# RURAL TIMES 18

## Wool III

*John Hyde*

The wool industry is in deep trouble and it is still not facing up to facts.

Although the average reserve price has been reduced by 20% to 700c/kg, the Australian Wool Corporation (AWC) has purchased 49% of the clip since the 1990/91 season opened. It now holds 3.4 million bales---equivalent to over half a season's Australian production and a considerably higher proportion of the 21 micron to 24 micron wool for which demand is declining. The huge stockpile will depress wool prices for years to come, while the cost of holding only the current stock is of the order of $1,000 million per year.

Obviously, that trend cannot be sustained and already the Corporation is telling the government that the AWC must borrow even more money than the government has agreed to underwrite.

In spite of all this, because the authority and standing of industry organisations and their leadership is threatened by any questioning of the level of the 'new' reserve price, public discussion of the real issues has been discouraged. Accordingly, public support for necessary policy changes is absent and the Minister finds his hands virtually tied.

The same wool industry leaders who a short while ago were telling the government to leave the industry alone are now begging the government to guarantee additional AWC borrowings. It will be interesting to see what conditions the banks imposed on the AWC should the government decline---a levy of 40%, perhaps?

The facts are simple: either more wool than has ever been sold before must be taken by the trade, or supply must be drastically reduced.

Since the floor price was reduced, the growers' average return has been reduced by approximately 27% (from 818c/kg to approximately 590c/kg). Such a large price reduction would, other things being equal, reduce supply---ABARE estimates only by about 5.5% in the first year and by decreasing annual proportions thereafter.

Other things are not, however, equal---already the price of one significant alternative to wool production, wheat, has fallen by 24% over the last 12 months and disruption of the live sheep trade has denied woolgrowers their most profitable outlet for surplus sheep. Typical gross margins show that, on present prices, the profitability of wool production has actually improved relative to wheat. Growers, who are flush with the proceeds of sales made above the 870 cents/kg reserve, will not reduce their flocks while they believe that it is current prices and not the recent peak are abnormal. Already, people who realise that there really is a problem have proposed impractical quota schemes and ewe-slaughter subsidies to encourage flock reduction.

On the demand side, a cheaper Australian dollar would, by reducing the price to purchasers, almost certainly increase sales of Australian wool. (Whether a government locked in by "The Accord" can afford to let the $A fall very far is another question.) It is, however, irrational to call for devaluation and at the same time to argue that reducing the reserve price will not increase demand. Although the opinion that the $A is over-valued is general, there is nothing in the stars that says it will be devalued. Unfortunately, too many growers are clutching at straws.

Another such straw is the belief that the industry can somehow get out of trouble by muscle flexing---by resort to its supposed market power. A seller with market power is one who can increase his revenue by restricting supply---for example: by reducing output by 10%, gain a price increase of greater than 10%. In the long run, however, alternative sources always undermine apparent monopolies. Our run would not be very long. Any government-induced reduction in the Australian supply would soon be filled by synthetics and by wool producers in other countries. The finest wools (that is, those the Commission has not been stockpiling) probably do have appreciable market power, but even they would eventually find they had lost the market they had declined to satisfy. Are we really game to dare our users to find alternatives to Australian wool?

The levy, by reducing the growers' price, to the extent that it is wasted in interest charges and handling costs, will reduce the supply of wool below that which would otherwise have prevailed. As much of the levy as is used for the payment of people other than woolgrowers is, in effect, a tax on production. On the other hand, to the extent that growers expect to get the levy back in higher prices or by way of refund, it will have no effect on supply and will not raise wool prices.

If the wool industry does have appreciable market power---a moot point for any wool and particularly so for wool stronger than 20 microns---then a tax on wool could benefit Australians as a whole. This is because it would be only partly paid by the Australian wool growers, the rest being paid by foreigners in the form of higher prices. However, I find it hard to believe that this is what woolgrowers have in mind.

The Corporation has not, so far, intended to reduce supply and raise prices in the long run. Instead, and at great cost, it has held off the market temporarily. Even if Australian wool does have some potential market power, AWC speculation does nothing to exploit it. The Reserve Price Scheme should not be confused with a monopoly pricing arrangement.

Only by further reducing the price can we increase consumption, reduce production and get rid of the dead-weight costs of that stockpile. This is unpleasant, but the sooner we face facts, the less the ultimate cost will be.

*John Hyde is Executive Director of the Australian Institute for Public Policy*

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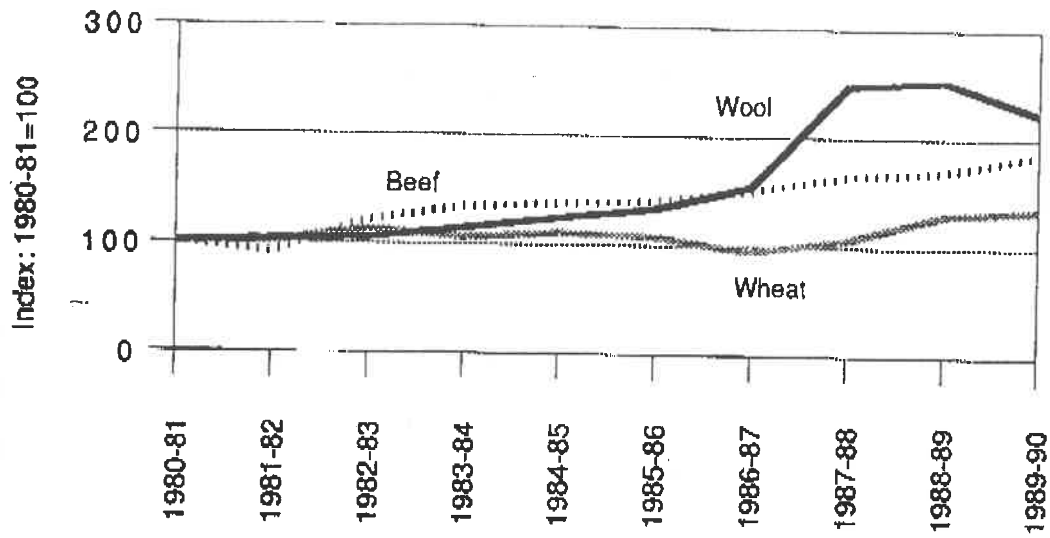
Figure 6: Prices of wool, wheat and beef - Australia




Source: Australian Bureau of Agricultural and Resource Economics