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## AN ECONOMIC PERSPECTIVE OF THE RATIONALE FOR SINGLE-DESK SELLING

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### ABSTRACT

Considerable public debate has recently surrounded the issues of retaining the compulsory acquisition powers and sole exporter status of the Australian Wheat Board (AWB). Various sections of the Australian wheat industry, in particular grain exporting groups, have called for more open competition in the export arena while the single desk selling status of the AWB has been strongly defended by producer groups and the AWB itself.

The objective of this paper is to assess the various arguments for retaining single-desk selling in the Australian wheat industry. The economic implications of the various policy alternatives are examined from an economic efficiency perspective.



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# 1. INTRODUCTION

## 1.1 The Issue

The concept of single-desk selling arises when a single marketing body, which has some form of legislative backing, acts as the sole seller of a product. The Australian wheat industry is an example of this type of marketing arrangement, with sole responsibility for the export of Australian wheat. There has recently been public debate on whether the Australian wheat industry should maintain its control of export marketing, or whether there are benefits to the industry from more open competition.

More than 80 percent of Australia's total wheat production is exported with the Australian Wheat Board (AWB) currently acting as the sole exporter. In 1989 Australia's domestic wheat marketing arrangements were deregulated through the removal of the AWB's compulsory acquisition powers and termination of administered domestic pricing arrangements. The export marketing arrangements were retained. Despite calls by some groups, such as the Australian Grain Exporters Association (AGEA), for open competition in the export arena, most primary producer organisations and the AWB itself have strongly defended the single-desk selling role of the Board.

In response to this debate, a Working Party consisting of representatives of the Grains Council, the AWB and the Commonwealth Department of Primary Industries and Energy, was convened to examine the future structure and role of the AWB. This working Party presented a proposal for the formation of a grower-owned and controlled organisation called NEWCO. In this proposal the Commonwealth Government would be required to provide specific taxation treatment and, in the initial stages, maintain the current financial support arrangements. The NEWCO proposal also involves the retention of the sole export status of the AWB.

In October 1992 the debate was suspended with the decision of the Federal Government to extend the current selling arrangements until such time as any gains are made in the Uruguay round of the GATT. It is important to consider the economic and welfare implications of maintaining single-desk selling and the alternative policy options for the future marketing arrangements for Australian wheat. This decision must be based on the best interests of the Australian community. In this case, as the issue pertains to an export product, the Australian community will be primarily represented by wheat producers. The retention of the status quo will be justifiable where there is evidence of benefits from the existence of single-desk seller status. In contrast, a more open export market may be desirable if it is shown that single desk selling itself does not lead to price premiums or that the AWB is unable to satisfy all aspects of the market and that competition would lead to lower cost structures, improved performance and better returns to growers. This paper examines the advantages and disadvantages of each option and looks at the issue from an economic efficiency perspective.

## 1.2 Background

Government intervention in the Australian wheat industry was instigated in 1948 with the introduction of the Wheat Industry Stabilisation Act. The Act was introduced in response to grower concern at the time with regard to the extent of price fluctuations in the world price for wheat, the perception that traders were colluding to force down the price paid for grain, and that traders were taking unfair advantage of growers who were forced to sell at the over-supplied harvest time. The stabilisation scheme was in operation between 1948 and 1989 with various changes implemented through five-yearly reviews throughout the period. In 1989 the wheat marketing legislation was changed dramatically. The new Act saw the ending of the compulsory acquisition powers of the AWB, deregulation of domestic marketing arrangements, removal of the guaranteed minimum price and greater commercial flexibility. The changes were made in response to criticism from several areas, including the Industries Assistance Commission (IAC), which led to recognition of the costs and inefficiencies of the regulated system. Deregulation was not extended to the export marketing arrangements and the Board's sole export status was retained.

On the world market, Australia is the 4th largest wheat exporter, holding 11 percent of the market in 1990/91. The United States dominates the market with a market share of 37 percent, followed by the European Community (22 percent) and Canada (16 percent). Argentina holds 5 percent of the market. Wheat is traded by both private commercial traders and government agencies on the world market. Private traders deal with approximately 75 percent of the wheat and coarse grains traded annually on the world market and are dominated by a small number of large multinational firms (IAC 1988, p43). In the US and the EC traders negotiate with growers and grain merchants and sell direct to other traders, end-users or government buying agencies in the importing countries. The next two largest traders, Australia and Canada, sell their grain through their respective central government agencies, while Argentina has a combination of both with private traders falling under the supervision of the National Grain Board.

In recent years the largest volumes of imported Australian wheat were received by Iran, Egypt, China and Japan (AWB, 1991). These nations have consistently been the major importers of Australian wheat although the individual volumes have changed from year to year dependent on various factors such as the political situation in those countries. Some countries have centralised government buying agencies for grain imports, such as the centrally planned economies. These nations often are involved in government to government trading. Most grain imports, however, are undertaken by commercial traders.

In the current debate, the major domestic players are the AWB and the AGEA. Arguments for both retention and removal of single-desk selling have been presented by both players. The merits of the various arguments will be discussed in section 4 of this paper.

### 1.3 The AWB's Arguments In Favour of Single-Desk Selling

In defence of its single-desk seller status, the main arguments put forward by the AWB against the deregulation of the wheat export arrangements are based on the perceived advantages with the current system and resultant price premiums. The Board claims that through the control of all sales of Australian wheat in international markets it can obtain higher prices than would be achievable without single-desk selling. The AWB is of the view that many of its services could not be duplicated by traders and that their loss would be detrimental to the industry.

The AWB has marketing advantages as a statutory marketing authority under Federal Government legislation. As a Government agency the Board can undertake government-to-government trading. Perhaps more importantly, the Government provides insurance for credit offered by the AWB to overseas customers through the Export Finance and Insurance Corporation (EFIC), a statutory body established by the Government to provide financial and insurance services to foster the competitive capacity of Australian exporters. The ability to offer credit is regarded as essential by the AWB, as it estimates that 30 to 40 percent of world wheat trade is now conducted using some form of Government backed credit and only a small proportion of the trade is conducted without any type of Government interference. The International Wheat Council believes the pattern of world grain trade will be determined increasingly by the availability of Government backed credit, particularly as the world's banking system is increasingly reluctant to provide credit (AWB Annual Report 1991, p12). Access to credit is considered to be necessary for Australia to be competitive in the world market.

The financial backing by the Government enables the AWB to undertake other activities beneficial to the industry. Although the AWB is grower financed, its borrowings are guaranteed by the Government for general operating costs as well as under a charter in the 1989 legislation to generate a stable capital base to undertake investment activities for the benefit of the wheat industry as a whole through the Wheat Industry Fund (WIF). This financial support gives the AWB greater ability and encouragement to extend its services and investments. As part of its marketing strategy the Board conducts promotional activities around the world including the provision of assistance, training and technical support in the development of processing projects or storage facilities to enhance the AWB's standing in various markets, and the coordination of goodwill or orientation visits from different countries. Government guarantees through the Wheat Industry Fund have also enabled the Board to undertake investment strategies in value-adding ventures. These investments are aimed to assist in the development of markets for the AWB and/or earn a commercial return on the investment in order to secure diverse revenue schemes. The Board is also involved in identifying the least-cost paths for the storage, handling and transport of grain and appropriately position resources to exert pressure on the relevant authorities and State Governments to reduce costs and improve their operational efficiency.

These promotional and investment activities are indicative of the grower-based emphasis of the AWB. The Board acts on behalf of Australian wheat growers, aiming to maximise the farmgate income of its supplier growers. In this role it is concerned with developing a long term strategy for wheat marketing. The AWB argues that, in contrast, international grain traders would be acting in their own corporate interest rather than in the interests of growers.

An argument frequently put forward by the defendants of the current system is that growers would be best served in a 'corrupt' international market by a single-desk seller. Indeed, this appears to be the basis for the recent Government decision to maintain the current selling arrangements. The major grain trading countries are heavily subsidised allowing them to sell wheat on the world market at a much lower price than Australian wheat. The AWB claims that its sole exporter status enables Australia to be competitive in this corrupt world market and to capture some price premiums. The ability to capture premiums has been attributed by the AWB to quality advantages obtainable under a single-desk seller organisation (AFR March 1992).

#### 1.4 The AGEA's Arguments in Favour of Free Trade

The AGEA, who represent the major international grain traders, have led in the push for the deregulation of the wheat exporting arrangements. These traders can currently buy grain for domestic purposes but cannot sell it overseas. They want these export restrictions to be removed so that they can increase their access to Australia's wheat production. The AGEA have based their arguments for deregulation on the premise that growers should have open access to the benefits of competition at the farm gate and that the current system is costly and inefficient.

The main marketing system used by the AWB is pooling which means that growers are not being paid the same price for their wheat as that for which it is being sold. Profits are going to the pool rather than to individual growers. While this ensures all growers a certain level of payment, it means that growers who are producing quality wheat types are being paid less than they could receive on the open market. The AGEA have raised the question "they have taken extra care to produce better quality wheats or invested on-farm, so why shouldn't they receive additional benefits?" (Australian Grain, May 1992, p26). The pooling system may mean that correct market signals are not reaching the wheat producer and is therefore inefficient.

The AGEA are promoting an alternative industry structure which they claim would benefit growers and the industry. They argue that growers will be offered better prices by traders, and prices which are more reflective of the type and quality of the grain, as well as different and more flexible selling options. Furthermore, the grain traders have argued that they would be able to provide many of the same services offered currently by the AWB; for example they have said that they may be able to have access to the use of the EFIC. Removal of single-desk selling would open the market to competition and thus give growers a marketing choice.

## **2. Previous Positions on Single-Desk Selling and Proposals for Future Wheat Marketing Arrangements**

Prior to deregulation of the domestic wheat marketing arrangements in 1989 several reviews of the wheat industry were undertaken. The IAC reviewed wheat marketing arrangements on a number of occasions, with the latest report released in 1988. In regard to export marketing arrangements, the 1988 report focussed on the ability of the AWB to realise price premiums in the market. The conclusions from the discussion are outlined in section 4.2. The IAC presented a number of recommendations with alternative marketing options, each favouring increased trader participation in export marketing of wheat.

The IAC report considered various submissions from interested groups, such as various state departments of agriculture and the Australian Bureau of Agriculture and Resource Economics (ABARE). A large number of submissions which referenced export issues supported the retention of the AWB's monopoly powers. Other submissions proposed modifications of the existing system. For example, ABARE supported retention of the monopoly powers but argued for increased use of open, unrestricted competitive tenders for wheat designated for resale through international grain traders. However, most of these submissions, including that from the NSW Department of Agriculture, concentrated on issues pertaining to domestic marketing arrangements and not on export marketing issues. Consequently, there appears to be a relative lack of information about the implications of different export marketing arrangements. Consideration of these implications is important in the light of current debate and in preparation for the review of the Commonwealth Wheat Marketing Act which must be undertaken in 1994.

In the current debate, there have been proposals put forward by various players in the industry for alternatives to the current wheat export marketing arrangements. As previously mentioned, the main proposal under consideration is that put forward by the joint working group from the Grains Council, the AWB and the Department of Primary Industries and Energy. Titled NEWCO, the alternative organisation would be a privatised Wheat Board with the maintenance of single desk selling. Producers in NSW have exhibited widespread support for this proposal. Growers in Queensland have developed another alternative in which wheat marketing would be undertaken by State grain Boards. This arrangement, termed EXCO, would limit the functions of the national marketing body to selling wheat internationally. The Queensland proposal therefore appears to endorse further regulation than currently exists, including the retention of the single desk selling status of the national marketing organisation. The Queensland Graingrowers Association has presented another proposal called VALCO which addresses value-adding opportunities. This organisation would be responsible for value-adding joint ventures, trademark promotion and quality control. VALCO would, similar to EXCO, be largely regulatory. Producers in Western Australia have supported a continuation of the status quo.

### **3. Conditions for Retaining Single-Desk Selling**

Despite widespread support for the retention of single desk selling by the AWB, there has been limited quantifiable evidence and rational argument to support the case. The debate regarding the future export marketing arrangements for the Australian wheat industry involves two mutually exclusive policy options. The first being the retention of the sole export status of the AWB, and the second being open competition for the sale of Australian wheat on the export market. As with any policy option, there are benefits and costs involved with each alternative.

A perfectly competitive market, free of government influence, results in a welfare-maximising position for society, where price and quantity reflect the optimal allocation of resources. There are a number of situations where the competitive market may fail to maximise welfare and thus government intervention may be justifiable. First, the actions of either producers or consumers may result in costs or benefits to others and do not show up as part of the market price. These benefits or costs are termed externalities. Second, prices may fail to provide proper signals to consumers and producers and the market fails to act properly in allocating resources to their optimal use (Pindyck and Rubinfeld 1989, p297). It is also important to consider which alternative would provide the greatest social benefit for producers.

If there was evidence of a market failure in the Australian wheat export market, there may be a case for government intervention in the form of retaining single-desk selling. This case would also be preferable if single-desk selling could be shown to provide for the greatest social benefits for Australian wheat producers. The arguments presented by each side of the debate will be discussed in the light of these economic considerations in the following section.

### **4. Economic Evaluation of the Single-Desk Selling Case**

#### **4.1 Monopoly Structure and Market Influence**

As the sole seller of Australian wheat, the AWB is acting as a monopoly firm. It has control over quantity and no other firm can enter the market. A monopoly, which is maximising profits, produces where marginal cost equals marginal revenue instead of the Pareto efficient position of price equalling marginal cost in a perfectly competitive market. This means that the monopoly firm will produce less than the efficient level of output and there will be a misallocation of resources because as the market remains unaware of its selling (or buying) options and the cost structure of its buyer (or supplier).

There are advantages associated with a monopoly structure such as economies of scale, economies of scope and centralised information collection. However, the



benefits from these functions can be equally accessed by large firms and are not exclusive to a monopoly structure.

Another situation in which a single firm could provide the most efficient industry structure is that of natural monopoly. Monopolists who have large fixed costs and small marginal costs will not make a profit if price was set equal to marginal cost. This means that the cost conditions make it infeasible for more than one firm to operate in the market. In this situation the firm is referred to as a natural monopoly. Typical examples of natural monopolies include public utilities such as gas, water and electricity supplies. Most natural monopolies are regulated or operated by governments. However, it is unlikely that the wheat export market could be considered a natural monopoly as there are already many traders who have expressed interest in selling Australian wheat who are already established in the world market. Access to the Australian export market would therefore represent a sub-market to the traders. In this case, opening up the export market would be beneficial for producers as the AWB would be forced to be more competitive.

Increased competition would be reflected in the returns offered to growers, that is the price minus the cost, and the services provided. Prices offered to growers would be likely to increase because of greater competition in buying. On the selling side, it is unlikely that a monopoly firm would be able to achieve higher prices on the world market through its control of quantity because Australia is in a "price taker" position internationally. This is assumed because Australia has a relatively small market share of 11 percent. The world market is dominated by the United States and the European Community, collectively holding approximately 60 percent of the market share in 1990/91. This means that Australian wheat is sold at the world price regardless of cost structures. The main implication of such an elastic demand is in relation to the argument that a single desk seller can obtain price premiums.

#### 4.2 Price Premiums

Many of the defendants of the AWB's sole exporter status have based their arguments on the belief that, because the AWB can control all sales of Australian wheat on international markets, it is able to extract price premiums in some export markets. Consequently the deregulation of the market would result in the dissipation of those premiums. Existence of such premiums is attributed to the variations in prices obtained by the AWB from sales to different export markets.

However, as a price taker, that is with a perfectly elastic demand curve, the AWB can not influence the world price. Variations in prices from different export markets may be due to a number of different factors such as different types, qualities and volumes of wheat in contracts, the provision of services such as technical assistance and advice, timing of sales or delivery, and the availability of credit. The Industries Assistance Commission (IAC) report on the wheat industry in 1988 stated that "price margins paid in recognition of differences in the product and/or related services cannot be construed to be price premiums which justify the status of the AWB as the

sole controller of exports of Australian wheat. Such differentials which are associated not only with wheat sales but with sales of virtually all goods and services, are likely to apply irrespective of the number of sellers of Australian wheat" (IAC 1988, p116). Furthermore, the AWB made a submission to the Commission, recognising that "there is certainly an Australian quality premium that clearly ought to be attainable by whoever is selling Australian wheat" (IAC 1988, p116). The IAC commented that, although it was unlikely, in some circumstances the AWB may be able to extract price premiums from some smaller markets by restricting competitive access to them. It goes on to say, however, that traders may be able to extract their own price premiums by specialising in servicing certain market niches (IAC 1988, p118).

There are insufficient grounds for the retention of single-desk selling based on the ability to extract price premiums because Australia is a price taker on the world wheat markets and any premia obtained will be due to product characteristics.

#### 4.3 Credit and Government to Government Sales

The AWB, as a Government backed organisation, utilises the Export Finance and Insurance Corporation to provide credit and has the ability to undertake government to government trading. There is concern that the deregulation of the marketing arrangements would mean the end of these marketing tools. There may, however, be alternatives within a competitive market. The AGEA do not see the use of the Export Finance and Insurance Corporation as exclusive to single-desk selling, so there may be scope to continue this facility. Furthermore, the traders themselves, as large multi-national businesses, may be in a position to offer credit to their customers.

Government to Government sales would still be able to occur in a deregulated market through the continued existence of the AWB and through the Government negotiating on behalf of traders

#### 4.4 Impact of Competition

The deregulation of the market would allow producers much greater choice in their production and marketing decisions. Every suggested scenario involves the continued presence of the AWB in the market, so it is likely that growers would be able to choose whether they would continue to trade through the Board or consider the options available through the traders.

In the case of pooling, producers' returns are currently paid in relation to the yield characteristics of their crop rather than for quality and are paid a pooled price rather than a price reflective of their particular grain. As seen in Figure 1 in the Appendix this can result in substantial cross-subsidisation across quality. Opening up the market would enable traders to offer a price for a particular type and quality. Consequently, growers can determine their plantings according to their assessment of which varieties would provide them with the highest returns. This means that supply decisions would be directly related to demand. In the current system producers are

receiving distorted market signals and resources are therefore being misallocated. Returns could also be related to marketing techniques as growers could choose the selling option most suited to them.

In order to attract producers away from dealing with the AWB, the traders would have to offer a more attractive deal. The AGEA has indicated that they would be able to offer the growers higher prices for their grains, particularly for the higher quality types, and lower off-farm costs. The IAC also acknowledged the likelihood that traders could make a profit and, at the same time, achieve higher returns for growers than could be achieved through a central marketing agency. This was attributed to various factors including the traders' ability to sell at a higher price and lower cost than the AWB, their knowledge and established association with particular markets through trading wheat of other origins and other grains, wider variety of marketing techniques employed by them, and their involvement with other activities such as arbitrage and currency dealing (IAC 1988, p113). This could only be beneficial for producers. The growers would have the ability to trade off the returns offered by the traders with the services of the AWB - whatever form they may take.

#### 4.5 Risk Management

The AWB has, in part, borne the risks faced by producers by ensuring a market for their product, although cost changes have been passed on back to producers. Deregulation would mean that producers would be more responsible for their own market risk. They would have to consider to a much greater extent the employment of risk management strategies as part of the production process. The introduction of competition into the wheat export market would be likely to result in the development of options such as futures trading and forward contracts. Producers would consequently be able to determine what level of risk-income tradeoff is suitable to them.

### 5. Summary and Conclusions

The issue of retention of single-desk selling has been one of public debate in recent times. The Australian wheat export market impacts on Australian producers and it is therefore essential that any discussion of policy alternatives looks at the costs and benefits for those producers.

Economic efficiency will be maximised when the market is in equilibrium, which will occur under a competitive market situation unless, as discussed in section 3, there is some form of market failure. There is a case, as discussed in this paper, based on economic theory, that the retention of single-desk selling incurs more costs than it provides benefits and that there would be no market failure in the event of its removal. Therefore, it is unlikely that single-desk selling in the wheat industry can be justified on the grounds of economic efficiency. The deregulation of the export market arrangements would mean that producers would have the choice as to whom

they sell their grain, and traders would have the ability to operate in the market to offer prices which reflect the demand on the world markets. It is possible that growers' returns may increase through reduced marketing costs and increased price and demand. Furthermore, it is expected that the AWB or its successor would continue to operate in a competitive market enabling the continuation of many of its existing services. Given these factors, the removal of the AWB's sole exporter status is likely to result in the greatest producer surplus and consequently net social benefit.

There are, however, areas which require further examination to allow a conclusive policy decision to be made. For example, there is capacity for traders to act in collusion which may prevent the maximisation of grower returns, nor be in the best interests of the long-term development of the industry. This would depend upon the actual structure of the new arrangements. The legal implications of the structure also need to be considered as it may not be possible for the Wheat Board to be wholly grower owned and still retain Government financial backing, or, as suggested in the NEWCO proposal, single-desk selling status.

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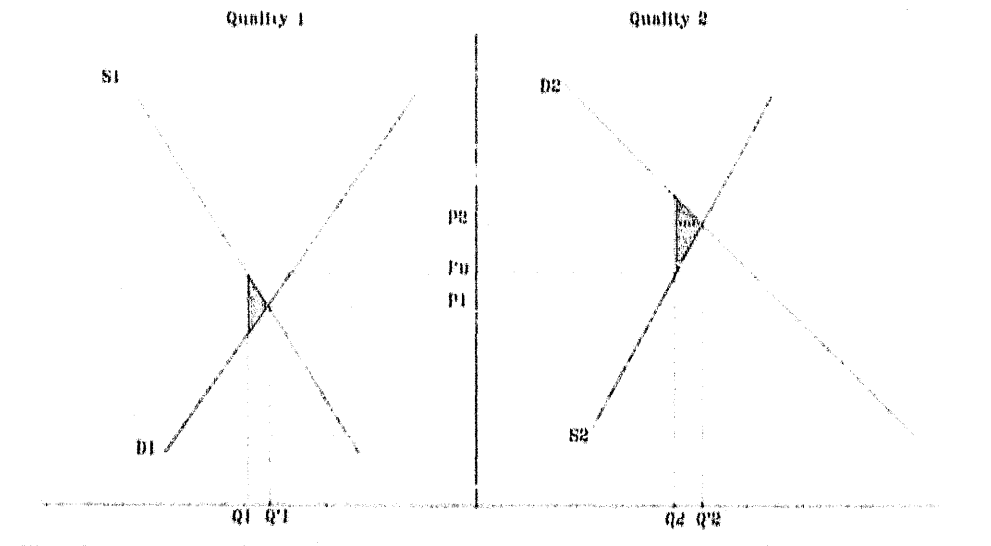
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## APPENDIX

The model of net social benefit can be used to describe the efficiency effects of prices which are nonreflective of quality. In the case where different qualities of the one product receive a single price and where there is no mechanism by which prices could reflect quality differences, producers will be receiving distorted market signals and resources will not be allocated efficiently. This will be the case if, in a competitive market, different qualities would fetch different prices.

Graphically, this can be represented with a 'back-to-back' diagram such as Figure 1<sup>3</sup>. In this diagram  $D_1$ ,  $S_1$ ,  $D_2$  and  $S_2$  are the respective demand and supply curves for a commodity consisting of two quality types, 1 and 2. If, under a regulated or uncompetitive market, producers of both quality types were offered the same price,  $P_u$ , they would supply the quantities  $Q_1$  and  $Q_2$ . This would be the case, for example, under a price pooling system. If the market were competitive, producers would be paid prices which were reflective of the quality differences, for example,  $P_1$  and  $P_2$ , and would supply the equilibrium quantities of  $Q'_1$  and  $Q'_2$ . It can be seen then that under the regulated system there is overproduction of quality 1 and underproduction of quality 2. The cost to society if this misallocation of resources, which might be avoided under a competitive market, is equal to the sum of the two shaded triangular areas. The hatched area in the left hand side diagram is the net social cost of overproducing at  $Q_1$ , and the hatched area in the right hand side diagram is the net social cost of underproducing at  $Q_2$ .

Figure 1: Costs associated with prices which are non-reflective of quality



<sup>3</sup> Based on a similar diagram used by Freebairn (1967)