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Wool Stocks

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So far this season the Australian Wool Corporation (AWC) has purchased over half of the Australian wool clip. It has done this by buying at an average minimum reserve price of 870c per kilogram which it has announced it will maintain at least until June. With half the season gone, the AWC already has built its stock to 1.8 million bales.

This wool mountain is financed by the market support fund, which in turn is financed from an 8% levy on growers' gross wool receipts. Nearly four percent of the eight is allocated to research and promotion. The rest is an interest-free loan to the market support fund. At current interest rates, interest-free loans are effectively taxes. Although the fund stood at $1.8 billion in July 1989, it has been used up and the AWC has raised a $500 million commercial loan using its stocks as collateral. The Wool Council has just written to the the Minister for Primary Industry asking that the Wool Tax Act be amended to raise the current 10% maximum levy to 15%.

The AWC's heavy purchases raise two questions:

- Is taking half the wool clip off the market responsible?
- Is there any point to what the AWC is doing, anyway?

Other industries, such as tin, provide evidence on the first question. The AWC has acquired big stocks before. Each time it has managed to sell these, and growers and politicians have tended to assume that, despite the failures of similar schemes, it will always be able to do so. The London Metals Exchange (LME) had a similarly successful record in managing the tin market before things went spectacularly wrong in 1985, demonstrating the high cost of holding stocks off the market when managers guess the future wrongly. Australia no longer rides on the sheep's back, but the wool industry is too important to us to afford a similar debacle---especially in our delicate economic condition!

The AWC once justified its existence by the need to increase competition on some lines and to prevent collusion. Even the case for 'filling the pot-holes', as this activity was called, is inconclusive, but it is a separate question.

Further, filling the potholes is not a very risky activity, whereas maintaining minimum reserves throughout an entire season is.

Minimum (floor) prices, if they have any effect at all, inevitably reduce the volume consumed. Experience tells us that whenever the average floor price is above about 92% of the average market price the AWC accumulates stocks. Later these stocks must be sold. Should there come a day when it becomes apparent that a huge wool stock must be liquidated to meet the AWC's interest bills, we can expect the market to collapse until the stock is cleared.

The second question, whether the floor price is pointless, is even more easily answered: it is. Because Australians are the dominant suppliers of fine wool and no-one could quickly take our place (which is not the case with wheat, sugar, coal and nearly everything else) by combining growers gain monopoly power. That is to say: by holding wool off the market they can raise the price by more than is needed to offset the lost volume. (For example, if by holding back 10% of the clip, the price is raised 20%, we increase our revenue by 8% at the expense of ultimate users.)

If the wool held off the market were then to be used to fill only the pot-holes in the roads, the gain would be permanent. But, when the Wool Corporation sells its stocks, the additional supply depresses prices---a point which will no doubt be made with force should the government be called upon to bale the AWC out of its mischief. There is no reason to believe that woolgrowers' gains (when the AWC is buying) exceed their losses (when the AWC is selling). AWC borrowings, however, enjoy a government guarantee and should the government ultimately come to the rescue of the Corporation there will be a transfer from taxpayers to woolgrowers---it might even exceed the costs of handling and holding the wool stocks.

Reserve-price enthusiasts sometimes claim that growers will cheerfully accept marginally lower prices for the sake of stability. I don't see why growers should. Certainly, if the AWC, unlike the LME, continues to guess right, it will continue to stabilise woolgrowers' prices. This is something woolgrowers can, if they are so minded, achieve for themselves by trading wool futures. Wool users can do the same. There are, moreover, more efficient ways of stabilizing incomes and liquidity (or varying these according to some personal design) than encouraging the AWC to build a wool mountain.

Mr Chip Sawers, the chairman of the Wool Council is already warning growers about over-production. He may not have realised the implication, but it follows from his warning that he fears that the AWC may not be able to clear its stocks safely, and from that it then follows that the current reserve price of 870c per kilogram is irresponsibly high. Since it was the Wool Council, against the advice of at least some AWC staff, who insisted that it be high, Mr Sawer's warning is ironic.

For so long as the AWC keeps the wool price high, growers will not even start the slow process of switching to beef or crops, or otherwise reducing production. Moreover, the higher price has encouraged overseas producers to also grow more wool.

The AWC should reduce the reserve immediately, but I can't see that happening between now and the election. It is too easy for the ill informed or the dishonest to portray a responsible retreat from an untenable position as the cause of the market reversal which has already occurred.

The more radical course of abolishing the wool reserve price is just another much-needed micro-economic reform---in principle like any other. Wool growers are correct in what they say about the wharves and the causes of unemployment, but it ill behoves them to criticise when they continue to attempt to defy gravity themselves.

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