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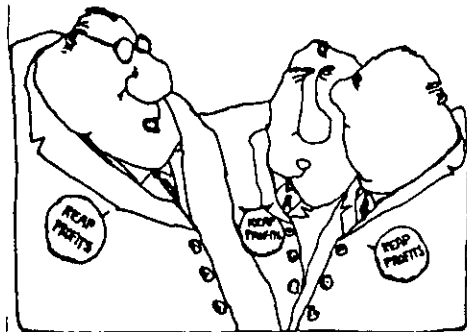
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THE LIBERALISATION OF THE AUSTRALIAN WOOL INDUSTRY

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The wool industry is currently experiencing extremely lean times, although it is mature, stable and arguably Australia's oldest export industry. Weak demand for wool during the last four years led to the accumulation of 4.6 million bales of wool (with an associated debt of \$2.5 billion) which helped deflate wool prices to less than half of those achieved during the 1980's. Accompanying this downturn was a process of liberalisation (or institutional de-centralisation) of many of the industry's key institutional structures. Important consequences of this process were the abandonment of both the Reserve Price Scheme (RPS) and the introduction of a scheduled release of the accumulated stockpile of wool. The two central controls - the nexus of the industry's centralised institutions - over the price of wool and the supply of wool were abandoned. This process of liberalisation not only further exacerbated growers' difficulties, but also kept reluctant wool buyers away from the uncertain Australian market. Despite the recent restoration of demand levels and the eventual achievement of institutional stability, the lot of growers has not improved, partly because of the drought which has permeated the great bulk of the Australian continent.

This article attempts to explain the inadequacies of the free-market policies which were imposed on the wool industry, and to place these changes in the context of the various forces which were driving the free-market push. The free-market approach was pushed during a period of crisis - during which time growers' hands were more or less tied - so as to relieve the Government of the responsibility of incurring any liabilities in the event of the industry going bankrupt. However, the initial free-

market push maintained its momentum with the further liberalisation which occurred following the Garnaut Report. The Garnaut Report effectively re-focused the industry's institutions away from the interests of the industry, and made them subordinate to the radical free-market agenda of the Government's trade policy.

Background

The reserve price scheme was introduced in 1970 to help protect farmers against 'potholes' in price levels [Vines, 1991: 15]¹. The price of wool in 1970 was 113.4 c/kg, some sixty percent of the price received four years earlier, and by far the lowest price since the end of the Second World War (ABARE, 1993: 41]. The scheme ensured a stable income for growers on which they could base their management decisions and reflected the adoption of a more centralised approach to the management of the industry. It was operated by the Australian Wool Corporation (AWC) - previously the Australian Wool Commission - but its policies were formulated by the Minister for Primary Industry (Vines, 1991: 15).

The centralised approach adopted with the introduction of the RPS involved the expansion of wool-related research and development, technology, commercial links, promotion and marketing. The centralised system is funded through the operation of a wool tax, which is a tax placed on all sales of wool. The tax is imposed by the federal government, and the revenue is passed on to the AWC and other wool-industry authorities.

Under the *Wool Marketing Act* of 1987 the AWC was handed responsibility for the management and day-to-day running of the wool industry, while the Government accepted a lesser role of broadly overseeing and directing the industry (ibid: 16). This move - which placed a great deal of control in the hands of the growers who dominated the AWC - was indicative of a 'managerialist thrust' that characterised

¹ Australian exports of wool represent 70% of the world's traded apparel wool. It is due to this dominance that the Australian market is a price-maker, and can operate a price-fixing scheme such as the RPS.

Labor Government policy during the 1980's. During this period, a series of government agencies were corporatised, and many primary-produce marketing boards were forced to adopt more free-market policies. This policy approach had the support of key industry groups such as the National Farmers Federation.

In a sense the greater managerial control exercised by the various marketing boards was a pay-off for the less centralised policies they were expected to pursue. In the wool industry, however, the power change created ambiguity both with respect to who was responsible for the RPS and the industry, and to the role and objectives of the RPS.

Wool prices had risen markedly since 1984/85, and in 1987 the AWC used its new powers to increase the reserve price by over 70% to a price of 870 c/kg (ibid: 18). Although below the record prices being achieved at the time, this price was far above previous levels and was an ambitious estimate of a long-term trend. The maintenance of a high reserve-price meant that the industry was being managed with a great deal of risk. When the wool market plunged into crisis, the risks taken by the AWC made the Government wary of the AWC's ability to administer the industry. The Government's fears were not merely for the industry, but also for the prospect that they were liable, as a lender-of-last-resort, for any debts incurred by the AWC.

The Wool Market Crisis

The wool market crisis arose from the massive imbalance between the supply and demand of wool which led to 4.6 million bales of wool being stockpiled in 1991 (ABARE, 1993). This imbalance was largely due to the high reserve-price policy of the AWC and the macro-economic factors which undermined the demand for wool.

Although the high reserve price and the AWC's commitment to it initially did little damage to the *demand* for wool, it sent a strong message to growers that returns to wool would be high, making it a

profitable agricultural investment². At the end of the 1987/88 financial year, central stocks in the industry had dwindled to only 9000 bales and wool was becoming scarce (AWC, 1991: 24). It now seems evident that the increase in supply - a medium-to long-term variable in agricultural production - was instigated primarily on the basis of short-term factors.

In conjunction with this increase in supply, the crisis was also caused by the withdrawal of the former Soviet Union and China from the international wool market. Both nations produce their own wool and import to make up for a partial, but significant, shortfall in supply. Between 1985 and 1989, these two importers purchased more than twenty percent of Australian wool exports (ABARE, 1993: 46). Their sudden withdrawal, between 1989 and 1991, exacerbated the downturn of the already fluctuating market and led to the creation of the massive stockpile and its associated debt.

It is important that this withdrawal of demand is understood. These 'ex-command' economies are qualitatively different from traditional markets. The importation of wool is determined not by consumer or manufacturer demand, but by central planning authorities. For example, in China the 'China Wool Group' regulates the importation of wool in light of its available foreign currency, which is subject to state controls over the distribution and use of foreign currency (ABARE, 1990). In other ex-command economies and developing economies (which are increasing their share of Australian wool exports) these macro-economic constraints also significantly influence the annual demand for wool. The demand from non-western economies has a tendency to be erratic and to be determined by forces which are essentially unrelated to the pricing policy for Australian wool. The relationship between the high reserve-price of wool and the decline in demand from non-western economies should not, therefore, be exaggerated.

In established western markets the demand for wool is also sensitive to macro-economic variables. Australian wool is retailed predominantly in the upper end of the apparel market - as a luxury item. As apparel is an

item which responds quickly to changes in disposable income, the luxury end of the wool market is extremely sensitive to the level of personal income growth. The demand for wool from developed markets is therefore also significantly influenced by external macro-economic factors which operate independently of the key variables of the Australian wool market.

The response of the Labor Government to the wool crisis was to draw on its powers over the RPS and reduce the reserve price to 700 c/kg. In doing so it overrode the AWC, which believed the industry was best served by maintaining the higher reserve price and riding out what was arguably only a temporary glut in demand. At the time of the crisis, both Hugh Beggs (chair of the AWC) and William Vines warned the Minister that, due to the nature of the buffer-stock scheme, dropping the reserve price would destroy all confidence in the wool market (Lander, 1990: 44; Austin, 1990: 41).

As predicted by those with knowledge of the wool industry, the reduction in the reserve price failed to alleviate the glut in demand and if anything diminished confidence in the market. The decision both reduced growers' revenue and increased speculation as to the future of the RPS.

It is pertinent that the decision to drop the reserve price to 700 c/kg was recommended by the Department of Primary Industry and Energy's (DPIE) think-tank, the Australian Bureau of Agricultural and Resource Economics (ABARE) (ABARE, 1990). That the analysis and recommendations provided by ABARE proved to be thoroughly inadequate is a good example of the limited utility of orthodox economic analysis. However, it was exactly this type of analysis and its emphasis on the role of price which later underscored the recommendations for the adoption of free market policies.

In addition to the failure of the lower price, the industry was left reeling by a sudden and abnormal decline in demand in January 1991. The rumoured, and probable, explanation for this decline is that William Vines (who was then currently commissioned to investigate the industry) canvassed with overseas wool manufacturers the idea of scrapping the RPS. If Vines gave any indication that the Government was considering

2 This message was exacerbated by the relative weaker performances of other agricultural commodities during this period.

the scrapping of the RPS, then this specifically explains the sudden and abnormal decline in the wool market. It seems likely that the Government was responsible for this decline in the wool market, but it was growers who suffered from the subsequent decline in revenues. Moreover, growers then had this decline used against them to argue that they could not satisfactorily manage their industry³.

The Vines Report - Establishing a Free Market

In September 1990, William Vines was commissioned to "... analyse changes which have taken place since the current arrangements were introduced in 1974 and to recommend to make the arrangements more effective." (Vines, 1991: 1]. The inquiry was to deal with four issues:

- the mechanisms by which the reserve price was set;
- the role of stock holding;
- arrangements for wool processing in Australia;
- the role of the International Wool Secretariat (IWS) (ibid: 3).

Although only the first two issues proved to be relevant to policy, the Committee's failure to address the last two issues as integral aspects of making the industry's "arrangements more effective" illustrates the myopic nature of the conceptual framework presumed by the Committee.

The report advocated:

3 The mention of this scenario is important as it is neither suggested nor considered in any of the orthodox literature concerning the wool crisis. The scenario provides a good illustration of how an orthodox analysis, which does not consider real-world factors such as market confidence and the role of the state, can block out and ignore the implications of Vines' irresponsible talks with wool buyers. Given that the wool industry and its problems were constantly depicted in terms of only orthodox market factors, it is of little surprise that the solutions suggested for the industry were couched largely, and blindly, in terms of free-market ideology.

- splitting the AWC into four separate institutions - Auswool, Australian Wool Realisation Commission (AWRC), Wool Research and Development Corporation (WRDC), and the Australian Wool Industry Council (AWIC);
- changing the manner by which board members were appointed to these institutions;
- the adoption of a price-triggered release policy for the sale of wool from the stockpile;
- a one-year freeze on sales of wool from the stockpile;
- minor changes to be made in the conduct of the IWS.

The freeze on sales from the stockpile was never implemented, and all of the other recommendations were reversed after the Garnaut Report. Significantly, the post-Garnaut reversal of the decision to separate the functions of the AWC indicates that either the Government had a political motive for the initial disbanding of institutions, or that the Vines Committee did not have a sound understanding of the institutional requirements of the industry.

The most critical recommendation of the report was to abandon the RPS and rescind the legislation which allowed such schemes to operate within the wool industry (Vines, 1991: 21). Despite the fact that the RPS had been beneficial to growers since its inception in 1974, the committee concluded that it could no longer be operated as the scheme had lost the confidence of all sectors of the industry (ibid: 20).

This mistrust of the AWC's ability stemmed primarily from the decision in 1987 to allow the AWC to increase the reserve price of wool to a price of 870c/kg. However, a lack of confidence in the AWC also seems to have existed for a variety of less important reasons (Todhunter, 1991). Given the crisis which the AWC's high pricing policies had generated, according to the report, the AWC could not be trusted to once again administer a mere 'pothole' RPS. This point was of great importance to the government, as it feared that in the event of an AWC collapse it would be held responsible for the bail-out.

The purported primary benefit of the move to a free market was that market signals would be better transmitted from buyers to growers. The

free marketeers argued that the imbalance between supply and demand which purportedly underscored the wool crisis was ample evidence that the signals were being significantly distorted to the detriment of the industry. Freer prices would make supply and demand more responsive to the variations which effected the market. The free market - in which futures and other risk-hedging facilities were available to industry participants - would also allow growers and buyers certainty about the current and future state of the market.

The Response to Free Market Signals

The free market did indeed provide the clear transmission of market signals. However, it should not have been assumed that these signals were either reliable or that the industry's response to them would be effective.

Under the free market and the influence of free prices the total output for wool in 1991/92 was 875 kt (ABARE, 1993). Although this represents a 200 kt fall in production, this decline was still short of industry targets (see below). The ineffectiveness of lower prices to reduce supply should have come as no great surprise to the analysts who proposed the free market. Most estimates of the elasticity of the supply of wool (for the industry as a whole) are below 0.30 (Fisher and Wall, 1990: 63). The supply of wool is very price-inelastic.

Prior to the abandonment of the RPS, the AWC had initiated its own crisis-aversion measures. Although the high reserve price was responsible for the significant supply growth, the AWC was legislatively hampered in its management of the industry. The *Wool Marketing Act* of 1987 gave the AWC greater freedom in setting the RPS, but it did not give the AWC the power to regulate the supply of wool coming on to the market (Weekes, 1993: 25). This imbalance of authority meant that it was not until late 1990 that the AWC was able to implement stock reduction systems and wool quotas. Eighty thousand applications for wool quotas - which were to reduce production to 750 kt for the 1991/92 season - were processed by the AWC. A stock reduction program had also successfully disposed of 10.5 million sheep (AWC, 1992: 18).

However both of these programs were terminated with the RPS in 1991 and their effectiveness (or lack thereof) was never determined.

Had the wool quotas operated successfully, the wool clip would have been 125 kt less than the clip under the free-market. Although the centralised manipulation of supply signals may have proven arduous, the new reliance on market signals failed to trigger a response sufficient to reduce supply in the short-to-medium term.

Likewise, the response of demand to free-market signals did not prove sufficient to restore an air of confidence and credibility to the market. Although initially encouraging⁴, the demand-response to deregulation was soon dissipated, implying that the initial increase in demand was due to an ephemeral recovery in market-confidence and catch-up purchases which followed a year of instability. The price of wool - which had initially dropped to 428c/kg - remained weak and fell to a low of 381c/kg in April 1993 (Garnaut, 1993). When selling the merits of the free market in Parliament, the Government asserted that the price of wool would rise to 665c/kg within twelve months (Hansard, 1992). Clearly, unfettered market signals could not influence purchasing decisions to the extent that free-marketeters believed. The response of the wool-buyers to the abandonment of the RPS suggests that the demand for wool is dominated not by price, but by exogenous factors whose determination is largely independent of wool-price levels.

What is the Role of Price?

The failure of market signals to transmit reliable and effective messages within the industry illustrates the cornerstone of orthodox economics' inadequate understanding of the wool industry. In the orthodox model the role of price is assumed to be primary. Any scheme, such as the RPS, which distorts prices, despite any role it may play in smoothing short-

4 Revenue from the wool clip increased from \$3 billion in 1990/91 to \$3.7 billion in 1991/92. The \$3 billion received in 1990/91, however, was only half that received in 1988/90 and was uncharacteristically low due to the extreme uncertainty of the market.

term market fluctuations, creates fundamental market imbalances and must be to the detriment of the industry. This view sees price as the variable which drives the industry, and depicts institutional and macro-economic factors as playing a secondary role. In fact, the roles are reversed.

The role of macro-economic factors in determining the demand for wool was outlined above with respect to the wool crisis. Although macro-economic factors are of diminishing importance in the long-term, their influence is such that they may have a significant influence on demand which can not be tempered by price levels. This is especially the case with the macro-economic factors which determine demand from 'ex-command' and developing economies.

Relevant in both the short and long terms is the institutional structure of the international textile industry. This institutional structure is determined by the nature of the garment-making process, the ability and willingness of participants to stock wool, the availability of processing facilities, the marketability of wool, and the physical variability of wool production.

It is important to understand the position of wool in the manufacturing process. Manufacturers' decision to buy wool is derived not so much from the price of wool, but from the perceived final demand for woollen articles. The commodity (greasy) wool contributes only ten percent to the final value of woollen fabric, and less again to the value of woollen clothing (Wool Processing Task Force, 1992). When woollen garments are in demand, manufacturers and processors may hold large stocks of wool regardless of its price. Alternatively, if demand for woollen garments is weak, manufacturers will use their (limited) cash flow to purchase more fashionable fibres, and allow wool growers to store any excess wool which has been produced (Vines, 1991: 7). Although this type of institutional phenomenon is not to be found in orthodox economic texts, it is a major source of the volatility experienced in the market for wool.

In the long-term, wool's market share will be governed primarily by its ability to integrate into the international textile industry. To achieve this end the wool-growing industry must not only establish relationships with

wool garment manufacturers and undertake marketing campaigns, but it must meet manufacturers' technical requirements and provide adequate storage facilities to supply a reliable and stable commodity. It is for these specific reasons that US manufacturers have not purchased Australian wool and that wool is significantly under-represented in this important market (Weekes, 1993). Addressing these factors, and not the level of prices, will determine the long-term demand for wool.

The assertion that macro-economic and institutional factors (rather than price) drive the demand for wool is supported by the fact that all major purchases of the RPS had previously been re-sold at a profit (AWC 1991). Moreover, the post-RPS plummeting of wool prices failed to change the fundamental character of the market. The underlying strength of demand was re-established only after the loosening of Chinese monetary policy and a turnaround in the outlook of economic growth in Europe and Japan. The free-market pricing policy was therefore ill-conceived. The short-term response was both costly and ineffective, and the long-term benefits are probably either negligible or non-existent.

Providing a Stable Market for Wool

Just as the orthodox approach did not understand the role of price in the wool industry, so too did it fail to understand the nature and sources of risk. Both the Vines Report and the Garnaut Report (and most of the orthodox literature in general) argued that, after abandoning the RPS, risk-hedging and insurance facilities provided by risk-bearing entrepreneurs would stabilise the market. This argument is flawed.

Indeed, the current orthodoxy ignores not only conditions in the industries in which it is guiding policy; it also seems ignorant of the factors which underscore the success of markets in other industries. Markets function well only within institutions and industry structures which allow them to work. If this process of equipping an industry to weather the storms of free-market capitalism has not occurred, then an industry will not automatically float.

Orthodox economists assume that entrepreneurial risk bearers are the universal medium through which market stability is provided. However,

market stability is not achieved through risk-bearing entrepreneurship, which does not address the forces of market volatility. Rather, market stability is achieved by the gaining and utilising of market power. Market power allows corporations to undertake marketing, promotional, and risk hedging activities whose external benefits will accrue to themselves rather than to other capitalists. In this way, the oligopolistic structure of the market is an integral part of its reliability. A consequence of this argument is that it is impossible to have both a free market (which requires no oligopoly) and a reliable market (which requires the influence of oligopolistic structures).

The centralised system of the Australian wool industry played a vital role in simulating such an oligopolistic market structure. The centralised system allowed a large and diverse number of growers to participate in the industry without jettisoning the benefits of horizontal and vertical integration which are derived from oligopolistic market structures. Growers have been able to manage production confidently, based on the provision of stable prices, while extensive commodity promotion, research and development and marketing has guaranteed market share in a dynamic, internationally-focussed industry. Without the centralised system there is limited scope for such collective action which ensures market stability and the maintenance of other 'external' benefits.

Indeed, it was the ability to act on behalf of growers collectively that allowed the AWC to prudently accumulate \$1.5 billion during the boom of the mid-1980's (AWC, 1991: 24). These savings played a vital role in ensuring that growers were able to weather the potentially fatal storm caused by the fall in demand during the wool crisis. Nowhere in the orthodox literature is there an admission that these savings accumulated under the RPS, rather than accentuating the wool crisis, significantly reduced the debilitating effects on growers of the turnaround in external macro-economic factors.

In addition, not all risk will be covered by the market. Given the significant forces of volatility in the wool market, without the RPS some risk may be averted through insurance, and other risk may be averted merely through a reduction in activity. Indeed, much risk will not be averted at all, but will be a further managerial problem for growers and manufacturers.

The likelihood of a reduction in activity due to risk is especially relevant to ex-command and developing economies. These economies do not have free markets and do not have access to the risk-aversion facilities or the insurance markets which are available in developed economies. Moreover, in the situation of drought, or a scarcity of wool, these economies will be out-bid in a purchasing war. If manufacturers in economies such as China and India can purchase alternative fibres on a reliable basis then these fibres will be preferred over wool. The orthodox approach does not consider that the demand for wool from these economies is contingent upon their limited ability to operate within the constraints of a capitalist market. These constraints should not be assumed away, but must be addressed by policy.

Who is Driving the Free-Market Agenda ?

The adoption of free-market institutions in the wool industry does not seem to have provided the effective transmission of reliable and effective market signals. Nor has it encouraged stability within the market. Although the exact nature of the risks and losses of the abandonment of the RPS could not have been accurately predicted, it is pertinent that the Vines Report gave no mention to the possible losses and changes which its recommendations would produce. The report was obviously informed by an orthodox view which had faith in free-markets, but it offered no consideration or understanding of the alternative economic views which question the ability of free-markets to maintain stability.

The reasons for the production of such a pro-free-market document are varied. One reason seems to be that, after the failure attendant on the drop in the reserve-price to 700c/kg, any subsequent attempt to re-establish the RPS would be both expensive and embarrassing for the Government. In this sense, the economic policies devised by the Vines Report and adopted by the Minister had less regard for the economic well-being of the industry, and were more concerned with pragmatically employing the situation of 'crisis' to abandon the centralised institutions of the wool industry. The report did not serve to enhance the wool industry, but rather to distance the Government from any financial liabilities the AWC may have incurred.

The Government did not face much opposition in pushing its free-market reforms. The NFF-supported 'managerial' reforms, which preceded the wool crisis, placed the NFF in more or less a pro-free-market position. Given the debts which had been accrued by the AWC, it was difficult for the NFF to then turn around and support the pro-centralised position of the AWC. Although there occurred dissent within the growing community, the institutional voice of growers (the NFF) was more or less committed to the free-market reforms. The wool brokers and merchants - who would take over the previously centralised functions of the AWC - were strongly in favour of liberalisation.

The AWC itself strongly opposed the Government's actions. However their bargaining powers, although based on a solid and practical knowledge of the industry, were diminished by the large debts for which they were responsible. The other main voice of dissent came from the overseas buyers of wool, who also had a solid and practical knowledge of the industry. Some wrote a submission to the Vines Report in favour of maintaining the RPS (Vines, 1991). This voice, however, was a distant one and did not greatly affect the local debate.

Playing a more subtle role in the liberalisation of the wool industry was the phenomenon of a convergence between the Canberra bureaucracy and academia which produced strong support for the adoption of free-market policies. A convergence occurred between influential 'rationalist' forces of the bureaucracy with the highly theoretical and insulated thinking of (mainly economics-based) academics. It was this convergence between bureaucracy and academia that would subsequently play a central role in informing the next inquiry into the wool industry. This inquiry was the Garnaut Report.

The Garnaut Report - Stockpile Policy

The final aspect of the liberalisation of the Australian wool industry was the stockpile-release policy that was adopted in the wake of the Garnaut Report. The practice of creating policy to mirror text-book prescriptions finds its pinnacle in the Garnaut Report. The abstract academic influence can be discerned not only in the policy prescriptions. It is also seen through the authors' framing of the document not in terms of an industry

policy, but rather as a set of policies designed to accommodate a pre-determined trade policy.

The Garnaut Review Committee was established in 1993 to "review the wool industry's structures and operational arrangements" [Garnaut 1993]. Its report makes recommendations in three main areas:

- the restructuring of the industry's governing institutions
- the sale of wool from the stockpile
- trade policy issues

The institutional changes are noteworthy as they represent an about-face from the 'separational' suggestions of the Vines Report. This about-face not only displays the Vines Report's misunderstanding of the industry's institutional needs; it also highlights the 'de-centralist' agenda which drove the recommendations given by the Vines Report.

The most significant institutional change proposed by Garnaut was the forming of a new company, 'Wool International'. Wool International replaces the Australian Wool Realisation Commission (AWRC), and will be privatised in 1997 when the stockpile has been sold. The functions of Wool International relate to the disposal of the wool stockpile.

Previously, the AWRC had managed the stockpile in a manner that maintained the buoyancy of current prices⁵. The Garnaut Report recommended against this policy in favour of the announcement of a schedule of stockpile releases which would reduce the stockpile to 240 kt by 1997. At this time the remaining stock could be used to underwrite a futures market for wool, and Wool International would be privatised so that its facilities can be operated by the private sector (Garnaut, 1993: 102).

The schedule policy recommended by the Garnaut Report was flawed for two significant reasons. First, the negative effects on growers of

5 This policy consists of a trigger price set ten percent above the average of the prices received in the previous four months. Thus, stocks were only released on rising markets, and did not greatly impinge upon the sale of growers' current clips (AWRC, 1992: 18).

releasing the stockpile were not given adequate weighting. Second, the schedule approach adopted showed no consideration of the ways in which the stockpile should be used as an instrument to regulate the volatile market for wool.

Effects of the Stockpile

An ABARE submission to the Garnaut Committee concluded that the net benefit of marketing the stockpile, as opposed to destroying it, amounted to a total of \$66 million over a ten year period (ibid: 99). In determining this figure ABARE used a short-term elasticity of demand equal to '-0.85' (Hone & Hope, 1993: 7). This short-term elasticity of demand is far in excess of most other estimates, and is inconsistent with ABARE's own model of the market for wool (Connolly, 1990).

Even though the Garnaut Committee used ABARE's conclusion, it had the audacity to re-produce the elasticities with which this conclusion is inconsistent (ibid: 100). If the printed elasticities had been used by the ABARE submission (and Garnaut) the destruction option would have been estimated as providing significantly *more* revenue than that from the 'marketing' option (Chisholm et.al., 1993).

In addition, the 'asset or liability' approach adopted by the Garnaut Committee failed to consider the possibility of de-naturing the stockpiled wool - ie. making the wool unsuitable for apparel use, but useful for other insulation purposes. Hone and Hope report that if a price of 150 c/kg could be realised for de-natured wool, then the industry would earn 1 billion dollars (ibid: 8). Although de-naturing either part or all of the stockpile may have involved establishing new markets and taking risks, it is the feasibility of these risks and possibilities that the Garnaut Committee should have investigated.

The fudging of figures and the narrow conception of the stockpile adopted by the Committee suggest that any alternative to the full marketing of the stockpile was not genuinely considered. The impact on growers of this pre-determined stance was not addressed by the Report. The Report assumed that the lower prices, which the full marketing option entailed, would benefit the industry by increasing demand.

"It is the Committee's view that the longer term volume effects [of price changes] have been larger than the estimates suggest, although there is no proof of the hypothesis" (ibid: 100).

As with similar assumptions made in the Vines Report, this assumption about the role of price is unjustified. The long term demand for wool will not be influenced by lower prices, which last only for a maximum of four years. Nor will lower prices be able to alleviate the fall-offs in demand which are caused by external macro-economic factors. Increases in long-term demand will only be achieved with the development of new markets and by addressing the institutional factors which determine the long-term demand for wool. Short-term fluctuations in the demand for wool, caused primarily by macro-economic factors, will not be influenced by lower prices. Rather, their effects may only be alleviated through the maintenance of minimum price levels which insulate the industry.

Given the institutional structures and macro-economic factors which govern demand, the Garnaut Committee was gravely wrong to assume away the effects on the market of releasing the stockpile. The short-term problems of the recent glut in demand would best have been handled through the manipulation of short-term variables, that is through a discretionary reduction in the stockpile.

Marketing the Stockpile

The marketing policy adopted in the wake of the Garnaut Report was one based on a schedule of releases. Under this schedule, the stockpile will be released regardless of what market conditions arise (ibid: 102). This policy neutralises any role which the stockpile can play in stabilising the market. This is an ill-considered and dangerous policy.

The schedule initially held down the price of wool on an already weak market, causing growers to cut back production and lose revenue. However, with the recent upswing in demand at the start of the 1994/95 season, the stockpile could not be utilised to make up the shortfall in supply as its release was locked into the pre-determined schedule. Growers could not take advantage of the demand increase to compensate

for drought-impaired current supply through an increased release from the stockpile.

The schedule imposed on the stockpile has not only harmed growers' revenue. The inability of Australian growers to meet the increase in demand - despite the fact that the wool required has already been grown - means buyers will increasingly look to alternative markets to ensure the stability in supply which is crucial to their managerial practices. Significantly, the inflated prices induced by the stockpile restrictions will nullify any benefits that may have been delivered by previous low prices - the *raison d'etre* for marketing the stockpile.

These failures of the schedule highlight the role which centralised stock holding played in the industry. Both the glut in demand and the drought are phenomena common to the wool market which the RPS and the stockpiling system were designed to accommodate. The schedule, by nullifying the flexibility of the centralised stocks, abandoned the damping instruments and ensured the industry felt the full brunt of these phenomena. This makes neither commercial sense nor economic sense.

The schedule was also supposed to provide greater market confidence. The argument in favour of the schedule is couched in terms of the need for both growers and buyers to be fully aware of the impacts on supply which the stockpile will have. The Garnaut Report ignored the fact that it is the repeated alteration of government policy which undermines market confidence. What is also ignored is that as long as a policy is clearly elucidated and generally understood, as was the WRDC policy which the schedule replaced, the impacts of the stockpile will be able to be equally well predicted by the market.

Free Trade and Industry Policy

Rather than couching the Garnaut Committee's recommendations in terms of creating marketing confidence, it may be more apt to see them as ensuring that the Government's industry policy remains subordinate to the agendas arising from trade policy. Indeed, the introduction to the Garnaut Report cites efforts to reduce international trade barriers as the

first of three sets of proposed changes which are of special importance to the industry (ibid: 11).

The mental leap required of outsiders to grasp the relationship between Australia's free-trade policies and the current crisis in the wool industry is staggering. The industry is beset with problems which have arisen due to the nature of specific industry structures and external macro-economic conditions. Moreover, the activities of the Australian wool industry are not significantly affected by either domestic trade policies or the trade policies of other economies.

Despite these features, the Garnaut Report claims otherwise. To impress the influence of trade-barriers on the demand for wool the Report prints a graph which supposedly "... leaves the strong impression that factors which raise price - and trade barriers are the principal factor amenable to policy action - will lead to large reductions in demand" (ibid: 141). The figure, however, shows only that market share within the apparel market is affected by premiums, and not that market share within a particular economy is affected by premiums brought about by trade barriers.

The Garnaut Committee ignored a previously published analysis of the benefits of removing trade barriers. In a paper published in the ABARE quarterly, it was estimated that if the US abandoned its quotas on apparel goods, the Australian wool industry would only earn an extra \$275 million over the next 20 years (ABARE, 1989: 82). This benefit, which accrues over twenty years, is far less than the \$300 million which the Government offered the industry when it implemented free-market structures (Vines, 1991: xi).

That this contrary analysis was not considered in the Garnaut Report highlights the pre-existence of a free-market, free-trade agenda in the minds of the authors. As was the case in the Vines Report, the implications of the Garnaut Report's recommendations were such that growers suffered significant losses. In addition, wool brokers and other market intermediaries benefited, by increasing their role and importance in the industry. In both reports the potential long-term benefits of free-markets were dressed up in rhetoric whereas the available and damning statistics which contradicted this rhetoric were suppressed. The structuring of the reports along these lines should not be surprising if

they are seen as political documents. Unfortunately, these political reports are dressed up and sent off to the ball as 'objective' economic analyses.

Conclusion

The woes of the Australian wool industry provide an important lesson concerning the limited value of economic rationalism and the effects of free-market industry policies. The influence of a neo-classical worldview, which emphasises the role of prices, ignores the role of market confidence, and misunderstands the operations and limits of the market has dictated the policies of the current Labor Government. This perspective has been adopted not only as a politically expedient way of distancing the Government from the risks of the wool industry, but as a part of the ideological drive to subordinate industry and other policies to the needs of free-trade policy. In so far as the adoption of free-market policies has failed the wool industry, the credibility of this agenda is brought into question. That the Labor Government is abandoning effective industry policy so as to attain the chereal benefits of free trade and free markets is disturbing not only for the members of the wool industry, but for the Australian economy as a whole.

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