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## **Australia's Wool Policy Debacle: Continuing Government Failure**

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### **Abstract**

Australia's Reserve Price Scheme for wool was abandoned in mid-1991 leaving in its wake a large "wool debt" of \$2.7 billion and a massive wool stockpile. With the astonishing acquiescence of the Wool Council of Australia, woolgrowers will continue carrying this debt under the new "Garnaut" wool legislation. I argue that Australia's wool policy debacle cannot be attributed entirely to "greedy woolgrowers" and that, indeed, the policy mess is largely the result of government failure in shaping and managing wool policy since 1987. There are good reasons on economic, legal and ethical grounds for the Commonwealth to write-off the "wool debt".

## Australia's Wool Policy Debacle: Continuing Government Failure<sup>1</sup>

The Australian wool industry is in serious trouble. In 1993 wool prices reached their lowest real levels for over forty years and specialist woolgrowers have been making substantial losses in recent years (ABARE 1993). The chances of any appreciable turn-around in the situation over the near future are not large. And, because of the mixed enterprise production systems predominant on Australian farms, the problems in the wool industry are also affecting much of the remainder of Australia's broadacre agriculture.

The origins of the current wool problem can be traced to adverse market developments and a series of errors from 1987 onwards in managing the former Reserve Price Scheme (RPS) for wool. The RPS was a buffer stock scheme designed to maintain minimum prices – the Minimum Reserve Price (MRP) – for wool sold at auction. The Scheme appears to have operated reasonably successfully over the period 1971 to 1987, probably having stabilised auction prices at relatively little cost for much of its history (Campbell, Gardiner and Haszler 1981; Hinchy and Fisher 1985). The Scheme was self-financing and woolgrowers were required to contribute *via* a wool tax to a contingency fund – the Market Support Fund (MSF) – established to meet any losses under the Scheme. By the end of 1986-87 the credit balance in the MSF had reached some \$1.8 billion, about one-third of the value of a normal season's production.

The RPS finally collapsed in mid-1991. The policy errors that contributed to its demise included, first, the decision to give the wool industry a large measure of control over setting the MRP (*Wool Marketing Act 1987*), second, poor judgements in perceiving a price spike as a new price plateau and, third, the subsequent decisions by the Federal Government not to exercise its veto power and to allow the MRP to be set and maintained at a clearly unrealistically high level (ABARE 1988; Watson 1990; Haszler 1993). When the RPS was finally abandoned it left in its wake a debt of some \$2.7 billion and stocks of some 4.6 million bales of wool (811 kt greasy) – about equal to a full year's clip.

A single question dominates all others concerning Australian policy towards the wool crisis. Are woolgrowers sinners who need to be punished for the excesses that eventually killed the Reserve Price Scheme? Or are they largely innocent victims of the poor judgements of Federal ministers and bureaucrats, victims of the poor judgements of their leaders, and victims, too, of their own limited knowledge, and their wish for higher wool prices? The general issue here is how we should account for government failures. The question arises in the case of wool because of the direct role of the Commonwealth and its agencies in shaping and implementing policies and decisions that brought about Australia's wool crisis – the most dramatic and, arguably, the worst rural policy debacle in fifty years.

As the RPS came under intense pressure in mid 1990, the Minister for Primary Industries and Energy established the Vines Committee (Vines, Millar and Davis 1991) to examine a range of wool policy issues. One outcome was the establishment of the Australian Wool Realisation Commission (AWRC). The AWRC took over the debt, the wool stocks and

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<sup>1</sup> This research was supported by a grant from the Wool Research and Development Corporation.

other assets that had been held by the former Australian Wool Corporation (AWC) and has been repaying the debt through a combination of stock sales and a tax on woolgrowers (AWRC 1992). By the end of 1992-93 the stockpile and debt had been reduced to just under 4 million bales and \$2.3 billion respectively (AWRC 1993).

Amidst all the continuing difficulties of the wool industry, the Minister for Primary Industries and Energy appointed another wool industry review committee, this time headed by Professor Ross Garnaut (Garnaut, Bennett and Price 1993) to "review the wool industry's structures and organisational arrangements" with the aim of helping the industry "..... work its way out of the present situation ....." (Minister for Primary Industries and Energy 1993). Unfortunately, the Garnaut Committee glossed over the key issues and instead resorted to "... marketing rhetoric ..." and restructuring as the panacea (Alistair Watson, 1993a) – none of which are relevant to the short term problems facing the wool industry. Partly because of this, the Committee's arguments and many of its recommendations remain controversial.

The purpose of this paper is to review the assumption concerning responsibility for the so-called "wool debt" underlying the analyses of both the Vines and Garnaut Committees. This assumption is based on the continuing attitude of the Commonwealth Government to the wool crisis – namely that woolgrowers should meet the costs of repaying the "wool debt". The paper begins with an overview of the Garnaut Committee's analysis and recommendations in the context of the wool crisis and of the policy decisions that contributed to it. The responsibility for the debt is considered on economic, ethical and legal grounds. The argument of the paper is that Australian wool policy since 1987 can be characterised as a continuing series of government failures. These arise from policy errors in designing and managing the former RPS and the Commonwealth Government's failure to acknowledge its direct contribution to the wool crisis.

## The Rites of Passage

The Garnaut Committee's recommendations have had an extraordinarily rapid and smooth passage – from their infancy as a series of recommendations to their maturity, virtually unblemished, as established Commonwealth law. The Committee was commissioned on 28 April 1993 and it released its report and recommendations in Melbourne on 11 August. Over the following month the Minister "... initiated wide-ranging consultations with all sectors of the industry ..." and convinced Federal Cabinet to endorse the recommendations almost unchanged (Minister for Primary Industries and Energy 1993). By late on Thursday 30 September the Minister had also introduced into the House of Representatives the Bills to implement the Committee's recommendations – in time to meet the Greens' Senate deadline. Despite the need to accommodate a Senate Inquiry (Senate 1993), albeit a very brief one, the Bills had become law by the end of October (Parliament 1993a, 1993b, 1993c, 1993d). Supreme efficiency or undue haste?<sup>2</sup>

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<sup>2</sup> In addition to the extensive press commentary, the Committee's analysis and recommendations are discussed by Watson (1993a) and Chisholm, Haszler, Edwards and Hone (1994).

That the Minister was able to so quickly endorse the Committee's recommendations and push them through Cabinet is perhaps not surprising – given that established public inquiry processes were not followed on this occasion. What is surprising is the speed with which rural industry organisations embraced the Committee's recommendations. Aside from a number of smaller groups of woolgrowers, the Pastoral Group of the Victorian Farmers Federation seems to have been one of the only rural organisations interested in questioning the Garnaut Committee's analysis and recommendations (Hawes 1993; Senate 1993).

This endorsement of the report by rural groups – including the Wool Council of Australia – is strange because on the issues that really count right now – the wool debt and wool stockpile – the report is seriously deficient. The Committee notes that there is "... no straight-forward answer ..." to the question of who owes the debt and who owns the stockpile (page 91). But then the Committee simply accepts the Government's line that woolgrowers are responsible for all the "wool debt" and will just have to accept the costs of repaying it. There is no analysis of this proposition based on any consideration of how the problems arose and, therefore, who should now bear the costs. Perhaps as a means of trying to justify this omission, the report notes that " .... the cooling of the industry's political temperature ..." is an objective and theme of its recommendations (p 5). But it is hard to see any intrinsic logic in trying to move towards that objective by endorsing a *status quo* that is so tenuous on economic, legal and ethical grounds. The existence of the remarkable consistency between woolgrowers' organisations, committees of inquiry and the Ministers for Primary Industries and Energy does not mean that the Government policy stance is necessarily correct or appropriate. The Government certainly has not argued its case and has relied instead on assertion to sustain its position.

Woolgrower interests were clearly implicated in the disastrous policy decisions of 1987 and later and – as a matter of Government fiat – have so far carried the liability for the debt. But it is difficult to ignore the case that the Commonwealth should shoulder *at least* some substantial share of the responsibility for the debt and the stockpile. This case rests partly on the fact that charges on woolgrowers may not be the best way to repay the debt, partly on the Commonwealth's direct involvement in the policy debacle, partly on the fact that *woolgrower interests* are not necessarily synonymous with *woolgrowers* and on the point that woolgrowers are not a single homogeneous group.

To be fair, the Committee's report does contain sensible analysis and recommendations. Of course Australia should work to free-up world trade in wool and wool products and of course Australia should develop new markets for wool. Australian woolgrowers certainly have a direct financial interest in encouraging world wool processing to continue moving to the least cost countries. And naturally there is a case for encouraging the development of forward markets for wool to help manage wool market risks.

But government and industry should have been working and should continue to work on all these issues quite independently of the wool crisis. These are ongoing matters where the principal gains will come gradually and in the future. Meanwhile, the debt and the stockpile are ever-present and many woolgrowers are in serious financial difficulties right now.

## The Road to Ruin

The changes made in the *Wool Marketing Act 1987* were the first steps on the road to ruin. Then came the Minister's failure to insist on responsible management of the RPS.

Under the pre-1987 RPS the Minister controlled the setting the MRP for each season. He was also responsible for setting the rate of and collecting the tax going towards the MSF (Parliament 1972; Beynon, Haszler and Johns 1982). So the Minister was taxmaster and spendthrift in one, and Australia had at least one individual who had to internalise the benefits and costs of decisions about how "aggressively" we managed the RPS. But the 1987 Act largely removed this link which had contributed to a relative conservatism in managing the RPS.

This relative conservatism had been reinforced by factors such as:

- the objectives of the pre-1987 Act under which the RPS was "not to defy or force the market";
- the initially low financial reserves for running the RPS – the Scheme commenced with a capital loan (subsequently repaid) from the Commonwealth Government;
- memories from the past – that imprudent management of New Zealand's scheme had caused its stocks to surge previously, memories of the 1965 referendum on a reserve price scheme which showed that the RPS was a potentially divisive issue, and that competing fibres might easily cut demand for wool and wool's market share;
- research by BAE showing the RPS was not a free lunch (for example Campbell *et al* 1980; Beynon, Haszler and Johns 1982; Hinchy and Fisher 1985)<sup>3</sup>.

The relative conservatism in setting the MRP and, given the floating of the Australian dollar, some good luck meant that by the late 1980's the MSF had grown to \$1.8 billion. This was equivalent to about one-third of the value of a year's wool clip and made the AWC a substantial lender to the Australian financial markets.

This financial strength of the AWC and the push from Canberra around that time to "corporatise" Commonwealth quangos would have been key reasons for changing the earlier Act (Department of Primary Industry 1986). Unfortunately the regulators got it badly wrong in 1987 – the contingency reserve of some \$1.8 billion was squandered over the next few years and with it went the chance to recast the RPS in a less risky mould.

The first mistake under the 1987 Act was the decision to pass a large measure of the control over the RPS to the AWC and the Wool Council (WCA) – the peak national

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<sup>3</sup> It is interesting to note that the concerns under the pre-1987 RPS "not to defy or force the market" and with wool maintaining its market share have some relevance to the recent debate concerning wool market elasticities (Beare, Fisher and Sutcliffe 1991; ABARE 1992; Connolly 1992; Chisholm *et al* 1993, 1994; Gamaut *et al* 1993; Senate 1993). The concerns of the architects of the earlier Schemes would be consistent with a view that while the wool market is not price-responsive in the short run – required for an effective buffer stock scheme – it is price-responsive in the longer term.



woolgrower organisation. The Minister's powers and responsibility in setting the MRP were much reduced but he remained responsible for collecting the Wool Tax and for making the whole Scheme compulsory. This change in the Act effectively gave the wool industry power to run up debts on the "RPS bankcard" while the Minister and Commonwealth stood liable for the bills.

The Commonwealth's second mistake was to allow the MRP to be lifted by 71 per cent over just two years to the very high level of 870 c/kg set for 1988-89 and 1989-90. These increases are hard to understand as it was clear even in mid-1988 that the near doubling of wool auction prices – to well above trend – had resulted from unusual and probably transitory influences. Moreover, the AWC could have been instructed to use the far less risky strategy of testing the market with "flexible" reserve prices. These had been used before and could have been reduced as demand and market prices fell subsequently without the same major trauma associated with dropping the MRP.

The changes to the Act created a problem of "moral hazard" for the industry, placing even careful industry leaders under enormous pressure to set the MRP "as high as possible". That is, the 1987 Act increased the political incentives for raising the MRP and reduced the incentives for setting a more conservative intervention price.

It was unfortunate that ABARE's annual analysis of options for the MRP for 1988-89 (ABARE 1988) provided some support for setting the MRP as high as 900c/kg for that year. This was despite the fact ABARE's own analysis showed that such a high MRP would put it well above the market trend. Under the pre-1987 legislation and constraints a reserve price even *equal to* the trend level of the market, let alone *above* it, would have been *unthinkable*. Of course ABARE did as usual qualify its assessments and pointed to the risks associated with the exchange rate, a potential drop in demand and also the production response that would follow the very high prices of the previous two years. The important point about ABARE's analysis is that its reserve price reviews had come to play an "honest broker" role in the debates about the setting of the MRP – it had no vested interest in the outcome of the policy decision but it did have requisite experience in forecasting and policy analysis. So, given the political incentives built into the new Act, once the honest broker had given even a qualified acknowledgment that a MRP as high as 900c/kg was feasible, the temptation to over-extend on the RPS bankcard became irresistible. And the political cost of the Minister appropriately exercising his powers of direction must have become enormous.

## Economics of the Responsibility

As far as the economics of responsibility for the wool debt is concerned, the key point is that bygones are bygones. The wool debt is a sunk cost and unless sheeting it home to woolgrowers will necessarily lead to more efficient operation of the economy, the debt should be funded at least cost. Consequently, there may be a case for shifting the burden of the debt onto the community as a whole simply because repayment of the debt that way may cost less overall than having the debt repaid by the wool industry. The parlous state of the wool industry provides one reason for considering this option, even acknowledging the many calls that governments normally have on taxpayers' resources.

Nevertheless, the "user pays" argument might provide a reason for placing the debt burden onto woolgrowers. Woolgrowers may need to better appreciate the costs associated with policy errors to guard against growers pressing for ill-considered policies in the future. But if this argument applies to growers, it applies symmetrically to the Canberra policy process that allowed wool policy to unravel as it did. Strategic behaviour – that might arise because poor incentives lead people into situations of making poor decisions – is as much a problem when it is practised by politicians and bureaucrats as when it is practised by industry or community groups. Politicians might act irresponsibly in order to win or maintain the support of industry and/or interest groups. And interest groups can act against the public interest by seeking to capture the policy system and turn it to their own perceived advantage.

The general issue here is to ensure that in the business of providing policy advice and making policy, the participants from industry *and* the government side (MPs, their advisers and bureaucrats) place as much emphasis on the possibility and costs of getting policies wrong as they do on racking up policy "achievements".

### *(i) Reserve Price Scheme Design*

The argument for running a national buffer stock scheme which, by its design, is compulsory for all woolgrowers rests on three factors which are all related to issues of market failure. The three factors are:

- perceptions that there had been cases of buyers colluding against the interests of woolgrowers and there was a missing market for price risks;
- acting collectively, Australian woolgrowers have a power to influence the wool market, at least in the short-term;
- there would be free-rider problems if a buffer stock scheme was not compulsory.

The fact that a futures market operated by the Sydney Greasy Wool Futures Exchange (1967) had been in operation for over a decade when the RPS was introduced and that a compulsory scheme imposes costs onto woolgrowers who prefer their own arrangements for insuring against price risk did not, in the end, counter the pressures to introduce the initial flexible form of the RPS in 1971.

In addition, the view that there should be equity in terms of the prices obtained for wools sold at different times during a particular season led to minimum reserve prices being set for a season as a whole. Finally, the asymmetry of information (on markets, market analysis, knowledge of stabilisation schemes, etc) between woolgrowers, on the one hand, and economists, bureaucrats, etc, on the other hand was recognised. As a consequence it was accepted that the overall management as well as the day-to-day running of the RPS should be put in the hands of "professional" managers rather than woolgrowers. Note that this point does not preclude woolgrowers even dominating the AWC Board, so long as that "professional/specialist" expertise is brought to bear.

At this point, however, the generally logical steps towards solving the perceived problems generate a new problem – the principal/agent problem – which also involves a market



failure. The failure here is that the agents may have different objectives than their principals so that the simple profit/utility maximisation assumptions underlying the standard neo-classical model may no longer hold. In addition, the ability to influence prices in the short-term under the RPS provided the incentives for grower interests to attempt to capture the price-setting system. The Wool Council certainly did "capture" the RPS system under the 1987 Act and this contributed to the downfall of the Scheme. There were two design features that were critical to the "successful" management of the RPS before 1987. They were the restriction against setting reserve prices contrary to the "competitive position of wool in world markets" and the fact the decision on the MRP was made entirely by the Minister. The industry – the AWC and WCA – had no direct powers at all in that regard. Before 1987 the MRP was set and operated effectively as a Ministerial direction to the AWC. These restraints against aggressive and risky setting of the MRP disappeared with the 1987 Act.

### *(ii) Internalising Policy-Making Benefits and Costs*

Although the wool industry may have sought and argued for the post-1987 design changes to the RPS, these faults with the Scheme are also the responsibility of the Canberra policy process. The issue now is whether that policy process can be made more cautious in designing and managing its interventions.

Central to the point about internalising policy-making benefits and costs, is the view that it is possible to conceive of a market for policy making and policy advice. In the present example, this market is characterised by woolgrowers who have a demand for policy and ministers and bureaucrats who supply it. Attainment of economic efficiency in this market, as in any other market, requires that "prices" do reflect all the costs and benefits to the participants from engaging in the business of policy making. The question is how to internalise these benefits and costs.

Internalising the benefits is relatively easy. "Successful" policy interventions are noticed and rewarded by promotions, overseas trips, another term of office, etc. However, internalising the costs of policy errors is much harder. Usually the penalty is lack of promotion or at least slower progress up the bureaucratic or political greasy pole than one's peers and competitors. But this form of indirect penalty may be insufficient deterrence against future errors, specially if the information and other asymmetries enable the policy system to off-load the costs of its errors.

The latter point is particularly relevant in the wool case. The "wool debt" is owed to various banks and other lenders with the Commonwealth Government's exposure taking the form of a contingent liability through its guarantees for the debt. If woolgrowers repay all the debt the Government's contingent liability might not be called upon. On the other hand, if the Government took over all or part of the debt, the transaction would appear in the budget making the policy error highly visible for years to come to analysts who might otherwise not be the least concerned with wool policy matters. It is, therefore, probably necessary to ensure the policy system – and that means taxpayers eventually – does shoulder the costs of its errors, so that bureaucrats, ministerial policy advisers and their political masters all face much stronger opprobrium for policy errors than otherwise. That

is electors should not easily forgive those who produce policies having "unintended consequences". Perhaps these errors do need to be much more obviously noted so that the public, in its turn, is better informed about the process of government interventions and so does not make uninformed and unrealistic demands on government.

The efficiency case for sheeting-home the costs of policy errors to those held to be responsible – woolgrowers or the Government, which means taxpayers – is strengthened by the fact that the alternatives are either not available or are higher cost. Woolgrowers cannot insure against sovereign risk and diversification of their enterprises to reduce their exposure to the risk of poor wool policy making will involve some opportunity costs – through maintaining cash reserves and/or production of less profitable products. In either case, these responses to sovereign risk involve efficiency losses.

Attempting to internalise policy-making costs to policy makers on this and other occasions may be judged unlikely to work. In that event it is not clear that internalising the costs to the wool industry will work either and there would be no more reason for punishing woolgrowers for errors that are not entirely theirs, than for punishing ministers, ministerial policy advisers, and bureaucrats in government and statutory organisations. That is we are again left with the "repay at least national cost" principle.

Nevertheless, the Government may still believe that it was unduly influenced by "greedy woolgrowers" who should now be brought to account over the collapse of the RPS and the wool debt. Extending this argument to other industries that have benefited, temporarily at least, from government interventions of various kinds raises some interesting issues. For instance, would a government now contemplate suing workers and firms in the textile and car industries – just for example – to recover the higher than current levels of assistance given to these industries in the past. There seems to be a parallel between the wool industry's interest in controlling the RPS and the efforts of the relevant car and TCF industry advocates who have lobbied hard to secure what they believe is appropriate treatment for their constituents. Perhaps the relevant point is that the Government does have a contingent budget liability in the wool case, whereas it is consumers who directly shoulder the costs of assistance to the vehicle and TCF industries?

There are equity issues concerning the asymmetry of existing methods by which policy makers generally seem to "pay" for their mistakes and the way woolgrowers and other private interests may pay. For ministers and bureaucrats, the cost of errors may simply be that they are not promoted further and therefore their penalty is a foregone benefit that *may* have been available to them. In an absolute sense such a foregone benefit may not be much of a penalty at all if the affected individuals already have entitlements to job, some power, generous superannuation benefits and health benefits – all perquisites of public employment and one of the reasons why talented people stay with public services despite often much higher salaries in the private sector. And in some cases, people "move on" before their errors are discovered so they may incur no penalty at all from their inadequate performance.

Contrast this with the penalties falling upon woolgrowers, particularly specialist woolgrowers who would have relatively limited adjustment alternatives. The penalties here include financial hardship that may bring on physical and educational deprivation for the

grower's family. At the extreme, woolgrowers are said to have committed suicide because of financial difficulties brought on, or aggravated, by the inadequate management of the RPS after 1987. This asymmetry of the potential penalties would be inefficient on economic grounds if woolgrowers and policy makers were equally risk averse and placed the same values on costs and benefits. Such asymmetry of penalties seems inequitable and would probably be challenged under the legal system.

## Legal responsibility

Ultimately the question of legal responsibility for the wool policy debacle is a matter for the courts and detailed consideration of the issue is beyond the scope of this paper. However, questions that would probably attract some attention from legal minds include:

- is there any financial or similar consideration involved – for instance have woolgrowers incomes been affected either beneficially or adversely?
- is it possible to identify any links between the Commonwealth Government's actions and the collapse of the RPS?
- did the Commonwealth and its agencies exercise due care in discharging their responsibilities both in designing the scheme and managing it?
- are there any relevant precedents?

On the basis of such questions and the available evidence, it is hard to see how the Commonwealth could possibly continue to escape all responsibility for the "wool debt".

First, all the actors, organisations and procedures involved in accumulating the \$2.7 billion debt and the stockpile were either established by, were directly responsible to, or were granted legislated status by the Commonwealth through the *Wool Marketing Act 1987*. The Act set up the AWC, it established procedures for setting the MRP and gave legislated status to the WCA. The Minister had responsibilities for appointing the Chairman of the AWC and its Board and for approving the AWC's operating plans. The Minister and his Department certainly had a role in nominating the Government member on the Board – the person responsible for protecting the public interest. And in marked contrast to the decisions made over 1990 – 1991, the changes to the Act in 1987 and the associated policy decisions were not made under any particular pressures of time or crisis. Internally set timetables – for instance within the Minister's Department – for achieving reform of the Commonwealth's rural marketing agencies would be most unlikely to constitute legal grounds for overlooking poor policy development.

Perhaps reflecting the legislative background, the Commonwealth Auditor-General has said that individual woolgrowers are not responsible for the wool debt and the stockpile. That view has been echoed in advice to individual woolgrowers saying they do not have an "equitable interest" in the RPS contingency fund – the MSF. This latter view would be consistent with a view of the RPS as an "insurance scheme" designed to stabilise prices in which growers – the policy-holders – paid a wool tax as the annual premium. In the commercial world, when such a scheme is wound-up, the insurance ceases and so does any liability for premiums and any debts the insurance company has, unhappily, accumulated. It is probable that under some circumstances policy holders (woolgrowers) might even

have a cause for action against the company (Government) on the grounds it had not exercised due care in managing its business.

Whether or not due care is considered to have been exercised with respect to the RPS, depends on whether its architects and managers could reasonably have been expected to have anticipated the problems that arose. The economic literature indicates an affirmative response. The idea that interest groups can be expected to attempt to capture the policy processes for their own purposes was known because of the original work on this (Stigler 1971) and because of work in Australia (Anderson 1980; Sieper 1982). And the critical importance of tying farm price policies to market trends was also well known, partly because of research within the Commonwealth bureaucracy itself. The literature here includes BAE's path-breaking "Red Book" on the EC's farm policies (BAE 1985), its subsequent reports on Japanese and US farm policies as well as Miller's (1986) work dealing with world agricultural policy reform. In any event, Australia's own experience with wool policy might have been warning enough! There also appear to be some precedents indicating that the courts might hold the Commonwealth accountable for at least part of the "wool debt". At the same time the results of the two actions against the Commonwealth's recent wool policy activities do not seem to provide cause for avoiding an action on account of the Commonwealth's poor management of the post-1987 RPS.

One defence for making policy errors in spite of all this information is that the Commonwealth Public Service underwent a major restructuring from 1987. This reorganisation was initiated to accommodate factional interests within the Labor Party by expanding the Federal Ministry. The reorganisation may well have generated benefits overall (Keating 1993) but it was disruptive in the short term since the attention of many public servants was diverted from their specified duties either towards maximising their career prospects or just surviving amidst the job spills that occurred. For its part, the former Department of Primary Industry was expanded significantly at the time to become the Department of Primary Industries and Energy with its portfolio of commodities growing from rural products to cover all commodities of interest to Australia. It took some time for the reorganised departments to settle down.

## Ethical responsibility

The arguments for the Commonwealth's responsibility for the debt and stockpile on ethical grounds also rely on its responsibility for setting up the whole legislative framework for the RPS. The fact that the "honest broker" ABARE effectively endorsed the high MRP for 1988-89 merely adds weight to the Commonwealth's responsibility as does the argument that there are information asymmetries between woolgrowers on the one hand and of ministers and the bureaucracy on the other. Whatever their other talents, woolgrowers first and foremost have to be specialists in wool production, otherwise they will go broke. Ministers and bureaucrats have chosen to specialise in public administration and policy making and should be expected, on average at least, to have more knowledge than the average woolgrower on matters such as the risks associated with commodity stabilisation schemes. And there is a responsibility to ensure that, within the accepted political system, this superior knowledge base is reflected in the design and management of public policy.

Of course, many woolgrowers did benefit initially when the high MRP held up the prices paid for their wool. But those initial gains have probably been more than dissipated by the subsequent pain of sharply reduced prices and associated financial stress. In deciding whether woolgrowers individually and severally should bear the costs of the "wool debt" it is important to distinguish between:

- woolgrowers who were members of various rural producer organisations and so had a say in the policy decisions and, alternatively, woolgrowers who were not members;
- woolgrowers who opposed the RPS, and particularly its excesses after 1987, and those who did not;
- woolgrowers who were and are still producing wool, and growers who have moved into other enterprises.

Moreover, some woolgrowers probably never enjoyed any gains at all – for instance growers who borrowed to go into wool production in response to the incentive of the very high MRP. While it may be administratively and politically expedient to do so, it is not likely to be either efficient or fair to treat such different groups of people in the same way.

Some would hold woolgrowers responsible for the wool debt because, they argue, producer groups eventually influence legislators to twist government policy to the producers' advantage thereby making inevitable the collapse of schemes like the RPS. This view would help explain how and why such schemes collapse, but it is not useful in assigning responsibility on ethical grounds. After all, we all know that death is inevitable – but we still punish murderers!

Furthermore, there have now been quite a number of precedents for governments being made responsible for and, indeed, accepting collective responsibility for policy and management errors. The precedents cover actions of both state and the Commonwealth governments. At the state level the examples include the Victorian Pyramid levy. At the Commonwealth level we have the State Bank of Victoria and State Bank of South Australia rescues and the Midford shirts case. In the SBV and SBSA cases the Commonwealth even accepted responsibility for the errors of *other* governments. These precedents strengthen the cases on economic, legal and ethical grounds for the Commonwealth accepting liability for the "wool debt". That is, these precedents show that government acceptance of such responsibility is within the politically feasible domain, such acceptance has, by implication, been judged to come at either "least cost" or at least acceptable cost, courts have found in favour of plaintiffs in similar cases and, finally, the people have judged such collective responsibility to be "fair" or acceptable in some cases. Nor does the experience with the two wool actions concerning the unravelling of wool policy deny the precedents that are emerging.

That some of these decisions by the Commonwealth Government to shoulder the costs of mistakes by others, including other governments, may have been purely political decisions does not reduce their force on legal or ethical grounds. However, it would certainly help to cement in the view that the precedents are relevant in the case of the "wool debt" if woolgrowers had a more forceful voice advocating their cause.



## A Less Circumspect Role for Wool Council?

It is puzzling that the Wool Council of Australia has not taken a more proactive role in pushing the Commonwealth to write-off at least some of the "wool debt". After all the stakes are huge – a wool debt still amounting to over \$2 billion plus the additional costs of repaying the debt. Wool Council may be adopting a low public profile because it is pursuing its own objectives, because it has itself been captured by the Federal policy process, because it sees the stockpile as a future asset or perhaps because it is embarrassed over its involvement in the policy decisions of the late 1980s.

Access to government is vital to interest groups. As an industry lobby group, Wool Council and its staff need to deal with government on a wide range of issues. These issues include wage policy and sheering contract rates, clip preparation standards, price stabilisation issues, R&D policy, promotion funding, macroeconomic issues affecting the wool industry such as bank lending policies, to name only a part of the broad agenda. To deal with government, Wool Council must have continued access to government, which requires it to maintain working relationships with government ministers and their departmental and private advisers. The present Federal Government has made it clear that access to and sympathetic consideration from the Government depend on lobby groups *not* criticising the Government. As evidence one can cite the HIA affair. This kind of behaviour is not restricted to Labor governments as evidenced by the fact the Victorian Government has black-listed the ABC's *7.30 Report* and the *Sunday Age* because it felt it was getting unfavourable treatment from those sources.

As agents of woolgrowers in general, members of Wool Council and its staff might have some objectives that are not necessarily consistent with maximising benefits to their woolgrower principals. Such aims might include an interest in wielding and being seen to wield power as part of the government process, ambitions for appointment to public agencies and they might wish for a quieter life. Given such dual objectives and the access question, rational people might well respond by treading more softly on particularly contentious issues, specially where the matters are complex and if there is room for debate.

In addition, politicians and bureaucrats can themselves be thought of as interest groups with incentives to capture their own constituencies. The constituencies include, obviously, the electorate but also the lobby groups with which they must deal. The motivations of politicians and governments in seeking to capture these constituencies would be the same as those pushing the traditional interest groups. The "reverse capture" idea is much harder to test empirically than its simpler more straightforward version. What is required in the reverse capture case is evidence of actions by interest groups that are not as forceful as they might be. This requires much more detailed knowledge of particular industries/policies than the alternative. Under the simpler version information on whether industries get assistance or not and some measure of concentration of the industry may be enough to test the theory.

One way that the government policy system might capture interest groups is by setting the agenda. The establishment of the IAC is an example of agenda setting – not by bureaucrats for the government but by government and bureaucrats for industry groups. The establishment of the IAC – like BAE's decision to hold outlook conferences – was



certainly important in bringing a great deal more transparency to the economic policy debate in Australia. The point in these circumstances is that when the government's agenda defines the realm of the possible, industry groups need to make pragmatic/strategic decisions about what is winnable and at what cost – to the employees of these groups and to their principals.

There may be two remedies against Wool Council's circumspect role. First, the WCA's negotiating and representational tasks could be split so that the wool-debt-for-other-policy trade-offs are minimised. This could be done by Wool Council adopting a "good cop/bad cop" approach. It could appoint a special negotiating group to handle the wool debt debate with the Government. If the negotiating group was seen to have status and power, its formation would help limit any spill-over animosity from the Government onto the more traditional activities of Wool Council. This arrangement of focussing attention on specific tasks is, in principle, no different to the Commonwealth's own behaviour when it sets up specialist agencies to carry out what may be unpleasant tasks. The existence of the Industry Commission, for instance, would have enabled ministers to divert some of the lobbying to which they would otherwise have been subjected.

One problem with taking a more aggressive stance on responsibility for the wool debt is that Wool Council would need to admit that it did not have all the necessary knowledge to set reserve prices. But this would be a very small and cheap serve of humble pie given the high stakes. For the Government's part, it is understandable why it would want to sweep the sins of its past under the (wool) carpet. But this is not good ethics and not good economics. And surely it is only good politics as long as woolgrowers allow.

The second remedy is information. The required information includes information about the nature of politics, about the fact that things can change, about alternative voting and decision-making procedures – for example more frequent referenda on major issues – and also information about the alternatives available to the wool industry. Governments with any interest in economic efficiency would also have some responsibility for providing information in cases of such "reverse capture". For instance they should ensure wherever possible that individuals have the opportunity to opt out of schemes that may be designed in circumstances where principal-agent problems may blur objectives. This may make the design of public policy more difficult, but it should help to ensure that *all* the neoclassical assumptions are met more often when governments intervene with the aim of correcting some market failure.

## Conclusions

There can be no doubt that responsibility for the wool debt and the wool stockpile must be shared in some way between the wool industry and the Commonwealth Government. The crisis in the wool industry is the result of a series of government failures. These include the failure to design adequate safeguards into the post-1987 RPS, the Minister's failure to override the wool industry's profligate price-setting experiment specially when it was obviously awry, and the failure to acknowledge the Commonwealth's role in the debacle. In all these cases the Government's initiatives have patently failed to improve on the preceding set of policies. Because it has refused to accept any responsibility for the policy

debacle, the Commonwealth has precluded one option for handling the wool debt with the result it may not be handled in the least cost way. Even if it is accepted that the wool industry is to repay the debt, it is argued elsewhere (Chisholm *et al* 1994) the Government may have again ruled out the potentially better alternatives for Australia.

It is understandable that the Commonwealth Government and its agencies do not want to admit liability for the debt. By denying the debt, the Commonwealth has more resources for its standard constituencies. However, Wool Council's compliant attitude is most puzzling.

One possibility is that Wool Council, or some of its members, may have an unstated agenda for future marketing initiatives based on Wool International. Wool International could begin its "commercial" life with a stockpile of some 240kt greasy. This is more than *twice* the average carryover under the RPS over the years 1970-71 to 1977-78. Some reincarnation of the RPS around these stocks is not beyond belief given the circumstances of the introduction of the RPS previously and given that some woolgrowers are interested in the return of the RPS. The evidence for this can be found in the motions put at conferences of farmers and in the letters columns of the newspapers. If there is some such hidden agenda, its adherents would be well-advised to base their views and actions on good information. One critical issue is that even a "privatised" Wool International would have substantial market power and therefore the capacity to affect the market and the well-being of individual woolgrowers – including growers who do not support the particular marketing initiatives.

As a postscript, the problems of our wool policy must be astonishing to Australia's GATT negotiators who worked hard for more sensible agricultural policies around the world. Their efforts over the long negotiations rested partly on the back of such research classics as BAE's "Red Book" mentioned earlier. Sadly, while Australia was busy launching this and similar agricultural policy documents onto the international stage, we forgot about the wool policy talent quest in the shire hall. Is the wool show now over, the policy players having quit the field leaving woolgrowers to clean up?

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