough to make imports of cotton yarn feasible, despite the 8.4% tariff on yarn (as compared to 3% for cotton). With the difference in prices now narrowing, yarn imports appear to be on the decline. However, given expectations of a smaller domestic crop in MY 02, yarn imports are likely to increase unless substantial quantities of imported cotton enter the market.

Stocks

After two years of reductions, stocks are forecast to remain relatively steady through the remainder of MY 01. This comes despite continued sales of state-owned stocks by the China National Cotton Exchange (CNCE), which amounted to over 212 TMT during MY 01 and nearly 500 TMT during CY 01. CNCE's sales have been offset by the accumulation of new stocks of Xinjiang cotton. Xinjiang CJC and the Military Construction Corps (MCC) have been able to sell only 1/3 of the cotton they have procured. The loss of export subsidies has made it increasingly difficult to export Xinjiang cotton, and domestic demand for the long-staple cotton produced in Xinjiang is relatively low. Xinjiang also faces problems due to their insistence on a floor price for cotton procurement. The Agricultural Bank of China, which provides the loans that support cotton procurement, has imposed terms that do not allow the sale of cotton procured with a loan at a loss. This arrangement leaves Xinjiang CJC and the MCC in a bind, should cotton prices fall after the cotton is purchased, as happened last year. According to government sources the central government recently offered to purchase part of this cotton at a break-even price for placement into national reserves. The offer was refused, apparently partly because the Cotton Reserve Corporation, which controls purchases into the national reserve, placed a number of unfavorable terms on the sale. Xinjiang CJC and the MCC may be hoping to take advantage of the recent upturn in cotton prices to sell at a profit. They could be disappointed, however, as the CNCE is scheduled to resume sales of national reserve cotton at the end of May. The cotton slated for sale is Xinjiang cotton that went into storage prior to 1998.

Given current forecasts for a sharp drop in cotton production in MY 02, Post is forecasting a resumption of the liquidation of stocks. Precisely how far stocks could drop is unclear, however. Sales will, by necessity, be conducted at a loss since most of the reserve cotton was purchased at relatively high prices. For example, the 1997 cotton currently slated for sale was purchased at a time of peak prices, so losses from these sales are likely to be particularly high. While the cotton must eventually be sold, just how much of a loss the government is willing to absorb at one time remains uncertain. A second source of uncertainty concerns the quantity of stocks available for sale. The precise amount and quality of the cotton in storage is unknown, and some industry sources believe that government estimates are overstated. At least one source believes that sales of national stocks will not exceed several tens of thousands of tons. If this proves to be the case, then imports will be much higher than the current forecast indicates.

Policy

Since support prices were eliminated several years ago, China offers little direct support to cotton farmers, instead preferring to make that support available to exporters and mills. The exception to this rule is Xinjiang, which continues to maintain a floor price. For exports, since the elimination of export subsidies, the main source of support is the VAT rebate offered for cotton exports. This rebate was originally available only for imported cotton that was used to manufacture goods for export, but was later extended to include exports of domestic cotton or products manufactured using domestic cotton. According to textile industry sources the VAT rebate on cotton textile exports is equivalent to the VAT for the cotton used in making the textiles, but does not include tax paid on the value added by processing the cotton. One industry source has noted that the rebate may amount to an export subsidy in itself, since it is being paid on a tax that is not actually charged. According to this source, when cotton is procured from farmers the farmer is paid a flat price for the cotton. The cotton is then resold to mills, charging that same price plus the purchasing agent's fee. However, the receipt for the sale to the mill reflects payment of the VAT on the cotton, included as part of the price of the cotton paid by the mill. If the final product is exported, the mill can then collect a refund on the VAT.

VAT rebates are not the only source of support. The primary handicap faced by Xinjiang is high transportation cost due to its isolated inland location. In March the government announced the cancellation of the railroad tax for cotton. This tax amounts to over RMB 100/MT (\$12/MT). Xinjiang also benefits from sales into government reserves. Over the past two years Xinjiang has been unable to market all of its cotton, the unmarketable portion of which is eventually purchased by the government and placed in reserve. These reserves will eventually be sold, most likely at a loss, effectively subsidizing Xinjiang's maintenance of a floor price for cotton. Although Xinjiang has refused to sell cotton into the reserve so far this year due to unfavorable terms, it is likely just a matter of time. A final mechanism for supporting cotton is the policy of government-controlled banks to provide pending accounts for export sales of cotton. This allows the sale of cotton at a loss, with losses transferred to a bank balance to be repaid from the profits of future sales.

Marketing

The transition of China's cotton procurement system away from a CJC monopoly has resulted in considerable confusion. According to one private industry source, up to 2/3 of CJC's local enterprises are technically bankrupt. However, without CJC, China has no coherent system for procurement and distribution. To fill this growing gap there has been a proliferation of independent cotton marketers. According to CJC the number of such officially registered companies went from 2,300 in 1998 to 7,000 in 2001, and is expected to reach over 9,000 by 2003. The number of unregistered marketers is unknown, but likely quite high. These numbers are clearly unsustainable, and most sources expect a massive consolidation of the industry, viewing the current chaos as a transitional period. The activities of the independent procurement agents are also causing problems for cotton quality. Small-scale procurement agents lack both the resources and financial incentive to sort and grade cotton. Competition from these independent buyers has undermined the ability of CJC to enforce strict grading standards, since CJC enterprises lose business to the independent buyers if they strictly enforce the standards. International cotton merchants have shown a growing interest in marketing cotton in China, but some feel that this will not become profitable until a futures market is established in China.

Although there are now many independent procurement agents, CJC enterprises continue to dominate cotton procurement and marketing. A key reason for this is credit. Most purchasing agents are unable to get credit from banks to purchase cotton, and must rely on cash payments from mills or CJC cotton enterprises which have access to credit. As part of the marketing reforms, the Agricultural Development Bank of China has plans to stop making 'policy' loans to CJC enterprises. However, in order to ensure a more orderly transition, China's State Council has ruled that these loans will be eliminated gradually. Many mills, unhappy with the unreliability of independent agents and the cost of working through CJC, are seeking their own solutions. Most of CJC's cotton gins have now been partly or fully privatized. In most cases, this means that gins have sold shares, often with CJC holding a portion of the shares and employees holding a portion. Local governments and textile mills also often hold shares. These gins are typically strapped for cash, and uninterested in marketing cotton. As a result, many mills have taken to renting out the services of cotton gins as a means of sourcing cotton. Farmers and procurement agents deliver cotton to the gins, which purchase and gin the cotton with funds provided by the textile mills. This solution is limited however, as smaller mills are also reported to be having credit problems, particularly as a result of rising prices for synthetic fibers.