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German-Egyptian Cotton Sector
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Report No. 168

COTTON MARKETING AND SPINNING

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Cotton Marketing and Spinning

Preface

The Ministry of Agriculture and Land Reclamation requested GTZ's collaboration and support in developing a long term strategy for the Cotton and Spinning Sectors. That assignment has been carried out under the direction of Dr. Ahmed Gohary, Chairman of the National Cotton Council, Dr. Heinz Burgstaller, German Team Leader of the Egyptian-German Cotton Sector Promotion Program (CSPP), and Dr. Jane Gleason, Chief of Party, RDI, Agricultural Policy Reform Program (APRP). A series of seminars were held in the first half of 2002 to design the long-term strategy for the cotton and textile sectors. These seminars were attended by an eminent group of professionals from Government and private sector involved in cotton production, trade, processing, and policy. Several groups were organized as task forces charged with focusing on well-defined segments of the sector. One of the task forces was assigned to cotton marketing, including spinning.

This marketing strategy is the outcome of a series of presentations and discussions started in January 2002 of draft strategy marketing papers with several groups of stakeholders. The National Cotton Council and GTZ's Cotton Sector Promotion Project organized three workshops with participants from public sector agencies and private sector representatives. These workshops discussed the main findings and conclusions of earlier reports developed by the same team of consultants -- Drs. Edgar Ariza-Nino, Ibrahim Siddik, and El Sayed Dahmoush,– under the direction of Dr. Heinz Burgstaller. The workshops also benefited from the support and participation of the Agricultural Policy Reform Program (APRP), an USAID funded project with the Ministry of Agriculture. Copies of those papers can be obtained from GTZ under the titles "A Competitive Marketing Strategy for Egyptian Cotton and Textiles" and "Cost of Production and Competitiveness of Spinning Yarns in Egypt."

This report is therefore both a result of the discussions held with the marketing working group, and a contribution towards further deliberations on these strategic concerns.

Cotton Marketing and Spinning

Executive Summary

The purpose of a marketing system is to find a balance between supply and demand, between the decisions of producers, consumers, and processors. As is generally the case, the interests of cotton producers and cotton consumers are quite different. The situation in Egypt is no exception. Egyptian farmers produce the finest and most expensive cotton in the world. Egyptian consumers, like consumers around the world, want reasonably priced, affordable, clothes and textiles. Egyptian spinners do need cheap cotton to satisfy the needs of the majority of consumers in the domestic market. The task of the marketing group is to find ways to reconcile the conflicting interests of cotton growers, cotton consumers, and cotton processors.

The overall mission statement adopted by the marketing groups is:

> *"Egypt competes effectively in the world market as exporter of cotton ELS & LS lint, textiles, and apparel. Egyptian spinners have full access to cheap cotton to satisfy the needs of the domestic market."*

The proposed mission statement has two parts, first we want Egypt to be competitive in the world market as an exporter of cotton lint, cotton textiles, and cotton apparel. At the same time, we want Egypt to be competitive in the domestic market and that requires the spinning industry to have full access to cheap cotton, regardless of where it comes from.

How are we to achieve these mission statement goals? We have identified six broad fronts to get there.

First, we need to separate in our thinking and in our plans the two sub-sectors -- cotton growing and cotton spinning. Cotton spinners should decide on their own what kind of cotton is best for their needs. Cotton growers should decide for themselves how much area of cotton to produce. Spinners should not be obliged to use the cotton produced by Egyptian farmers, and vice versa, we should not require farmers to produce for the spinning industry if other types of cotton are more profitable.

Second, Egypt needs to look beyond exports of extra-fine cotton. This is too small segment of the total cotton market. Extra-fine cotton only accounts for 3 percent, maximum 5 percent, of world consumption, and it is not growing significantly. Egypt can compete also in the Fine and Medium High categories, with cottons like Acala and Barakat and Central Asian long staples. These are larger market segments. Egypt already has varieties to compete in those markets. Giza 80 and Giza 83 can compete in the Medium High market, and Giza 85 and Giza 89 can compete in the Fine category, but these varieties must be priced more competitively against the foreign varieties in those groups.

Third, we need to recognize that all Egyptian cotton varieties and grades are exportable. Even scarto and type exportateur and cotton waste (noils) are exportable, at the proper price of course. That means that we should not place any bans on exports or limits on what varieties to export or what grades to export, and equally importantly no restrictions on what prices exporters can negotiate.

Fourth, we should not overprice Egyptian cotton. Ideally, Egypt should eliminate attempts at fixing export prices altogether. Most of the problems we have in both cotton sector and in the textile sector can be traced to the failure of our pricing mechanism, especially to the tendency to set prices too high for all our varieties and then failure to adjust those prices when market situation requires it. But we recognize that this is too big a change to suggest. However, if Alcotexa must fix export prices, at least it should not set them consistently so high, because it cannot reduce them later on. It is better to start the season with reasonably low prices and then, if export sales are much higher than anticipated, then increase prices gradually. We need to draw target export sales and adjust export prices accordingly. The ultimate end is to end up the season without any unduly high carry over stocks. Any carryover stock is evidence of the failure of our pricing system.

Fifth, we need to acknowledge in our thinking that prices are inversely related to export volumes: high prices result in low export sales, low prices lead to higher sales. This is obvious to most traders. We highlight it here because we sometimes hear officials in our trading companies claiming that export prices have nothing to do with export sales, that foreign demand is fixed, that foreign spinners have a given demand and we can charge any price and it makes no difference. We need to eliminate these misconceptions from our minds.

Finally, we need to ensure that Egyptian spinners are free to purchase the cotton that they think is most suitable for their needs, at the best possible price. That means they should have access to cheap cotton, whether imported or produced locally. Some private spinners already are using imported short staple cotton from Greece and Sudan, but public spinners are not able to use imported cotton. The cost of importing cotton is too high, nearly 8 cents, over the CIF price in Alexandria. That means nearly 20 percent on cotton that is purchased at 40 c/lb CIF Alexandria. Any reduction in the cost of importing short staple cotton will help the spinning industry to become more competitive.

In summary, there are some basic steps to make Egyptian cotton and textiles more competitive in the world and in the domestic markets:

- Letting exporters negotiate the best price they can get without restriction on what varieties or grades they export.
- Letting spinners decide what cotton is best for their needs.
- Letting farmers decide what is the most profitable cotton type for them to grow.

These basic steps are doable. All can be implemented now. And they do not cost anything; on the contrary they save Government money and reduce the losses of the public spinning companies.

Cotton Marketing and Spinning

Introduction

The main impetus behind the urgency to develop a competitive marketing strategy for the cotton and spinning sectors is the pervasive sense of imminent crisis gathering around this critical sector of the Egyptian economy. The overall world market situation for cotton is the worst it has been in two decades and the prospects for prompt recovery are negligible. These external developments are testing the resilience of the Egyptian cotton economy to the breaking point, and have exacerbated the weaknesses inherent in the current cotton marketing system.

Egyptian cotton experienced over the past decade a marked decline in area planted, production and consumption. Area planted to cotton in 2000 was the lowest on record -- just over 500,000 feddans. Lint cotton exports have partly recovered but stagnated at 100,000 tons in the last four years. The spinning industry, dominated by state-owned companies, uses half as much cotton now than in 1990, for it finds increasingly difficult to compete against foreign yarns, fabrics and apparel. Huge stocks of unsold cotton accumulate in Government hands.

Egyptian spinners do not need expensive Egyptian cotton to produce yarns and fabrics for the domestic market. A few private spinners are increasingly turning to imported cheaper short staple cottons and polyester to fulfill the needs of Egyptian consumers. Public-sector spinners, forced into using almost exclusively Egyptian cotton, are financially bankrupt and are using less and less Egyptian cotton each year. If current trends continue, the eventual demise of public sector spinning is unavoidable within a few years.

The most critical problem facing the Egyptian cotton sector in the summer of 2002 is the massive carryover stock -- 175,000 tons as of June 1st, 2002 -- in the hands of the public sector trading companies. The financial cost to the Government of keeping so much cotton on long-term storage is unsustainable at a time when budgetary pressures are mounting. Moreover, the new 2002/03 crop is expected to be even larger than last year's, thus bringing additional supply into the picture. The US Government also accumulated large inventories of American Pima under the loan guarantee program and the new Pima crop is also expected to be slightly larger than the last. Added to the existing stock, Pima supply reaches over one million bales, the highest it has ever been. The Egyptian cotton authorities are therefore facing the prospects of adding a large new carryover to the already existing stock.

In order to address this potential threat to the long-term prospects of the cotton sector, the GTZ Cotton Promotion Program initiated a concerted effort to inform policy makers of the dangers ahead and of the limited options available at the moment to alleviate the ultimate consequences. Several memoranda were prepared for high officials. GTZ urged greater pricing flexibility by the public sector trading companies to dispose of at least 50,000 tons of stock in the last six months of the season. Partial success was achieved, increasing export sales by 35,000 tons in the past five months, but the basic problem of excess inventory remains very worrisome.

Why is the future of cotton important to Egypt? Because it impacts on the lives and wellbeing of millions of Egyptian in both rural and urban areas.

Employment and income in agriculture. Cotton production occupies over half a million rural households during eight months of the year and it constitutes the main source of cash income for those households. Most producers have very small plots of cotton; thus, income from cotton is widely distributed among the rural population. Farmers in the entire country grow cotton in roughly the same proportion of land in rotation with other crops.

Employment in industry. The textile industry employs half a million workers throughout the year, and indirectly through the multiplier, generates over one million additional jobs. It constitutes the principal manufacturing activity in the country in terms of employment. Removing constraints to liberalization of the cotton and textile sectors will further increase productive employment. Ready-made-garment export factories employ large numbers of semi-skilled workers, mostly women. Employment in cotton, textile, and apparel sectors thus benefit rural and urban communities.

Foreign exchange earnings. Cotton and textile exports generated in 2000 over one billion US dollars, an amount only exceeded by oil exports. Cotton lint exports account for about $200 million dollars; the higher value-added manufactured products accounted for the rest.

Competitive advantage in these sectors. Cotton has been Egypt's main agricultural export for many decades and it consistently offers comparative advantages over most other crops. Only rice offers comparable competitiveness, but its market is more limited and it uses large volumes of irrigation water. The ready-made-garment industry dedicated for export has already demonstrated to be internationally competitive and generator of both foreign exchange and large number of jobs.

The cotton marketing and spinning strategy presented below is structured into five main strategic objectives (headings) corresponding to five areas where key decisions are needed regarding the future orientation of the sector. These areas are the choice of varieties, seed cotton trade, ginning, marketing of lint cotton, and the spinning industry.

But before getting into the changes required by the new marketing strategy, it is worthwhile to recall the significant progress made in the past five years in this regard, thanks to the deliberate policy of market liberalization and privatization pursued by cotton authorities.

Recent Progress on Cotton Marketing

Privatization of Alcotexa. The composition of the management board of the Alexandria Cotton Exporters Association has radically changed in the past four years. Ten out of the twelve members are now private trading companies and the Chairman of Alcotexa is also a private exporter. Private membership has also increased to 18 out of 24 total members. These changes reflect the diminishing fortunes of public trading companies, as the gradual liberalization of cotton marketing has opened opportunities for private traders to compete.

Increased Exports of lint. Export commitments of cotton lint in the past four seasons have hovered around 100,000 tons, with the exception of 2001 when they dropped to 83,000 tons. This is considerable progress from a low of 19,000 tons in 1996.

Pricing flexibility. Stronger presence of private traders has also resulted in some pricing flexibility in both exports prices and buying prices from farmers. Despite Alcotexa setting narrow export price ranges, private exporters regularly offer discounts to foreign clients. Discounts were especially high in 2001 and 2002 because the devaluation of the Egyptian pound after October 2001 has led to windfall profits for private traders.

Introduction of Price Deficiency Payments. Before the introduction of price deficiency payments the only way the Government could honor its commitment to farmers of a floor price, was using the public sector trading companies to purchase the entire cotton crop. Now, Government is only required to pay the difference between the market prices and the guaranteed floor price.

Realistic Floor Prices. Floor prices guaranteed by Government have become more realistic and in harmony with international prices. Government has not had to pay much in price deficiency payment in the past few years even though international prices have been very low by historical standards. The devaluation of the Egyptian currency allowed Government to live up to its floor price commitments to farmers without incurring much of a cost.

Private Marketing Rings. Private non-PBDAC cotton marketing rings are now possible. Farmers now have more choice of buyers for their cotton, and prices offered by private traders and through cooperatives are more favorable. Official cotton marketing rings are also more fairly distributed.

Privatization of trade. Private sector share in cotton trade is greater now while public sector trading is rapidly shrinking, especially in exports. Public trading companies still are assigned most of the official marketing rings, but private sector has opened alternative marketing rings or direct purchases from farmer cooperatives. Allocation of PBDAC rings is now more transparent. Financing for private purchases has not been as big a problem, perhaps because banks can use purchased cotton as collateral for credits.

Imports of short staple cotton allowed. Spinners in 2001 imported the equivalent of 25,000 tons of short staple cotton from Greece, Sudan, and Syria. The cost of imported short staple is roughly half the price of the long-staple cotton varieties (Gisa 85 or Giza 89). Most of that was brought in by private spinners because public spinners are forced to use cotton from the accumulated stocks now in the hands of the Government or public sector trading companies. This has given a market advantage to private spinners who have expanded their operations despite the gloomy outlook for the spinning industry worldwide.

Introduction of New Varieties. Several new cotton varieties with good export potential have been introduced in the last four years. Giza 88 in the ELS category has replaced Giza 77 and Giza 76. Giza 86 has excellent fiber characteristics, though farm productivity remains a problem. Giza 91 is being tested and it appears promising in Upper Egypt.

Private Spinning. Increased privatization of spinning has taken place quietly and despite little progress in divestiture of public spinners. Private spinners now produce a growing percentage of cotton yarns, using significant quantities of imported cotton lint. Private spinners also handle nearly all yarns made from man-made fibers.

Private ginning. The privatization of ginning is a remarkable achievement that brought about the introduction and rapid expansion of universal-density bales and improvement of quality through better handling and reduced contamination. Private gins now handle over half of the cotton crop, and nearly three-quarters of the exported quantity.

Cotton Logo. An "Egyptian Cotton" logo was designed and adopted by the Ministry of Foreign Trade to be used as a promotional device in marketing products made of Egyptian cotton worldwide. The Egyptian cotton logo has been trademarked in Europe and the United States. Several licensed manufacturers of towels, household accessories, and other products are already using it. At least two companies in China and one in India have received licenses to use to Egyptian cotton logo recently. Alcotexa has been assigned responsibility for managing the Egyptian cotton logo.

Variety Map. Production of ELS varieties almost came to an end in 1999 when the authorities decided to discontinue production of three varieties -- Giza 70, 77, and 76 -- in view of the enormous stocks of unsold ELS cotton accumulated in previous years. Only a small area of Giza 70 was retained. The cotton authorities realized that the real problem was overpricing of those varieties and in following years they adjusted prices down and those stocks have disappeared. The new 2002 variety map expands the area and production of ELS varieties (now including Giza 88). Cotton authorities have become more aware of the importance of market prices in deciding the choice of varieties, and the perverse effects of accumulating unsold stocks on decisions concerning production in subsequent years.

CATGO HVI testing and website. Spinners around the world are adopting the measurements of cotton fiber properties available from the HVI (high volume instrument) equipment. These measurements enables them to make better decisions regarding blending of different types of cotton to achieve yarn specifications at minimum cost. Users of American cotton have enjoyed that information for many years from tests conducted by USDA. Egypt now has a nation-wide program of HVI testing of every lot coming out of gins, performed by CATGO (Cotton Arbitration and Testing General Organization). The results of these tests are now made publicly available through the Internet, thus enabling foreign and domestic spinners to identify specific lots that satisfy their needs.

E-trade in Cotton Lint. Availability of HVI through the Internet makes it possible for potential buyers to contact Egyptian exporters to negotiate transactions directly. In the past, Egyptian cotton was not sold to spinners but to large merchant houses in Europe for subsequent sale to spinners. USDA already conducts large-scale auctions through the Internet to sell cotton (upland and Pima) that growers forfeited to the US Government under the loan deficiency program. But before e-trade in Egyptian cotton can be made, some regulations need to be changed. The Ministry of Foreign Trade has authorized that Alcotexa will accept transactions carried out through the Internet in a transparent manner. Public sector trading companies can thus sell some of the unwanted stocks in their hands.

Phasing out of Farfara. Until 1996 all Egyptian cotton exported was subject to "farfara", a procedure to blend cotton from bales of different grades to arrive at a mix of average quality. The mix was re-pressed into high-density bales for export. This procedure was performed by a single state-owned company in Alexandria and costs from 14 to 17 cents per pound. Private exporters first got the right to export standard UDB bales directly out gins. UDB presses spread very rapidly in the past four years, and nowadays nearly three quarters of cotton exported leaves without farfara. This has saved private exporters the cost of farfara and enables them to offer discounts to foreign buyers below the official Alcotexa export prices.

Cotton Lint Export to the USA. It is especially satisfying for Egypt that American manufacturers are importing Egyptian cotton, instead of using their own Pima or other types of US cotton. Two varieties account for the bulk of those exports, Giza 83 and Giza 80, which are the shortest staple and cheapest Egyptian varieties. These buyers use Egyptian cotton mainly to produce yarns for toweling and terry cloth. This illustrates the potential of Egyptian cotton for use in producing coarse yarns (Ne 12-16) with special characteristics such as softness and high absorbency. We need to break out of the mindset that Egyptian cotton is only for making extra-fine yarns for very special purpose garments. Clearly, MLS varieties also have a wide market potential.

Better Market Information. Great improvements have been made in the past four years in improving accessibility of market information to cotton traders, exporters, and potential buyers of Egyptian cotton. Alcotexa's weekly reports of export sales are now available through its Internet website. CATGO now publishes two weekly reports in Arabic with updated results of both cotton classing and HVI tests on ginned cotton. CATGO recently opened its own website to make those reports available through the Internet. APRP has designed and set website for reporting cotton prices and market performance of Egyptian cotton in comparison with its main competitors in the world market. Other sources of market data -- USDA, ICAC, and CAPMAS -- are also becoming more accessible through the Internet.

Increased exports of apparel. Ready-made-garment (RMG) exports already amount to over $500 million -- as much value as exports of cotton lint, yarns, and textiles -- and their importance keeps growing year by year. Unfortunately, over 99 percent of those RMG exports are made of imported yarns and fabrics, i.e., they do not incorporate any Egyptian cotton. This illustrate clearly that garment manufacture in Egypt is an internationally competitive activity in both quality and cost. It also demonstrates that the costs of yarns and fabrics made in Egypt with Egyptian cotton are not competitive for use in making most of the RMG exports. Some private spinners are only now starting to produce yarns with imported short staple cotton that can compete in price with imported yarns from Pakistan and India, but they prefer to sell them in the domestic market where prices are higher.

Proposed Marketing Strategy

The cotton marketing strategy presented below is structured into five main headings corresponding to five areas where key decisions are needed regarding the future orientation of the sector. These areas are the choice of varieties, seed cotton trade, ginning, marketing of lint cotton, and the spinning industry.

Area One: Choice of Cotton Varieties

> ***Mission Statement: Egyptian cotton growers are free to choose the cotton varieties most profitable for their conditions.***

Egypt needs to accept a cotton consumption pattern in closer harmony with the rest of the world, i.e., where most of its domestic market needs are fulfilled with short staple cotton. Egypt expands its production over a wider range of cotton types beyond the narrow ELS/LS (Extra-Fine) segment, in order to compete in the larger segments of the world market, and to address the needs of the domestic market.

Egypt is the only country that limits its cotton production and consumption to varieties classified in the Extra-Fine category. All other major exporting countries produce a wide range of cotton varieties. The Extra-Fine category is a very small (3 percent) segment of world cotton demand, though it commands much higher prices (more than double right now) than upland varieties

This can be accomplished through:

- Pricing more realistically LS and MLS varieties
- Finding out the true market value of Egyptian Varieties
- Bringing consumption in line with the rest of world.
- Using floor prices to protect cotton farmers against excessive losses
- Expanding beyond Extra-Fine varieties
- Enabling private sector participation in cotton planting seed production and distribution
- Avoiding the accumulation of excessive carryover stocks
- Allowing farmers to plant as much cotton as they wish
- Testing the performance of all commercial varieties

Pricing more realistically LS and MLS varieties to allow them to compete in the Fine and Medium-High cotton categories, respectively. At present, prices for Egyptian LS and MLS varieties are set only a few cents lower than ELS varieties, but much higher than the prices of the better upland varieties, thus putting the Egyptian varieties out of competitive range.

Finding out the true market value of Egyptian varieties. Current prices, administratively set, generate unwanted carryover stocks. Whenever a variety has an unwarranted carryover stock at the end of the season, it has been overpriced.

Bringing consumption in line with the rest of world. Egyptian consumers cannot afford to continue using expensive Extra-Fine Egyptian cotton to produce ordinary fabrics for their everyday needs. For most ordinary uses, yarns made of Egyptian cotton are too expensive to compete with imported yarns made of cheaper upland cotton. Smuggling of imported fabrics and the bankruptcy of the state-owned spinning industry are the obvious results of forcing the local market to consume only Egyptian cotton.

Using floor prices to protect cotton farmers against excessive losses. In years of exceptionally low world market prices, Government can protect farmers supporting a floor price, but without distorting the cotton trading system or removing market signals from affecting farmers' decisions. A fixed flat deficiency payment that does not distort farmers decision on which variety to choose is preferable to multiple floor prices favoring some varieties over others.

Expanding beyond Extra-Fine varieties. To be able to compete in the larger world market for superior cotton Egypt cannot confine itself to the Extra-Fine cotton category. Varieties such as Giza 85 and Giza 89 could capture a suitable share of the Fine category exports of 680,000 tons/year worldwide, by offering them at suitable prices in order to offer better and more competitive products than any other offered in this Fine type group.

Enabling private sector participation in seed production and distribution. Supplying seed to cotton farmers does not have to be a state monopoly. Private competition in promoting alternative varieties would encourage a more market oriented variety composition than it is currently.

Avoiding the accumulation of excessive carryover stocks. When carryover stocks are concentrated in a few varieties, their presence distorts subsequent decisions of cotton authorities about which varieties to produce. Cotton authorities cannot differentiate when a large carryover is evidence of loss of marketability of a variety of simply the result of assigning it too high a price.

Allowing farmers to plant as much cotton as they wish. At present cotton authorities impose limits on the area planted to each variety both by assigning districts to that variety and by distributing seed only in proportion to official planting estimates for that district or village. Farmers can plant less than the target area, but not more.

Testing the performance of all commercial varieties. in all cotton producing areas. Current performance testing data leaves many gaps because some varieties are tested in some production areas but not in others. This makes meaningful comparisons difficult if not impossible. Farmers need to know how alternative varieties can perform in their districts. For most districts relative performance data only exists for one or two varieties. For example, farmers producing Giza 85 at present might want to know how well Giza 83 or Giza 89 perform in their districts. They can't because such tests have not been done.

Area Two: Marketing of Seed Cotton

> ***Mission Statement: Farmers can sell freely all the cotton they produce, in a competitive market to whoever offers them the best price and condition. Farmers benefit from deficiency payments, regardless of the chosen marketing channel, in exceptional years when market prices fall below guarantee floor prices.***

Egypt needs to encourage greater market participation by private sector traders and cooperatives in seed cotton marketing. It is also necessary to establish a stable competitive marketing framework ruled more by market forces than by administrative decision. In order to plan ahead, it is best that rules and regulations not change drastically and unpredictably from one year to the next. Private sector traders and cooperatives have demonstrated the capability and willingness to handle larger and larger shares of the market in recent years and might be able to handle the entire crop in a few more years. Direct Government intervention in cotton marketing through the state-owned trading companies is not longer essential, it constitutes a heavy burden to Government finances, and it distorts the overall performance of the seed cotton market.

This vision can be accomplished through:

- Making Deficiency Payments to Private Rings and Cooperatives
- Encouraging and enabling the establishment of private marketing rings
- Encouraging and enabling farmers' cotton marketing cooperatives

- Keeping price deficiency payments as an insurance mechanism
- Making the Optional Marketing System truly optional
- Eliminate monopoly of marketing crop reserved for planting seed
- Reducing number of public trading companies
- Withdrawing Government as Buyer of Last Resort
- Simplifying grading system to a few grades
- Increasing role of domestic traders association
- Encouraging bank financing to purchase the cotton crop

Making Price Deficiency Payments to Private Rings and Cooperatives. Insert clear statements in the Inter-ministerial Decree that sets the structure and regulations at the beginning of the cotton marketing season, that cotton purchased through private marketing rings is eligible to receive price deficiency payments on the same basis as cotton purchased through PBDAC rings. The Government of Egypt already agreed to implement this rule under one of the benchmarks for the release of Tranche V of the Agricultural Policy Reform Program (APRP). This rule was issued as a decision of the Cotton Marketing Supervisory Committee for the 2001/2002 season. It is preferable that language to this effect be incorporated as part of future Inter-Ministerial Decrees, to avoid ambiguity about the rights of farmers to sell to private rings.

Encouraging and enabling the establishment of private marketing rings. Private sector traders should be responsible for purchasing as much of the cotton crop as they can possibly manage. That way the Government reduces to a minimum its own obligations and potential blame for the fortunes of the cotton and textile sectors. Government does not really need to keep the public trading companies to maintain the floor prices. Public spinning companies could easily purchase cotton directly from farmers, private traders, or importers.

Encouraging and enabling farmers' cotton marketing cooperatives. Farmer cooperatives are already very active in cotton production, distributing seeds and inputs to farmers, and coordinating integrated pest management at the village level. In the past couple of years some farmer cooperatives have also served as market channels for farmers to sell their cotton at better prices and conditions than through official marketing rings. Cooperatives should be encouraged to become more involved in cotton marketing to enable farmers to negotiate better selling conditions with traders.

Keeping price deficiency payments as an insurance mechanism. Price subsidies are the chosen instrument to guarantee farmers a minimum floor price, not necessarily to guarantee them profits. Government would be wise not to set floor prices expectations too high or run the risk of massive costs when production is high and market prices are low. Moreover, the Government's commitment is to supplement the market price to reach the floor price, not necessarily to purchase the cotton at the floor price.

Making the Optional Marketing System truly optional. The Inter-Ministerial Decree sets the rules for the Optional Marketing System for Seed Cotton. However, in previous years the price subsidies (deficiency payments) were only paid on cotton purchased through PBDAC operated rings, meaning that farmers had the option of getting the price subsidy selling through official rings or not getting the subsidy at all. Under the new rules price subsidies are payable also on cotton sold through private rings. Thus the system now lives up to its name of "optional" for a farmer can choose the market channel most favorable to him or her without making a financial sacrifice.

Eliminate monopoly of marketing crop reserved for seed production: There is general consensus among cotton participants that the allocation in the past two seasons of 30 percent of the cotton crop to the Horticultural Services Unit (HSU) for the purpose of selecting planting seed for next year is unnecessarily excessive. Neither private nor public traders are allowed to set up collection rings in the areas allocated to HSU for planting seed purposes. Farmers in those areas are put at a disadvantaged for they often produced the best quality cotton for that variety but are unable to profit because HSU, the only authorized buyer in those districts, only pays official prices. In reality, many farmers and cooperatives find ways to evade the requirement and sell to private traders at better prices. A better solution would be to return to the earlier practice of allocating smaller areas for planting seed (7-10 percent for most varieties). In those areas the Central Authority for Seed Production -- CASP -- simply bought seed at selected ginning mills, after the seed cotton has been ginned, by offering premium prices for the selected seed. All other cotton seed was sterilized using heat treatment. CASP thus avoided having to engage in buying and trading of seed cotton, an activity in which it had neither expertise nor experience, nor the necessary financial resources. HSU is in a similar situation. Until last year it had had no prior experience in cotton trading, since its expertise is in fruits and vegetables.

Reducing number of public trading companies. The six public sector cotton trading companies are the legacy of a former era when the cotton crop was twice what it is today and the State was solely responsible for purchasing the entire crop and to dispose of it either for export or domestic consumption. Those conditions are no longer in effect. The spinning companies use now half the cotton of 10 years ago, the crop size is equally down, private traders and cooperatives now account for nearly half of seed cotton sales, private exporters now account for over 70 percent of exports and are now the dominant force in Alcotexa. The rationale for maintaining six public cotton trading companies is now questionable. These companies are now partially consolidated into the Holding Company for Cotton and Textiles and their autonomy is highly circumscribed. Their main functions nowadays are procurement of the raw material for their affiliated spinning companies and as buyers of last resort in cases when farmers find no private buyers willing to take their cotton. Spinning mills, however, are able to do their own procurement of cotton lint. The trading companies have become a financial burden to Government from their trading operations, and at the end of the season they are left with large unsold stocks of cotton that the Government has to accept at great loss.

Withdrawing Government as Buyer of Last Resort. Cotton authorities feel strongly that the Government's commitment to farmers of a floor price for their cotton requires that a state agency be ready to purchase cotton at such price. However, introduction of price deficiency payment means that Government discharges its obligation by paying the difference between the floor price and average market prices for cotton of that variety and grade. It is not necessary for Government to purchase the cotton directly. Farmers will always find a buyer willing to take the cotton at the appropriate market price. The need for public trading companies to act as buyers of last resort is therefore superfluous.

Simplifying grading system to a few grades. There are 80 different grades for seed cotton and another set of 80 grades for lint cotton. By contrast, American Pima only has six grades for lint cotton and none for seed cotton. Farmers in Egypt need CATGO to class seed cotton because farmers sell seed cotton while in the USA farmers retain ownership until after the cotton is ginned. Nevertheless, most graded seed cotton in Egypt fall within a narrow range of the grading scale. Most international experts agree that the number of grades is excessive, but few alternatives have been seriously considered.

Increasing role of domestic traders association. Greater voice and participation of the private domestic cotton traders' association would be desirable in drafting the cotton marketing inter-ministerial decree setting the overall marketing rules each season. Establishment and operation of private sector marketing rings should be encouraged by making them participants in defining the rules and in enforcing the code of ethics for their conduct.

Encouraging bank financing to purchase the cotton crop. Encourage banks to lend to private sector traders and cooperatives, using cotton as collateral for loans. Smallholder cotton growers want to be paid cash immediately for their production. This means that buyers must be able to obtain the necessarily large financial resources at the beginning of the marketing season. Even wealthy private traders might find difficult to provide sufficient collateral for banks to advance the required amounts. Public sector trading companies are able to secure loans from commercial state banks because the Ministry of Finance provides the Government's guarantees to back the loans. Despite annual losses, banks thus advance new loans to public trading companies. But banks should be able to use cotton itself as collateral, since cotton is a non-perishable commodity that retains its value when stored under proper conditions. Banks themselves might provide the bonded warehouses to store cotton bought with their loans until it is exported or sold domestically.

Area Three: Ginning of Seed Cotton

> **Mission Statement:** ***Ginning services are offered to cotton growers, cooperatives, trading and spinning companies on a competitive market basis. Competition among ginning mills leads to improvements in the quality of cotton lint produced and in lower costs for the service.***

This can be accomplished through

- ☐ Expanding the capacity to produce UDB bales in ginning mills
- ☐ Reducing the need for Farfara and repressing
- ☐ Complete the privatization of ginning companies
- ☐ Combating contamination with foreign fibers
- ☐ Improve cotton lint quality
- ☐ Expand the use HIV test of lint cotton
- ☐ Liberalizing the market for cottonseed

Expanding the capacity to produce UDB bales in ginning mills. This has been one of the more successful initiatives introduced in ginning and cotton marketing in Egypt in the past decade. Universal Density Bales (UDB) are accepted worldwide and they reduce marketing costs considerably. UDB bales make Egyptian cotton internationally compatible with most other bales used in the trade, and reduce costs because they do not require farfara and re-pressing before exporting.

Reducing the need for Farfara and repressing. Farfara is necessary to remove foreign matter when cotton lint is not sufficiently cleaned during the ginning process. Repressing is needed because many bale presses in old ginning mills are only capable to compressing to low-density bales. Farfara and repressing into high-density bales was mandatory until 1997, but with the introduction of UDB their need has waned, and their cost has come down from 17 c/lb to 10 c/lb in 2002.

Complete the privatization of ginning companies. Encourage competition among ginning mills to reduce ginning costs and improve cotton quality, and discontinue the current collusion agreements to fix ginning fees and terms. Government was very successful in privatizing several ginning companies three years ago, but nearly one half of the ginning capacity still remains in Government hands. Public sector trading and spinning companies are obliged to use those public ginning mills even tough .

Combating contamination with foreign fibers. Private ginning mills have pioneered the use of simple but effective processes to remove dirt and contamination from their cotton lint. Public sector mills remain behind in the control of contamination. But the struggle for contamination free cotton goes along the entire processing chain, starting with harvesting in the field until the cotton is baled and sealed.

Improve cotton lint quality. The ginning process can do much harm to quality of cotton fibers unless special care is dedicated to equipment renewal, maintenance, and calibration. Appropriate training of the work force employed in ginning is key condition for success.

Expand the use HIV test of lint cotton. CATGO has set its goal on testing every single bale coming out of ginning mills, not merely a few bales in every lot. CATGO needs encouragement and the resources to make this goal come true in the next couple of year. Make widely available such HVI test data through the Internet to potential buyers in-country and overseas.

Liberalizing the market for cottonseed. This means removing unnecessary restrictions on the sale and movement of cottonseed after it has been sterilized at the ginning mills. Farmers should be allowed to claim back and use their own cottonseed when they wish to use it for animal feeding, for example. Introduction of genetically modified varieties might require separate handling of the cotton seed if Government still considers that cooking oil from GM cotton poses a public health hazard. No evidence to that effect has been put forward, but precaution is perhaps advised.

Area Four: Marketing of Lint Cotton

> ***Mission Statement: Egyptian cotton traders are free and able to sell all their cotton in a competitive world market at freely negotiated prices or in the domestic market at their equivalent international prices.***

This vision can be achieved provided that we abide by the following precepts:

- All varieties/grades are exportable
- No bans or limits on exports
- No grade restrictions on cotton lint exports
- Review and revise pricing of cotton
- Allow for greater pricing flexibility
- Unsold stocks belong to trading companies
- Expand HVI testing and public dissemination of test data
- Introducing E-Trade in cotton
- Expand Market Information system
- Opening the marketing season for Egyptian cotton earlier in the year

All varieties/grades are exportable. Exports of Egyptian cotton are restricted at present in a number of ways. First, there are minimum export prices that prevent traders from exporting larger volumes at lower prices. Second, some varieties are designated as exportable while others are reserved for the domestic industry consumption. Third, minimum exportable grades are imposed and that prevents over half of the crop being exported. Fourth, outright bans on the export of certain varieties are imposed on certain years. Fifth, upper limits are placed on the volume of exports of certain varieties either by administrative decisions or informal instructions to trading companies. All these measures are designed to restrict export quantities and to ensure an abundant supply of raw material for the domestic spinning industry at below-market prices. All varieties and grades of Egyptian cotton are exportable. A good example of this: Exports to the United States of America consists entirely of the cheapest varieties: Giza 80, Giza 83, and Giza 85, and "type exportateur" that constitutes the cheapest possible form of Egyptian cotton for export.

No bans or limits on exports. The single factor that caused most damage to the cause of Egyptian cotton exports was the decision to ban exports of all long staple varieties in 1995. The decision was taken in response to a low production and high prices that year and to ensure a supply of cheap cotton for the state-owned spinning industry. It took several years for Egypt to recover from that blow to its image as a reputable and reliable supplier of long staple cotton. Outright bans are no longer imposed, but there is still the practice of setting informal limits on export volumes of long-staple varieties. As recently as last year exports of LS varieties were kept under 50,000 tons, even though at the end of the season it became evident that large carryover stocks of those varieties were looming ahead. Cotton authorities could make a explicit and public announcement that henceforth Egypt will not resort to arbitrary limits or bans on exports of any cotton variety.

No grade restrictions on cotton lint exports. Over half of the cotton harvest is kept out of the export market by imposing and enforcing a minimum exportable grade. The alleged rationale is to protect the good image of Egyptian cotton as a high quality product. Unfortunately the good image of Egyptian cotton has been soiled by the previous reputation for high levels of foreign matter and contamination with man-made fibers. American Pima exports even its lowest grades and waste to willing buyers, but with the full and clear understanding of what they are getting. The important matter is that there be no deception. Egypt exporting already "type exportateur" cotton, which is at the botton of commercial cotton quality. Cotton waste from the combing process is eagerly bought by private spinners to use in production of open end yarns.

Review and revise pricing of cotton. One of the main reason for the serious problems facing the Egyptian cotton and textile sectors is the price control system currently in place. Alcotexa is given the legal power to fix minimum export prices and to enforce them since any export requires contract approval by Alcotexa. No one can export Egyptian cotton unless he/she is a member of Alcotexa. Egypt currently contributes about one half of the Extra Long Staple cotton market, which enables Alcotexa to enforce its fixed prices. Unfortunately, high fixed prices reduce export sales and benefit Egypt's main competitors, American Pima growers. Alcotexa consistently tends to set prices too high, meaning prices at which demand is not sufficient to clear available supply. Lack of market clearing prices results in excess inventories at the end of the marketing season. These inventories accumulate in Government hands and they constitute a major financial burden and a threat to the prospects of Egyptian cotton in the future. Real harm is caused by Alcotexa fixing high export prices in terms of foregone exports, generating high carryover stocks, and making the spinning industry uncompetitive. These damages far outweigh the benefits of limiting competition among Egyptian exporters. It is now a good time to discontinue fixing export prices administratively. Alcotexa has many important roles to play to promote Egyptian cotton exports. Fixing prices is not one of them.

Allow for greater pricing flexibility. In principle, Alcotexa can adjust prices up or down on a weekly basis. The 1994 Law that specifies the functions of Alcotexa gives it legal authority to do that. In reality however, once opening season export prices are announced it becomes nearly impossible for Alcotexa's Managing Board to agree on reducing prices. The reasons are not obvious. First, opening prices are the basis for prices paid to farmers; if export prices are reduces traders would incur a loss. Second, foreign buyers are mainly merchant houses who buy Egyptian cotton for subsequent sale to spinners; Alcotexa members want to protect their foreign clients; if export prices were lowered those clients will make a loss. The end-result is that Alcotexa's announced prices cannot be lowered. Private exporters can of course offer discounts to their buyers. This is an open secret. Public sector trading companies are bound by Alcotexa's minimum prices because public officials cannot negotiate discounts without exposing themselves to potential accusations of corruption. The outcome is predictable: private exporters sell off their inventories while the public trading companies are left holding large stocks of unsold cotton. The inefficiencies of the price fixing system and its inflexibility are obvious, and are working to the detriment of the Egyptian cotton and textile sectors. Trading companies, private and public, should be free to sell at the best export prices they can negotiate.

Unsold stocks belong to trading companies. A private trader cannot afford to hold cotton stocks for long without incurring large financial losses. Public trading companies, however, can accept those financial losses because their loans from the banks are underwritten by the Government, and because at the end of the season they can transfer the cotton to the Government and be refunded what they paid farmers. Ownership of the carryover stocks is therefore vague: even though the public trading companies have physical control, those stocks really belong to "The Government." Once the new marketing season starts, selling of those old stocks is not a priority to the public trading companies. Carryover stocks thus accumulate year after year and no one feels responsible for its disposal. Public trading companies should remain accountable for all carryover stocks.

Expand HVI testing and public dissemination of test data. Great advances have been made by the CATGO (Cotton Arbitration and Testing

General Organization) in introducing widespread testing of cotton lint for every lot coming out of ginning mills. Eventually these data will become the basis for commercial transactions, because the better spinners around the world are using HVI data to determine the best combination of cottons with different properties needed to produce yarns with given specifications. HVI data could thus provide Egyptian cotton a major selling advantage by advertising its excellent spinning characteristics.

Introducing E-Trade in cotton. Electronic trading in commodities is becoming a reality worldwide. It is inevitable that as spinners get access to HVI information regarding cotton available in Egypt, they will like to negotiate directly with the exporters. CATGO is making early progress is making access to HVI data on Egyptian cotton available through the Internet. For transactions to occur, CATGO and Alcotexa need to coordinate their efforts. Pilot efforts at selling cotton through Internet online auctions could be tried with the existing carryover stocks.

Expand Market Information System. Alcotexa is already doing an excellent job in reporting all export commitments and shipments, and making their reports accessible through the Internet. CATGO has also made recent strides in making data on cotton classing and fiber properties by lot and varieties accessible through weekly hardcopy reports, and they are now developing a website for that purpose. Both these efforts in improving market information on cotton should be supported and encouraged. Similar data needs to be made available for production and exports of the spinning industry. The Textile Consolidation Fund collects such similar type of information from the industry but their data is not as easily accessible or timely.

Opening the marketing season for Egyptian cotton earlier in the year. If export prices were free, many farmers and cooperatives would probably negotiate sale contracts in March or April, when growers are planting and want firm commitments from potential buyers. The main roadblock against making early contracts is that Alcotexa does not announce opening season prices until September. However, if Alcotexa were no longer to be engaged in price fixing there would be no impediment to have forward contracts being registered several months in advance of harvest. Already most early contracts are registered with Alcotexa before exporters have actual cotton on hand.

Area Five: The Spinning Industry

Mission Statement: A profitable and private Egyptian spinning industry can export high quality yarns made of Egyptian cotton, and provide the domestic market with coarse and medium count yarns made of cotton and/or made-made fibers.

This Mission could be accomplished in the medium term by ensuring that the outcomes prescribed below are attained.

- □ Emergence of a two-tier cotton spinning industry
- □ Emergence of a modern viable textile industry
- □ Emergence of brand-name end-products using Egyptian Cotton Logo
- □ Availability of abundant supply of high quality low priced yarns and fabrics for the garment industry
- □ Install, support and participate in an Egyptian National Campaign to combat contamination
- □ Install, support, and participate in vocational training programs
- □ Install, support, and participate in the founding of service companies
- □ Seek partnership with world trade companies
- □ Support development programs for design and production of new products
- □ Make available low priced short staple cotton lint
- □ Privatization of the spinning industry
- □ Allow unimpeded access to low cost short staple lint

Emergence of two-tier cotton spinning industry. Tier One producing fine count yarns, and Tier Two producing medium and coarse count yarns

Fine count yarns

- □ Using 100 % cotton, ELS and LS Egyptian cotton varieties to produce combed single and twofold fine count yarns, mainly for export

- □ Targeting higher value added demand in gassed mercerized fine count yarns for high value products, mainly for export

- □ Attracting foreign spinners of Egyptian ELS and LS cottons to relocate their production facilities in Egypt

Medium and Coarse Count Yarns

- Using cheap short staple cotton lint to produce 100 % cotton or blended cotton/polyester medium and coarse carded single count yarns, mainly for domestic knitting and weaving industries

- Open-end spinning dominating production facilities for coarse counts reducing investment in space and machinery, and also reducing labor requirements and total cost of production

Emergence of modern viable textile industry. Encourage private investment and joint ventures in modern spinning plants managed in a business like fashion, supplying the ready-made garment industry and satisfying domestic and export demand. The cotton industry in Egypt can prosper in an environment where cotton breeders, researchers, growers and manufacturers act in complementary roles guided by free trade market oriented principles.

Emergence of brand-name end-products using the Egyptian Cotton Logo. These high-end products can be produced in Egypt in collaboration with world famous distributors with strong distribution channels and image (St. Michaels, Calvin Klein, Victoria's Secret, Liz Claiburn, etc.). Such brand-name products follow the same two-tier pattern for spinning:

- Fine light weight products like high quality twofold yarns, men's shirts and blouses, made from combed twofold fine count yarns spun from ELS and LS Egyptian cotton.

- Fine light weight underwear for men and women, made from combed two-fold fine count yarns, gassed mercerized, spun from ELS and LS Egyptian cotton.

- High quality 100% cotton men's socks made from combed twofold fine count yarns gassed mercerized, same as above.

- High count bed-sets made from single combed fine count yarns spun from ELS and LS Egyptian cotton.

- Coarse count high absorbency terry towel sets, made from single and twofold coarse count yarns spun from Egyptian cotton.

Availability of abundant supply of high quality low priced yarns and fabrics to the knitting and ready made garment industries in Egypt, as follows:

- Coarse and medium count, carded and combed, 100 % cotton and blended yarns at prices comparable to those available from the main world suppliers (India and Pakistan)

- Heavy and medium weight 100 % cotton and blended twills and denim at prices comparable to those available from the main world suppliers in the Far East.

- Light weight shirting material in 100 % cotton and blended poplins, yarn dyed ginghams and printed flannel sheeting at such varieties and prices comparable to those available from the Far East and Pakistan.

Install, support and participate in an Egyptian National Campaign to combat contamination of cotton lint and yarns with foreign colored and uncolored synthetic materials.

The campaign must cover the whole chain of:

- collecting the cotton crop from the fields
- ginning
- blow rooms in spinning mills (detecting devices and hand picking)
- winding machines in spinning mills (ultra modern yarn cleaners).

Install, support, and participate in vocational training programs for skilled laborers in the production and maintenance functions of all the manufacturing chain in spinning, weaving, knitting, dyeing, printing, and garment making (confection).

It is little appreciated that in spite of the apparent high unemployment in Egypt, there is real scarcity of trained labor for skilled and even semi-skilled jobs in the textile and garment making industries. The lack of serious, effective training facilities in Egypt leads to a combination of high turnover, high absenteeism, low capacity utilization, low productivity, low quality, and of course, high costs of production. Egypt, being a low wage country, does not translate itself into a low cost of production country.

Abundant supply of highly trained skilled labor in the textile and garment making industries in Egypt is the guarantor of reviving those industries and attracting new investment from domestic and foreign sources.

Install, support, and participate in the founding of service companies to undertake the maintenance of small and medium size factories in both textile (spinning, weaving, knitting, and processing) and apparel (garment making) industries. Quality of final products is increasingly dependent upon the good performance of new sophisticated machines equipped with pneumatic, hydraulic, electronic and even computerized controls. Those sophisticated equipment need the care of highly qualified and highly paid personnel. Small and medium sized companies cannot afford to have full-time service staff to perform those tasks. Last and not least, such highly qualified service personnel are not easily available and must be catered for in the training schemes outlined above.

Seek partnership with world trade companies to produce in Egypt and market globally textile and apparel products manufactured from Egyptian cotton using the trademark logo, including yarns, fabrics, towels, bed-sets, and garments.

Support development programs for design and production of new products using Egyptian cotton and active strong participation of brand-name Egyptian cotton products, in international specialized trade fairs (Frankfurt, Milan, Paris, Las Vegas).

Make available low priced short staple cotton lint at same prices available in the world market, as indicated by Cotton Outlook A Index and B Index. It is obvious that such very low priced cotton lint is most welcome to be grown in Egypt. Every attempt to this end should be welcome and supported by textile industry in Egypt for the mutual benefit of cotton growing and manufacturers.

Privatization of the Spinning Industry. The underlying problem with the cotton and textile sectors is state-ownership of the large spinning and weaving industrial complexes. Their inherent management inefficiencies force Government to impose restrictions to protect them from competition, and those restrictions also cause enormous damage to consumers, to the rest of the sector, and to the economy at large. Given the political barriers to privatization of these industrial complexes and their steady decline, it may be best to let the public sector spinners gradually disappear while encouraging new private spinners to invest and expand.

Allow unimpeded access to low cost short staple lint. Spinners need access to lower cost short staple cotton to produce yarns and fabrics for the domestic market. For the Egyptian cotton spinning industry to survive it needs access to the cheaper short staple cotton, whether imported or produced domestically. Otherwise, spinners producing yarns made of polyester and other man-made fibers will surely take an ever larger share of the market.