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100% Rotten

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America's cotton subsidy program has morphed into a budget-busting mess so twisted it even sends taxpayer money to the French. Now it threatens to ignite a perilous trade war. Which leads us to a question for the U.S. Congress: Are you out of your cotton-pickin' minds?

By G. Pascal Zachary, **December 2005 Issue**

On Sept. 27, hundreds of America's top cotton growers gathered in the convention center in Visalia, Calif., in the heart of the San Joaquin Valley. They'd come for the annual meeting of Calcot, one of the largest cotton producer co-ops in the United States, and they were in a festive mood. They were winding up a record harvest; Calcot will sell $500 million worth of cotton this year, fully 10 percent of the U.S. crop. Inside the convention center, the farmers sat down at tables bedecked with candles shaped like cotton bales and floral centerpieces accented with fluffy bolls fresh from the fields. They ate steak and toasted the robust health of the American system of growing cotton.

For growers like these, old King Cotton is alive and well, a generous liege indeed. But for all the rest of us, the king is, with each passing year, more and more of a royal pain. American cotton production today is governed by a system of federal subsidies originally set up in the era of the Dust Bowl and the New Deal, then generously sweetened in the 1970s, 1980s, and as recently as 2002. In the old days, when cotton was still an important pillar of the national economy and the country was fighting out of the Great Depression, subsidies made some sense. But more than 70 years on, cotton farming has become almost entirely driven by an ever more surreal system of taxpayer payouts that mock any notion of free markets, entrepreneurial risk, or economic rationality.

The federal government now pays more than $2 billion a year to farmers and traders to produce cotton that the world, already awash in cotton, simply does not need. The Calcot co-op, for instance, got direct payments from American taxpayers of nearly $10 million last year and $114 million over the past decade; its farmer members collected sizable additional subsidies. Without subsidies, it would cost more for most U.S. growers to raise cotton than they could ever recoup by selling it. And yet grow it they do -- in ever-increasing quantities. Between subsidies and technological improvements like pesticide-resistant seeds, U.S. cotton production has increased by a third during the past five years, and this year's harvest is expected to equal last year's record of 11 billion pounds. That means a bumper crop of subsidies as well. From 2001 through 2004, farmers got nearly $10 billion in direct payments from the U.S. government. By a broader measurement of subsidies used by the World Trade Organization, American cotton growers got $4 billion in 2004 alone and are expected to collect roughly the same amount this year.

The cascade of money leads to an unending series of perverse incentives and damaging outcomes, at least to the wider world beyond U.S. cotton farmers and traders: As the subsidies stimulate higher production, global prices are further depressed, dealing punishing blows to cotton farmers in poor countries, particularly in Africa. Nor is the program done much credit by who gets the money. It's not generally the stalwart family farmer, although there are some subsidy recipients who still might fit that mythic American mold. Mostly it is large corporate agricultural operations. Some are indeed owned by families -- including many millionaires and even a billionaire or two, like members of the Boswell family,

1793	**American inventor Eli Whitney creates the first cotton gin, automating the separation of cottonseed from the**

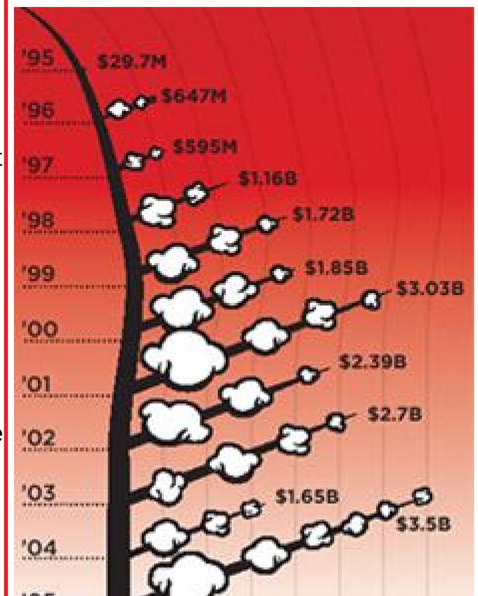
which runs one of the nation's largest farming enterprises and has received tens of millions of dollars in cotton subsidies over the decades. Other subsidies go to a handful of powerful international trading firms that market U.S. cotton. Cargill, the Minneapolis-based agribusiness giant that's one of the richest privately owned companies in the country, received $155 million in government payments during the past decade for trading U.S. cotton abroad. Subsidies aren't even limited to American companies: Louis Dreyfus Co., the global commodities trading power based in France, got $34.6 million in U.S. subsidies last year alone. "Cotton subsidies," says economist Pietra Rivoli, a professor at Georgetown University, "are way too high, unfair, and embarrassingly hypocritical in a country that's the world's self-proclaimed free trade champion."

Such ire is directed at the cotton program because it is increasingly seen as more destructive than the many other subsidy regimes embedded in the U.S. economy. Cotton isn't a food staple, and its subsidies can't be defended as a form of national food insurance, as many argue of payments to producers of wheat, corn, and milk. Cotton subsidies are also narrowly targeted; roughly three-quarters of the money goes to 10 percent of the growers -- about 2,500 enterprises. Even as industrial policy, cotton subsidies are problematic: When the government helps automakers or the steel industry through tariffs and other mechanisms, it doesn't then turn around and cover the losses of individual companies. But for cotton, the government imposes crippling duties on foreign growers -- and in addition covers any losses U.S. farmers sustain. That's not industrial policy, "that's corporate welfare," says Ann Tutwiler, head of the International Food and Agricultural Trade Policy Council, a pro-business advocacy group whose members include tech and manufacturing interests. Cotton interests mount many defenses. They point out that other countries subsidize their growers too and say the program creates American jobs. They warn of dire consequences if the United States had to buy its cotton from, say, China, where production is surging. They note that subsidies have come under attack many times before and have always survived. Indeed, the charges against cotton today may sound to some like a familiar lament; even Congress on occasion has tried to rein in the program, though reform never seems to take.

But what's different now -- and largely unnoticed -- is that there are alternatives. A small band of innovative growers are beginning to ponder life without subsidies, focusing on new methods, other crops, and even organic cotton, for which there is increasing demand and strong pricing. That may prove farsighted, because there is another development in cotton that has escaped wide notice -- and that makes the subsidy system a threat to a far broader spectrum of the public than ever before. The World Trade Organization, in a case brought by Brazil, has ruled that part of the U.S. cotton subsidy program is illegal. Congress was supposed to cancel that part of the program by July 1. It hasn't. The impasse threatens to explode at a crucial round of global trade talks in December, but more threatening is this: Under WTO rules, Brazil can begin to impose duties of as much as $1 billion on American products of its choosing at any juncture. The Brazilians are eyeing things like computers, software, and heavy machinery. If and when those duties are imposed, it won't be just critics of government waste that will be alarmed over the cotton program. It'll be Caterpillar, Intel, Microsoft, and scores of other companies that, generally speaking, don't get a dime of direct subsidies and are far bigger players in the U.S. economy. It'll also be their customers, and anyone who believes good global trading relations and free markets are important to world -- and, more pointedly, American -- prosperity.

CASH CROP

Direct payments to cotton growers have exploded in the past decade.



Cotton has had a fraught history in this country. Massachusetts inventor Eli Whitney's cotton gin, patented in 1793, set off an epic surge in U.S. cotton production -- and the slave trade. By the mid-1800s, cotton was by far America's biggest cash crop, and the plantation system that supported it

	fiber and paving the way for industrial-scale cotton production in the United States.
1840	**The United States produces about half of the world's cotton.**
1894	**The boll weevil begins ravaging U.S. cotton crops.**
1914	**The Department of Agriculture forms its Extension Service to attack the boll weevil scourge with federal funds and manpower.**
1933-1940	**As the Great Depression savages U.S. agriculture, Congress enacts laws setting up the precursors to today's cotton subsidies.**
1950	**The tractor-mounted cotton stripper becomes widespread, fully automating the harvest and leading to massive efficiency boosts.**
1984	**China's production soars as the government lifts the price it pays its growers; today China remains the world's top producer and consumer of cotton.**
1996	**Worried about the costs of the cotton program, Congress restricts price supports; when growers suffer, Congress sends them huge sums of emergency cash.**
2002	**Congress passes the most recent farm bill, which increases base**

Sources: Environmental Working Group; Office of Management and Budget; U.S. Department of Agriculture

program expenditures by 80 percent.

2005 **Siding with Brazil, the WTO in March rules that some U.S. cotton subsidies are illegal, giving Brazil the right to impose tariffs on American goods.**

was about to become a chief cause of the Civil War. In 1860, cotton accounted for half the value of U.S. exports; today the figure is well below 1 percent. Cotton generates only about $5 billion in revenues each year, even with subsidies at times equivalent to upwards of 80 percent of that amount.

The initial Depression-era cotton program has been loopholed, recast, and, especially since the late 1990s, sweetened into a byzantine but generous trough. Basically, growers are supported from preplanting through harvest, making cotton essentially a risk-free venture. A direct payment based on a farmer's historical acreage goes to every cotton grower every year before an acre is planted, even if the farmer isn't going to raise cotton that year. (The payment is sometimes used to fund a different, more valuable crop.) A second payment kicks in at planting time. Then a grower can borrow against the crop, using the newly sown cotton as collateral. But the loan is no normal loan. If the price of cotton falls below 52 cents per pound on world markets, the government -- not the farmer -- takes any loss on the loan. And there's a third payment, from a so-called countercyclical program. If prices fall below 65 cents per pound, the grower gets a payment from the government of roughly 13 cents per pound. With cotton trading in the 50s, countercyclical payments are triggered all the time. Another element of the program, called Step 2, pays trading firms to market U.S. cotton.

Most of the subsidies go to farmers. But it's not easy sorting out which ones, and subsidy recipients are rarely identified publicly. The U.S. Department of Agriculture's tracking system for the payments is difficult to decipher, and many farmers have mastered the art of subdividing their operations under numerous different names, partnerships, and ownership structures to skirt payment limitations. (In cotton country, that's called "harvesting the program.") Farmers are disinclined to say much about the program. They seem to have taken to heart an old adage of J.G. Boswell, the patriarch of the cotton-growing Boswell family: "As long as the whale never surfaces, it is never harpooned," he liked to say. The family and related interests today own more than 140,000 acres in the San Joaquin Valley and elsewhere; they're one of the biggest cotton growers in the United States. Boswell, who came to the area in 1921, always kept a low profile. Current leaders of the family, whose net worth is in the billions, have occasionally surfaced long enough to say they're opposed to subsidies. But they've accepted some nonetheless: Federal data compiled by the Environmental Working Group, a Washington-based advocacy group, shows that between 2000 and 2003, J.G. Boswell Co. got $16.8 million for cotton.

The Boswell turf, radiating outward from the little town of Corcoran, Calif., is prime ground for some of the other large recipients of subsidies. Dublin Farms received $9.2 million for cotton in the 10 years ending in 2004, Agriculture Department data shows. Dublin Farms is owned in equal measures by 17 partnerships, each bearing the name of an Irish county or city. The major entity behind Dublin Farms is the McCarthy family, long-standing local ag players. Hansen Ranches, also based near Corcoran, raked in $8.8 million for cotton between 1995 and 2004. Boswell and Dublin Farms officials declined to comment on their subsidies. James Hansen, head of Hansen Ranches, initially agreed to an interview but changed his mind after consulting with his sons. "There's no win for us in talking about this," he said.

In other cotton centers, the story is much the same. Perthshire Farms, based in Gunnison, Miss., received $10.2 million in the 10 years ending in 2004. Perthshire is a 10,000-acre spread in the Mississippi Delta run by four Hood brothers, the eldest of whom, Kenneth, is a former head of the National Cotton Council, the industry's powerful lobbying group. Perthshire lists 14 total owners. Another large Mississippi recipient, Due West, received $12 million during the same period. It's run by the Sturdivants, who've been growing cotton for generations. Mike Sr., the family patriarch, ran unsuccessfully for governor in the 1980s; his son Mike Jr. was on the board of the Federal Reserve Bank of St. Louis. Ritchey Bayou Farms, of Greenville, Miss., received $7.3 million. Ritchey consists of 16 partnerships, each with an equal stake. Perthshire, Due West, and Ritchey officials all declined to comment.

The part of the cotton program that pays subsidies to cotton traders is to some economists even more difficult to defend -- indeed, its subsidies are the ones ruled illegal by the WTO. The case of Allenberg Cotton of Cordova, Tenn., is particularly galling. Allenberg is owned by Paris-based Louis Dreyfus, which has operations in 53 countries. Beyond the $34.6 million it got last year, Allenberg has received $151.5 million in additional subsidies since 1995, simply for trading American cotton. On its website, Louis Dreyfus describes Allenberg as "one of the world's leading cotton companies" and says it moved 1.7 billion pounds of cotton in 2004, worth an estimated $850 million. That means Allenberg's subsidy from the U.S. government approaches 5 percent of its total turnover -- and a much larger portion of its profits on cotton trading. Allenberg's president, Tommie Malone, declined to talk about subsidies, saying he's been misquoted on the situation in the past: "I now have a firm rule: No comment."

There are countless other oddities in the cotton program. For instance, even large American consumers of homegrown cotton get a subsidy simply for buying the product. Parkdale America, a privately owned maker of yarn, received $135 million in Step 2 payments for the 10 years ending in 2004. Parkdale, which is majority-owned by Parkdale Mills, a privately owned North Carolina company, declined to comment. The company has 36 yarn-spinning plants in the United States, likely making it America's largest producer of textiles and one of the few that haven't succumbed to foreign competition. Economists point out that Parkdale could probably import foreign cotton cheaply enough that it might not need the subsidy, just as Apple Computer (AAPL) buys foreign-made memory chips and is none the worse for it. Parkdale could, that is, if the government did not impose steep tariffs on cheap foreign cotton that effectively bars it from the U.S. market.

The cotton program's web of production and marketing subsidies has succeeded at making America by far the world's biggest cotton exporter. American cotton has made up roughly half of the cotton traded across borders for many years. But the market distortions the program creates are severe and damaging. Terry Townsend, a leading cotton analyst, says dumping U.S. subsidies would instantly raise world prices by as much as 10 cents a pound and cut U.S. production by at least 15 percent. The effect would be particularly beneficial in places that desperately need economic help, notably West African countries like Burkina Faso that are significant exporters but can't make money at today's prices and whose governments are far too poor to provide any subsidies. The environment, too, would catch a break from reduced production; growing cotton can be tough on the planet, especially now that genetically modified seeds encourage U.S. growers to soak their fields in a defoliant that kills everything from bugs to the cotton bush itself and knocks the unharmed bolls to the ground, where they can be scooped up by mechanical harvesters. All in all, U.S. subsidies are "too harmful," says John Baffes, the World Bank's top cotton expert. "They need to be reduced."

Much of the rest of the world would agree. Indeed, the U.S. cotton program has become a focal point of broad disputes between the United States and many of its trading partners over subsidies and tariffs. During the last round of major global trade talks in Cancún in 2003, negotiations collapsed because of disagreements over cotton. Many experts fear that the same thing will happen in Hong Kong when trade ministers from the WTO's 148 member countries gather in mid-December. This kind of trade wonkery tends to glaze the eyeballs, but it's serious stuff: If the talks collapse again, it may doom hopes of reducing economically damaging subsidies and tariffs throughout the world.

The negotiations and competing agendas are incredibly complex, but in general, the U.S. position has been that it's willing to cut subsidies if others do so at the same time. There's logic there: Some countries and trading blocs -- Japan and the European Union, for instance -- have far bigger farm subsidies than even America does and have been equally resistant to giving them up. But the U.S. stance is undermined by American refusal to comply with the WTO ruling that elements of the U.S. program are illegal and must be scrapped. Brazil, where production costs are half what American growers spend, brought the case in 2002, as part of a concerted effort by that country to challenge U.S. dominance of the cotton market. U.S. trade officials say they intend to drop the program but are waiting for Congress to act. The Brazilians want immediate action. "It's completely illegal," says Brazilian trade adviser Pedro Camargo Neto. "If there are costs to ending it, the U.S. can bear them. It's a rich country."

It's unclear how the impasse will play out, but there is a real chance that a new kind of trade war will be ignited by any American refusal to reduce cotton subsidies. "If the trade negotiations in Hong Kong crater, you can expect Brazil and other countries to make claims at the WTO against other parts of the cotton program and other U.S. farm subsidies," says Brink Lindsey, a trade analyst at the Cato Institute. The nightmare scenario, Lindsey and others say, is a trade melee in which other countries' attacks against broader U.S. subsidies gain them the right to impose their own penalties on all sorts of American exports -- and possibly trigger U.S. retaliation. "The random collateral damage to nonfarm actors in our economy will be immense when other countries harmed by our cotton subsidies win their cases," Lindsey says.

All the wrangling over cotton subsidies raises a simple question: What would happen to the U.S. cotton industry if America killed off the protections growers have for so long enjoyed? Without subsidies, the cotton business would operate at an estimated loss of $1 billion a year. Cotton growers would go through the same kind of painful contraction suffered by other U.S. industries, from cars to textiles to steel, forced to face more Darwinian economic conditions. But many growers, in theory at least, could adapt: They would still have their land and, in many cases, could grow other crops, ideally ones for which there are higher prices and authentic demand -- fruits, vegetables, and nuts, for instance.

In fact, some growers are already preparing for a postsubsidy era. Steve Wilbur, a Tulare County, Calif., farmer and the recipient of $600,000 in subsidies from 2001 to 2004, is already shifting hundreds of acres into pistachios, a crop without subsidies and with real profit margins. Other growers are repurposing land to grow apricots, asparagus, and other unsubsidized fruits and vegetables. "Farmers are going to have to learn to diversify, to be nimble," Wilbur says.

Halfway across the country in the West Texas cotton belt, Jimmy Wedel isn't pondering the end of the cotton industry as much as he's helping to pioneer a new one. On a recent morning, he stands in one of his fields near Muleshoe with a slight Japanese woman named Chieko Watanabe. She has built a small clothing empire in Japan marketing baby clothes, maternity outfits, and skin-care products that use organic cotton. Wedel is one of her major suppliers.

Wedel is part of a small community of organic growers in the area, about 20 families strong. Their output is dwarfed by the production of the thousands of other Texas farmers who grow traditional cotton. But Wedel is convinced that organic is cotton's future. Even without pesticides, he's gotten his yields up to about 90 percent of what traditional growers get, and he commands 50 percent higher prices than they do. He's able to sell his crop well in advance. He still receives subsidies, but he believes that with organic cotton he can survive if they go away.

Watanabe rolls some of the organic bolls between her fingers. “Long fiber,” she says. Wedel says he wishes he had more acreage. “You know we’d buy more from you if you did,” Watanabe says. Wedel also sells to Sweden’s Dibb International, one of the largest textile businesses in northern Europe. Dibb uses organic cotton for popular towels and sheets and likewise wants all the organic cotton it can find. A few miles away, organic grower Terry Pepper’s fields recently played host to Fruit of the Loom and Wal-Mart, which Pepper pitched on the virtues of organic cotton. “I’d love to be able to say someday that we’re totally market driven,” he says. In New Mexico, other growers are planting pima cotton, a long-fiber variety that’s in high demand. Pima prices are at record levels -- double traditional cotton prices. Pima isn’t subsidized. “But we can make a profit without subsidies,” says Las Cruces, N.M., grower Jim Hill.

Other innovators are exploring cotton biotech and are close to producing varieties that could be waterproof, that never wrinkle, that even kill pathogens -- perfect, say, for hospital uniforms and bandages. Subsidies? “Cotton growers are going to have to get over them,” says Brent Crossland, global marketing manager for the agribusiness unit of Germany’s Bayer.

Which invites another question, not so simple: When might cotton subsidies fade? The current system has powerful defenders, including the National Cotton Council, one of the country’s oldest and most effective lobbying groups, and many friends in Congress. And for every forward-thinking grower, there are many more cotton farmers who can’t bring themselves even to contemplate a postsubsidy world. Hundreds of them gathered on a recent morning in an auditorium at Texas Tech University in Lubbock, cotton’s top research university.

The farmers have come from across the country to give Secretary of Agriculture Mike Johanns, a former Nebraska farmer himself, input about the next iteration of the cotton program, due out in 2007. It’s standing room only, and the event is being broadcast on live radio statewide. Three local congressmen share the stage with Johanns.

Johanns leads the farmers in the pledge of allegiance. A military honor guard marches in, bearing colors, and a student sings the national anthem. Soon farmers line up before a lectern to speak to the secretary. Many emphasize that the cotton program is vital to national security. “In view of terrorist activity,” one farmer advises, America must not rely on foreign cotton. Other dark warnings follow about China’s surging production, Brazil’s potential as a cotton exporter, and the damage cutting subsidies would do to farm communities and the American way of life in general. Secretary Johanns nods. The congressmen nod. The other farmers in the hall nod.

At that moment, it seems that King Cotton may have a while yet to rule.

IN TALL COTTON

Top Subsidized Growers

RANK	RECIPIENT	LOCATION	PAYMENTS 1995-2004
1	Tyler Farms	Helena, AR	$24,297,994
2	J.G. Boswell	Corcoran, CA	$16,808,427
3	Due West	Glendora, MS	$12,163,162
4	Wolfsen Land & Cattle	Los Banos, TK	$11,265,515
5	Colorado River Indian Tribes Farm	Parker, AZ	$10,880,965

Top Subsidized Traders

RANK	RECIPIENT	LOCATION	PAYMENTS 1995-2004
1	Allenberg Cotton*	Cordova, TN	$186,054,814
2	Dunavant Enterprises	Fresno, CA &	$166,959,725

		Memphis, TN	
3	Cargill Cotton (a division of Cargill)	Cordova, TN	$154,915,538
4	Parkdale America	Gastonia, NC & Charlotte, NC	$135,421,863
5	Calcot	Bakersfield, CA	$113,591,332

***Owned by Paris-based Louis Dreyfus Co. Sources: Environmental Working Group; U.S. Department of Agriculture**

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