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THE WOOL BOARD'S SECOND REPORT ON MARKETING: A REVIEW ARTICLE

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The second report on Wool Marketing by the Australian Wool Board is critically appraised. Particular attention is given to the proposals for elimination of small lots, price averaging and supply management. The presumption that price stablization is good and the conclusion that private buying is bad are also discussed in detail.

Background

Grower agitation for change in the system of marketing wool in Australia dates back at least to the 1860s. Demands, mainly from small growers, for some sort of price stablilization plan have been especially strong in times of depressed prices and in the periods following the suspension of auction selling during the two world wars. Larger, more specialized producers, however, have generally been opposed to government intervention in the market.

In the recent past, a campaign by some grower organizations for a reserve price scheme led to the establishment of a Wool Marketing Committee of Enquiry in 1961. Their report [11] recommended against a buffer stock scheme or a monopoly marketing board. More promotion and research, instead, were favoured, these to be integrated by a permanent Commission. Following these recommendations, the Australian Wool Board was established in 1963 and a government subsidy for promotion was introduced.

One function of the new Board was to carry on the investigations into marketing begun by the Philp Committee. The first report on wool marketing of the Board [1] in 1964 recommended a conservative reserve price scheme, and this was accepted by the 'wool parliament', the Australian Wool Industry Conference. In 1965 as in 1951, however, growers in a referendum voted against such a scheme.

This and other marketing issues, however, remained unsettled, and the A.W.I.C. requested the Wool Board 'to continue, with all possible speed, research into all aspects of preparation, distribution and disposal of the clip with the view of strengthening and improving the method of Marketing (*sic*) the Australian wool clip'. The Board, however, narrowed down these terms of reference somewhat in transmitting them to its Marketing Committee. Unrevised since 1963, the Board's terms required in addition to a general investigation of all aspects of wool marketing *specific* investigations of a reserve price scheme, acquisition schemes, central appraisement, and private selling. The resulting Report[1] released in October, 1967, is the subject of the present article.

* I am indebted to several of my colleagues, particularly J. N. Lewis and J. J. Quilkey, and to F. H. Gruen and E. L. Jenkins for comments on earlier drafts.

[1] Australian Wool Board, *Report on Wool Marketing*, Melbourne, 1967.

Content of the 1967 Report

The broadness of the basic terms of reference and the formidable length of the combined Report and appendices lead the reader to expect a wider and more fundamental approach to the problems of wool marketing than is to be found in the 1964 report of the Board [1] or the 1962 report of the Philp Committee [11]. This expectation is unfortunately fulfilled only in part.

Firstly, the Report is less substantial in terms of 'utilizable equivalent' than its length suggests. Volume II, the Report of the Wool Marketing Committee, and Volume I, Part 1, the Board's amended version, are largely identical, differing mainly in the emphasis placed on supply management in the scheme for price averaging.[2] Moreover, the Appendices are liberally laced with poorly predigested data often in appendices within appendices. For instance some fifty pages are devoted to a presentation of the monthly availability of the Australian wool clip in 1960/61 to 1962/63 by type and centre—in both chart and tabular form.

A more serious disappointment, however, lies in the mix and balance of subject matter. Taking as a framework the classification of marketing functions[3] suggested by Kohls [27, pp. 18-19] we find firstly, a disproportionate emphasis upon a particular joint aspect of storage and risk bearing, namely the manipulation of storage to reduce price instability. Selling, by contrast, receives little attention. The activities of the International Wool Secretariat in promotion, market research and product development are occasionally given vague and fulsome praise but nowhere critically assessed. Perhaps, however, it is unrealistic to expect the Board to publicly question a daughter's virtue. Less understandable are the lack of detailed discussion of market intelligence and the cautious treatment of the exciting possibilities of improved standardization. Of the remaining functions, transport and financing are given a more detailed and rigorous treatment than hitherto. The sections on handling of wool are particularly informative, reflecting an atypically dispassionate and rigorous approach to the improvement of wool marketing. Assembly is given fair coverage, if in respect of private buying not always fair treatment.

Objectives and Recommendations

The recommendations of the Report are geared to the avowed primary objective of 'providing the Australian woolgrower with the maximum net return for his product' (Vol. I-1, para 1). While this objective seems to be beyond the scope of the marketing system narrowly defined—maximizing the farm gate demand for wool (and transmitting all aspects

[2] Further modifications show the Board to be less *overtly* aggressive in promoting grower interests. Thus, in Vol. I-1, paras. 1 and 72, the Board states 'providing the Australian woolgrower with the maximum net return for his product' as only one among several objectives of the marketing system whereas the Committee states this as an *overriding* objective. Similarly the Board drops the Committee's specific requirement that three members of the proposed Wool Marketing Authority be woolgrowers (Vol. I-1, para. 190).

[3] The functions of marketing are thus classified. A. *Exchange Functions*, 1. Buying (Assembling), 2. Selling, B. *Physical Functions*, 3. Storage, 4. Transportation. C. *Facilitating Functions*, 5. Standardization, 6. Financing, 7. Risk-bearing, 8. Market Information.

of that demand most efficiently to growers) might be a more appropriate goal—the emphasis on the interests of growers cannot be faulted, given the basic function of the Board.[4]

Some of the subsidiary or intermediate objectives underlying the recommendations are less understandable or acceptable. 'To market wool at the lowest possible cost to the grower' is certainly a reasonable partial objective.[5] Objective (ii), however, 'to achieve a reduction in price fluctuations of wool in the interests of both producer and processor' is open to several interpretations. The most obvious interpretation, and probably the one intended, has the implication that *any degree* of price stabilization (around presumably the 'basic trend') will *necessarily* benefit producers and processors as *separate* groups. This proposition is at least open to question.

To achieve the Board's objectives the Report recommends the following main actions:

1. Star lots of less than four bales are to be eliminated (except in the case of specified lots, mainly of specialty types) by interlotting, otherwise bulk classing.
2. All interlotted and bulk classed lots of the same type delivered into wool-broker's store within specified price averaging periods of six months duration are to receive a common clean price.[6] This price would be the average price obtained for *all* wool of that type (net of selling charges) sold by all brokers in the State concerned during the averaging period. Lots other than bulk classed or interlotted would participate in the scheme at the producer's discretion.
3. A statutory Wool Marketing Authority is to have the power to instruct brokers to withhold or withdraw lots within the averaging scheme from sale when ruling prices are at 'unreasonably low levels'. These lots would be released when price levels are improved, and if not sold within the original price averaging period would be bought by the authority at the State average price for that type.
4. The proposed Authority will also:
   (i) Define and enforce standards of clip preparation.
   (ii) Establish a market intelligence unit.
   (iii) Supervise the elimination of star lots (within a period of three years).
   (iv) Administer the price averaging plan, providing a clearing house for brokers.
   (v) Provide advances at low rates of interest to all growers against

[4] Indeed, given that wool is nine-tenths an export commodity and the bargaining power of Australian participants in the marketing chain, this objective, problems of subsidy apart, could be argued to be reasonable for society.

[5] It cannot, however, be accepted as a complete objective for growers, contrary to what Burston suggests in his minority report (Vol. I-1, p. 34). Indeed further on in his own submission Burston argues 'woolgrowers can benefit themselves by promoting a consumer demand . . . favourable to wool', thus implicity conceding increases in marketing expenditure benefit growers when the outward shift in the consumer (or user) demand curve outweighs the increase in marketing margin.

[6] Payment of the average price would be made in two instalments (i) within fourteen days of receival into store, a first advance of 60 per cent of the brokers' valuation, and (ii) at the end of the price averaging period, the residual amount.

wool in broker's store, to the extent of 60% of broker's valuation.

5. A Wool Selling Organisation, controlled by brokers, buyers and growers is to be set up principally to:
   (i) Establish a code of ethics between parties to the auction room.
   (ii) Enforce and (if necessary) revise the wool selling regulations.
   (iii) Set selling rosters.

The Board's recommendations appear to be a judiciously selected *pot pourri* of the proposals reported elsewhere in the Report with supply management as the indispensable ingredient and some adjustment of seasoning. Ideas have been drawn not only from the appendices of the Board's own staff and *ad hoc* committees but also from the *ex parte* statements published as subsidiary appendices. The proposal that unsatisfactory classed wool be removed from the market by a statutory authority, for example, appears to emanate from Mr Killen's submission (Appendix 10).

Elimination of Lots of Three Bales and Under

The elimination of lots of one, two and three bales, and the consequent increase in average lot size from 4.4 bales in recent seasons (App. 1, app. 10, p. 40) to about 8 bales (App. 1, p. 7, para. 8) would clearly reduce the costs of both buyers and selling brokers. In buying a given amount of wool in fewer lots, buyers could reduce time spent in valuing, sampling, assembling orders and invoicing. The closing of separate sale rooms for star lots would permit further economies in the use of labour. A less quantifiable advantage would be a reduction in the mixing of wool from different lots on the show floor; with fewer bales on display, there would be less chance of wool being pushed into the wrong bale after inspection. Buyers' views on savings possible (as reported in App. 1, pp. 6-7) are understandably cautious. From a recent study by the Bureau of Agricultural Economics [60], however, it may be deduced that buyers' costs per pound greasy, are on average about 0.7 cents more on lots of three bales and under than on larger lots.[7] This reduction would, however, according to the study result largely from the elimination of one bale lots. It is estimated that had all one, two and three bale lots in the 1964/65 clip been converted to five bale lots, nearly two-thirds of the total cost savings to buyers of $1.4 million would have been due to the elimination of one bale lots. Therefore one might question the proposal to immediately eliminate one, two and three bale lots, rather than only one bale lots as proposed in the 1964 Report and as envisaged in the terms of reference given the Ad Hoc Committee on One Bale Lots *et alia*. In any case, even the estimate of 0.7 cents a pound greasy may overstate the likely cost savings to buyers from the elimination of lots of three bales and under, since the presumably greater heterogeneity of built up lots could involve some extra offsetting costs, particularly in valuation. Nevertheless, a worthwhile saving in buyers' costs from the elimination of lots of three bales and under seems certain. This would be complemented moreover by

[7] The basic data for this computation are to be found in Table 7 and 9 of Reference 60. Average bale weight (303·4 lb.) and average size of big lots (7·80 bales) for 1964/65 are taken from Table 1 of reference 55.

some economies to selling brokers.[8] A smaller proportion of bales would need to be displayed and more bales would be sold in a given time. Competition, one hopes, would ensure these savings in marketing costs resulted in some reduction in the basic uniform brokerage charges and the elastic demand for wool relative to supply should, in turn, lead growers in general to receive slightly higher net prices than otherwise. Whether all growers of small lots would receive a further net benefit, however, is doubtful.

Two general propositions on price relations are here relevant:

(i) Lots made up of one grower's wool fetch more than mixed lots.
(ii) Big lots sell at a premium over small lots.

Proposition (i) is supported by work of Whan on commonly traded lines in Melbourne (1959/60) and Sydney (1962/63) which indicates a premium for grower brand wool over bulk classed and interlotted of about 0.8 cents a pound [54; 55].[9] Various reasons may be suggested for this premium. Many buyers apparently use district of origin as a guide to appraisal of fibre dimension, substance and yields [56]. Bulk classed wools are opened to the atmosphere and therefore absorb moisture [54]. Moreover, quality number (based on crimps per inch) is likely to be a better guide to fibre diameter within flocks than between flocks.

A premium for big over small lots is suggested by the Ad Hoc Committee's comparisons of average prices of a selected number of types sold in one bale lots on the one hand and in lots of five or more bales on the other, over four recent seasons (App. 1, p. 12-13). A more sophisticated analysis by Whan which, though confined to five selected types in the 1963/64 season, abstracts from the influence of time of selling and considers also two and three bale lots, found a premium for big lots over small lots *irrespective of size* of about 1.2 cents a pound greasy [53]. This is of the same order as the extra costs of buying small lots.

Assuming the above price relations are correct, the grower with a small lot has currently the choice between pooling at a discount of about 0.8 cents a pound or selling in the star saleroom at a discount of about 1.2 cents a pound. On this basis, building up lot size in conjunction with other growers would be profitable, only if this could be done at a cost of less than 0.4 cents a pound. Taking the charges of selling brokers and classing centres quoted in the report (App. 1, app. 7), bulk classing charges in all centres easily exceed 0.4 cents, 1.7 cents a pound appearing to be the minimum charge. Interlotting, however, appears profitable in all states except N.S.W., the charge in southern selling centres being only 0.25 cents a pound. In N.S.W. the charge quoted is 0.5 cents a pound and, were this service freely available,

[8] The enthusiasm of brokers for the elimination of star lots is some indication that it will reduce their costs. The basic proposal of the Ad Hoc Committee on One Bale Lots *et alia* (App. 1, p. 2, paras. 2-3), in fact reproduces verbatim the relevant part of the submission of the National Council of Wool Selling Brokers (App. 8, page 149, paras. 58-59).

[9] The existence of this premium is not completely substantiated by the Ad Hoc Committee's own analysis (App. 1, p. 17). The comparative averages of prices there quoted, however, are unweighted by type, and do not abstract from the influence of selling centre, lot size or within season changes in the pattern of offerings.

one could not confidently deny interlotting might be profitable even for growers selling at N.S.W. centres. In fact, however, interlotting is *not* freely available in northern centres (which handle close to 40 per cent of the national clip). Thus, in the 1965/66 season only 3 per cent of rehandled wool sold at Sydney and Brisbane was interlotted compared to 48 per cent in Melbourne (App. 1, app. 11, p. 43).

It would seem then that many growers producing small lots in N.S.W. and Queensland could well be disadvantaged by the elimination of lots of three bales and under, unless interlotting facilities were made more widely available. The report hardly makes one confident that will happen. A mild request is made to brokers. 'It is considered that brokers may adopt a more liberal attitude in deciding whether or not a bale could be interlotted'. (Vol. I-1, para. 200.) It seems, however, the final decision on suitability for interlotting will remain with the brokers. Possibly some leverage might be exerted by the proposed Authority *via* its specified standards of clip preparation. In the light of the other powers proposed for the Authority, however, this would be a surprisingly weak guarantee.

Growers concerned are surely entitled to a clearer statement on the future availability of interlotting. It is remarkable that the Report contains neither a detailed appraisal of the obstacles to interlotting in northern centres (baldly stated in App. 1, p. 8, para. 5 as 'the short interval beween sales in Sydney, the time restrictions on brokers to prepare their catalogues and the display floor space requirement')[10] nor any explanation of how these obstacles could be overcome either by the compulsory elimination of lots of three bales and under or the associated scheme for price averaging.

A final consideration ignored by the Report is the impact of increasing the proportion of wool rehandled on the discount against built up lots. Even if there were no resulting increase in the average heterogeneity of the wool after interlotting (and therefore in the risk of buying it), it might still be supposed a greater proportion of wool in a less preferred form (rehandled) would be absorbed only at a greater discount to wool in the preferred form (grower brand).

An alternative solution to the problem of star lots is that brokers should adjust their charges to more closely reflect the extra costs of handling star lots.[11] In this way (since buyers already reflect their added costs back to producers), a good solution could be found through the price mechanism—particularly if brokers were also to extend interlotting facilities. This solution would involve an expansion in store classing.

The wool brokers would no doubt defend their present equalized charges as an 'equitable procedure in which the interests of the smaller grower and buyer are protected equally with those of the larger buyer and grower'. (App. 8, p. 145, para. 21.) Such an argument should not, however, be taken very seriously. Firstly there is an economically less justifiable precedent for such discrimination by class of grower, in

[10] In their comments on the Report of the Ad Hoc Committee, the Marketing Committee suggests grower reluctance as an additional obstacle to interlotting in northern centres. The implication that this obstacle is a dominant one, is however, implausible.

[11] One possibility mooted by the Ad Hoc Committee on One Bale Lots *et alia* is that the warehousing charge could be divided into (a) a charge for receiving and weighing, and (b) a charge for showing, applying only to shown bales.

the typical scale of selling commissions which varies by value of clip. [32]. More fundamentally, the redistribution of income between woolgrowers can not be regarded as a legitimate function of selling brokers.

Price Averaging

The proposals for elimination of star lots and for averaging of prices are linked explicitly in the Report by the need to compensate growers for the possible delay in offering of interlotted and bulk classed lots (Vol. I-1, para. 203). (Price averaging would also, no doubt, facilitate the delaying of offering to obtain more satisfactory rehandling.) A further possible implicit link is that the scheme in its final form (with in-built subsidy) is intended to compensate growers who may be disadvantaged by the elimination of small lots.

A more general case for price averaging is that the aspect of price uncertainty which is most objectionable to growers is the 'gamble associated with a choice of sale day', a choice, which is of course largely not the grower's [31]. A widespread desire of growers for price averaging is, however, disputed by Docker in a minority report (Vol. 11, p. 39) and by Gruen [19]. Views on price averaging as an efficiency measure will vary with views on the proportionate breakdown of the intra-period price movements of particular types between:

(i) Recurring differentials giving useful messages on desired qualities (within a type) and/or time of shearing.
(ii) Avoidable movements due to (a) inefficient speculation, and (b) inconsistent appraisal of quality.
(iii) Unavoidable movements associated with unforeseeable events (and perhaps inherent in a purely competitive market [47]).

Those who believe component (iii) is dominant will support averaging on efficiency grounds as a means of clearing price messages of confusing 'noise'. Those stressing the importance of (i) by contrast will oppose averaging as a hindrance to improvements in the efficiency of wool production. If we favour (ii) as an explanation of short term price instability, price averaging *may* be opposed as a measure which attacks the symptoms of the problem rather than the root causes.

The general case for or against price averaging is then not clear cut on either welfare or efficiency grounds. Imposition of price averaging (particularly over at least 40 per cent of the clip as envisaged in the final version of the scheme) therefore seems unwarranted. Growers who wish to reduce the variance of possible expected prices can do so by—(i) joining a *voluntary* pool, (ii) spreading sold positions on the futures exchange over several or all months of the selling season [5, p. 19] or, (iii) (in appropriate cases), splitting one large lot into two smaller lots [59].

Nevertheless, if there must be a price stabilization scheme, price averaging in principle does have some considerable theoretical advantages [31; 11, para. 418; 1, para. 49]. Standards of clip preparation can be improved; wool can be more cheaply assembled in standard types and large lots; operation is inexpensive with little risk of capital loss; and a better distribution of types throughout the season can be achieved. Unfortunately, several of these advantages would not be obtained under the scheme proposed. It appears to be intended that brokers shall retain

responsibility both for lot preparation and typing, and thus the full potential savings from bulk handling of wool of the same type will not be obtained.[12]

It cannot, moreover, confidently be said the scheme runs no risk of capital loss. It is likely that the average price received for wool of a particular type within the pool, will usually be less than the State-wide average price which is the basis of payment. Firstly, rehandled lots are believed to sell at some discount to grower brand lots [54; 55]. Secondly, the provision for voluntary participation of growers with marketable lots will probably be adversely selective. The scheme will be most attractive to those growers whose wool normally sells at a discount within its type, say because of district of origin [56]. There is therefore reason to believe the price averaging scheme would not be self financing.[13]

The price averaging scheme, however, is definitely intended to achieve the advantage of 'a better distribution of types throughout a season to meet users' requirements and avoid oversupply of particular types and qualities of wool at any point of time in the season' [11, para. 418]. Indeed, the Board has converted the relatively modest proposal of the Ad Hoc Committee on One Bale Lots *et al.* for price averaging into a much more ambitious plan for supply management (more exactly stock management). The scope of the scheme has been extended by the Board to cover *all* interlots and bulk classed wool and other wool if the grower so wishes (Vol. I-1, para. 215). The price stabilizing intent has also been considerably strengthened. The Ad Hoc Committee envisaged no more than the brokers would, largely at their own discretion, use the flexibility provided by price averaging to spread offerings to the best advantage, rather than strictly in accordance with arrival date into store (App. 1, p. 10, para. 2-6). The Marketing Committee, however, proposed that offerings of wool subject to averaging should be controlled by a statutory authority (Vol. II, para. 213). In addition, the Board suggests the authority would value *all* wool in the catalogue and, with the grower's consent, pass in to the price averaging scheme, wool which failed to meet the authority's valuation. A cynic indeed might well regard the Price Averaging Scheme as a Trojan Horse, shielding something strongly reminiscent of the Reserve Price Scheme—with the not unimportant innovation that there would be no reserve price.

Price Stabilization and Supply Management

Implicit in this Report, as in its predecessor, is the belief that stabilization of prices should be the main objective of wool marketing reform.[14] Despite the space devoted to the subject, however, no serious attempt is made to systematically justify stabilization or to analyse the causes

[12] The physical possibilities and economics of such bulk handling are, however, to be further investigated following the feasibility study commissioned by the Board (App. 11).

[13] This conclusion is not, I think, affected by consideration of the provisions for supply management in the scheme. Supply manipulation may raise overall prices but will not necessarily raise the price of wool within the pool relative to wool outside the pool.

[14] Thus, in introducing the report to the A.W.I.C. on 31st October, 1967, the Board's chairman stated 'the main problem facing the wool marketing committee remained . . . to devise means by which fluctuation in price of wool not representing a variation of true demand could be reduced as far as possible'.

of price instability. Greater price stability may benefit woolgrowers by (i) improving the efficiency of resource allocation, (ii) shifting outwards the processor demand for wool, (iii) pure speculative profits to the grower authority, (iv) intertemporal price discrimination, (v) making grower incomes more stable, or (vi) some combination of the above. In assessing the value of price stability all these factors must be considered—a course not always followed either by proponents or critics of stabilization.

The efficiency argument for price stability, due to Gale Johnson, is that when prices are uncertain, the expected prices on which resource use (both within and between enterprises) is planned will frequently not be realized so that *ex post* profits are not maximized. Even when expectations are correct, profits are still not maximized because the expectation will have been discounted for price risk [26, pp. 43-46]. The argument, though strong in logic, is of doubtful relevance to short term or even medium term stabilization of wool prices.

Even setting aside the peculiarities of the wool production process, it should be noted that the efficiency argument relates to price *certainty* and not price stability as such. Price certainty is not inconsistent with some instability. (Furthermore, of course, complete or artificial price stability is undesirable on efficiency grounds, since prices must have some flexibility, if they are to move resources into their most profitable uses as demands and production possibilities change.).[15] It follows then that improving price certainty need not entail supply manipulation.

The demand shifting argument for stabilization [19, 30] is given wide, if not always deep, coverage in the Report. Thus, Mrs Ryde (App. 6, p. 131) states by stabilizing prices we should be offering to industrial users of wool an improved product, that is one from which they could make a higher profit, because their costs would be reduced. (They would be relieved of the risk cost, inherent in fluctuating prices.)

The argument has several threads. Originally a ratchet effect was postulated; processors who switched out of wool when wool prices were high would not return to the fold in the down swing [22, p. 568]. The force of this argument has been weakened by the widespread adoption of machinery which is more flexible in fibre use [11, para. 184]. Emphasis now is placed more on the aversion of the modern processor to the inventory risk associated with wool, especially in relation to synthetics, which (supply being better controlled) are more stable in price and of which a much smaller stock need be held. The increasingly dominant large textile firm, vertically integrated and diversified by fibre, is argued to regard fluctuations in material prices as a risk rather than an opportunity [2, p. 36] unlike the traditional Bradford processor [46, pp. 56-58, p. 79, and p. 83]. The Board has previously argued that salaried managers do not like speculation and shareholders do not like fluctuating profits [2]. On the other hand, one might argue that larger integrated firms should be better able to pass on changes in material prices, using their market power to pyramid rather than price line. A stronger variation of this argument is that prices of end products in many sectors where wool and synthetics are competitive will be increasingly based on the prices of synthetic fibres rather than the price

[15] A more debatable 'efficiency' argument for price instability is its 'winnowing' effects in eliminating inefficient producers [18, p. 499].

of wool. In this situation, making the price of wool stable and independent of the prices of synthetics would make margins (between prices of finished goods and prices of materials) received by many processors using wool more unstable than in a free market, where prices of wool and synthetics would be directly related. Therefore, price stabilization would discourage the use of wool in end uses where synthetics were closely competitive.[16] Certainly the expressed opinions of textile organizations on supply management appear to be less enthusiastic than in 1964. It may be, however, that in 1964 processors believed some radical change in the system of wool marketing was inevitable and that a reserve price scheme was preferable to an acquisition scheme.

Even if price instability is one factor restricting the demand for wool relative to synthetics it is not clear that it is a dominant factor. Other factors in the wool *versus* synthetics battle to which the Report might have given more attention are:

(i) Changes in processing costs (both in the relative costs of transforming different fibres by the same process, and the relative cost of different processes (e.g. knitting versus weaving) favouring different fibres [21, p. 9-36; 39; 9, pp. 40-41].
(ii) The greater flexibility and certainty of synthetics in respect of quality [22, p. 566; 11, para. 55].
(iii) The costs of reproducing synthetic qualities in wool products (and not just the technical possibilities) [21, p. 9-35]
(iv) Fashion changes (movements away or towards end uses in which wool is especially strong) [20; 25].
(v) The relative effectiveness of the promotion strategies adopted by producers of different fibres.

Finally, one may question to what degree the problem facing processors is one of price instability as such and to what degree one of uncertainty which may be tackled individually through futures trading or contracting and institutionally by better market intelligence.

The possible advantages of obtaining speculative profits and of intertemporal price discrimination, however, relate specifically to price stabilization by producer organized storage. Given the commitment to price stabilization and, in any case, the impossibility of imposing, in Meade's terms [33], deficient or perverse storage on the market, a producer storage organization will make normal or above-normal profits only by being better at speculation (i.e. forecasting) than existing speculators. Any such superiority would have to be the result of better techniques since the various proposals have not envisaged that the producer storage organization should have exclusive access to information from (say) the Government. The Report does little to help us choose between the opposing views existing on the relative efficiency of institutional forecasting [12, pp. 8-9; 30]. Private speculation is treated in the Report either as non-existent or perverse, but neither view is well substantiated. Early in the Report, the Board states 'with a regular pattern in the supply of wool being offered, imbalance between supply and demand in the short term results in short term price fluctuations' (Vol. I-1, para. 4). Parish has, however, correctly pointed out that 'the combination of unstable demand and inelatic supply is itself

[16] The hub of this argument, if not its exact form, is due to J. H. Duloy.

insufficient explanation for fluctuating prices. Rather any explanation must run in terms of the existence of insufficient stabilizing speculation or excessive destabilizing speculation ' [38, p. 283]. The speculative role of merchants is certainly recognized by the Board (Vol. I-1, para. 98) and in the case of futures markets the influence of speculators is even deemed stabilizing (Vol. I-1, para. 111). Generally, however, no attempt is made to seriously appraise the effects of speculators on spot wool prices. In some sections (Vol. I-1, paras. 80 and 126 and App. 6, para. 10) speculation is apparently regarded as normally perverse.[17] Even if we accept that perverse speculation may be profitable in a free market [4], convincing evidence has not been presented to show that speculation in wool is normally price destabilizing (through being self feeding or based on spotting turning points). Nevertheless, equally, we can not be sure it is normally stabilizing. Therefore, no firm forecast can be made of the profits, as a *speculator*, a producer authority could make.

The 'intertemporal price discrimination' argument for price stabilization relates to the 'hidden gains or losses' of a producer storage organization [17; 44; 45; 35; 36] i.e. to the benefit or otherwise to producers *qua* producers and not *qua* speculators. If it is accepted that the wool market is characterized by a shifting demand combined with fixed and inelastic supply [43] then it is clear that the benefits to producers from price stabilizing storage will depend on the relation between the slope of demand at high prices (when authority stocks are being released) and the slope of demand at low prices (when authority stocks are being accumulated). If consumption is more responsive to price when demand is strong than when demand is weak (and would remain so after market intervention), then it will pay a producer authority to undertake stabilizing speculation where it would not pay private speculators. However, neither logic nor empirical investigation [17, p. 33-37] allow us to confidently state that the relation between the strength and responsiveness of demand for wool is such that institutional price stabilizing speculation will raise the long run average price received by growers.

The final argument for price stabilization to be considered is that price stability by increasing income stability will increase producer welfare, even though average income over time will be unaffected. It can readily be accepted that where price instability is largely demand induced (and therefore receipts and price are directly related), stabilizing price will stabilize cash receipts both to the industry and (on average over time) to individual producers. We may also accept that since to most people the marginal utility of *income* must diminish with income, a given long run income will give more satisfaction evenly spread over time than in uneven instalments. However, one may argue that a producer can convert unstable cash receipts into more stable income (defined in the Hicksian sense of a flow that can be maintained indefinitely [23, pp. 171-188] by a judicious investment strategy [14]. In the light of the difficulty of forecasting (both price and production) and the imperfections of capital markets, this argument may be less strong in practice than principle. It does, however, suggest the thought that this particular advantage might be gained more flexibly for the

[17] Note in contrast the view of the Chairman of the New Zealand Wool Commission that 'speculation (. . . in the sense of looking forward) demand . . . is probably normally conducive to stability in the industry'. (App. 4, p. 110).

individual producer if the authority were to merely *publish* its estimates of future prices and not seek to implement them by supply manipulation. In any event, it is clear that storage by producer cartel is not necessarily the most effective way of increasing the stability even of cash receipts. Buffer funds or even income insurance [51] may well be preferable.

The above analysis it is hoped, will indicate that the advantages ot price stabilization, particularly by instititutional storage are by no means as self-evident as the Wool Board appears to think.[18] The advantages of the particular stabilization scheme proposed are even less obvious. In particular, it seems unlikely the scheme will much increase price certainty for processors. More plausibly, it would add a further element of uncertainty. This view is well put by Burston in his dissenting opinion (Vol. II, p. 34). 'It (i.e. supply management) actually means the creation of a "buffer stock" of wool of unpredictable size and quality to overhang the publicly announced wool selling roster as the day to day judgement of the authority determines'. The Report does not even state the criteria the Authority would use in setting reserves on the wool under its control. Since prices will not be announced in advance, moreover, possible gains from greater price certainty to growers will not be attained. Finally, it seems the proponents of the scheme do not expect the authority to be much better at forecasting than speculating merchants. Thus, in Vol. I-1, para. 223, 'It would not require the wisdom of Solomon to administer but correct commercial judgement . . . such as successful wool merchants . . . must exercise in their buying and selling decisions'. We may agree that the scheme is more flexible than the previous Reserve Price Plan and that there would be less danger of accumulating a stock pile (Vol. I-1, paras. 184-185). However, it seems at least part of the baby has been thrown out with the bath water. What is left may not be worth saving and may even be malignant.

Market Intelligence

Some form of market intelligence is certainly in principle desirable, not only as an adjunct to any scheme of supply management, but also as a means of improving price discovery in a free market. The particular form the proposed unit would take is unfortunately not explained in the Report. To properly assess the proposal one would need to know what source of information is to be collected, at whom it will be aimed (and if indeed any of it will be made public at all), the length of the forecasting period, and the relation of the unit to the International Wool Secretariat. The lack of details provided in the Report is surprising considering the space devoted for instance to the advances proposal and compares very unfavourably with the presentation of a similar proposal by the New Zealand Wool Board [34, paras. 323-325].

Advances at Low Interest Rates

The proposal that the authority would make available loans against wool in store at a concessional interest rate (presumably financed by the

[18] A separate case for supply management of course, as Gruen suggests [19], may have been made out on the grounds of improving producers' bargaining power against collusive buyers. In fact this is not done in the Report presumably because 'pieing' is not now considered a serious problem by the Board. In any case, were oligopsony serious, it could probably be countered only by strong and comprehensive supply control, i.e. by acquisition.

Reserve Bank) seems to receive an unwarranted amount of attention in the Report. As is admitted, the income advantage would be only $10 annually to the average grower (App. 12, p. 202). Moreover, the detailed analysis in Appendix 12 provides no evidence there is any serious problem in obtaining such credit from existing sources. Therefore, it seems unlikely that the 'grower's opportunity for better production management' (Vol. I, para. 227) will be very great.

Wool Selling Organization

The proposal to give growers some control over the exchange of wool at auction is welcome and overdue since the interests of producers and brokers can not be assumed to be identical. The power to set selling rosters could, if buyers and brokers permit, prove a powerful complement to the supply management powers of the authority. On this question, and on market reporting, however, there would surely be conflict between Authority and the Organization.

Other Findings

Besides making and justifying the major proposals already discussed, the Board and its Committees have reported investigations on three free enterprise methods of improving price certainty (namely private trading, forward contracts and futures trading), on grading, on acquisition schemes (rejected as too radical), and on wool handling (particularly between receival into store and dockside).

Private Trading

The Ad Hoc Committee on Private Sales of Wool (App. 3) concludes that 'private buying for direct export is opposed to the interests of all sections of the industry'. The Board accepts what is correctly termed the 'opinion' of the Committee and suggests that private selling may need to be controlled not only by 'grower education' but also by export licensing in the interests of effective supply management.

In Appendix 2 it is claimed that private trading creates uncertainty by interrupting orderly rostering and the free and even flow of wool and 'restricts access'. An extension of private selling it is asserted would raise unit wool handling costs and adversely affect price levels.

It can be agreed that private buying creates some uncertainty for auction buyers by making amounts and types of wool to be offered less predictable. This argument, however, as also that on the free flow of wool, cannot readily be run in tandem with the argument that institutional control of offerings is required to stabilize prices. (Similarly, the *orderly* rostering prized by the Ad Hoc Committee is not elsewhere in the Report regarded so enthusiastically). The argument relating to the even flow of wool is, however, not only possibly inconsistent with other parts of the Report but dubious in itself. Firstly, it is not clear that private buying necessarily increases the unevenness of supply. In some respects at least, the contrary is true. Thus wool can flow privately when no auctions are being held or when particular types are not on offer at auction (App. 2, para. 136). Secondly, the value of an even supply of wool is based on three suppositions (i) that speculation is inefficient, (ii) that the existing division of stocks between the producing and consuming countries is optimal [6, p. 530]

and (iii) that an even flow of each type of wool is desired by processors. None of these hypotheses have been verified. The argument that private buying 'restricts access' is difficult to appraise since the reader is given neither a definition of restricted access nor an explanation of how it comes about.

The more concrete allegation that private trading depresses price levels is not substantiated either in logic or by evidence. The Ad Hoc Committee did not find it possible to make any empirical comparisons of prices of auctioned and directly sold wool, and thus have given us no reason to reject Scobie's earlier finding of no significant difference [48]. It is true that private buying reduces demand at auctions (App. 2, para. 196-201) but then it equally reduces the supply of wool at auctions. The argument that an extension of private selling will reduce the farm gate prices by increasing marketing costs is also rather implausible. It is unlikely that an economic model in which intensified competition raises prices is applicable to the assembly of wool, even in the long run. Rather (*contra* the comment of the Marketing Committee on page 108 of Appendix 3) it is in the long run that any *ad hoc* collusive agreement to share the market will break down.

Moreover, it is possible that direct buying may be a technological advance on the auction system, reducing costs by saving on labour [19] and by bulk handling (App. 2, para. 110). At the very least, it may serve as a 'pacesetter' for the auction system, complementing the (sometimes weak) force of internal competition. Private trading can also provide other benefits to growers. The genuine reservation demand it allows (App. 2, para. 71), in contrast to the auction system, gives the grower much greater flexibility in marketing and could provide an economic liberal's solution to short run price instability. Again, if private buying were to develop into contractual forward buying, growers would have greater price certainty and possibly better information on market requirements. In some situations, it may pay growers to sell small lots privately to avoid bulk classing charges. Finally, growers whose wool is consistently undervalued by the rule of thumb methods used at auctions [58] may be able to sell privately on the basis of agreed objective measurements.

The true danger of an extension of direct trading is that auction prices may become unrepresentative and growers, selling directly, therefore handicapped in the bargaining by inadequate information. This point is mentioned though not highlighted by the Ad Hoc Committee (App. 2, paras. 157-161). This problem, however, is at present remote and in any case not necessarily insoluble. Prices might be discovered by futures trading [37, p. 9], co-operative price exchanges, or mandatory reporting of prices to a government agency.

Forward Contracts and Futures Trading

In contrast to the irrational views expressed on private buying, forward selling and futures trading receive more reasonable treatment. Both are recognized to provide valuable services to those desiring greater price certainty.

The argument, however, that the reputation of wool is being prejudiced by contractors delivering 'skin grade' when prices move against them, while not obviously incorrect, seems inconsistent with other parts of

the Report. If contractors can cheat in this way, either competition between buyers or the grading system must be defective. Nowhere in the Report, however, do we find either of these propositions.

The proposal that the Sydney futures market should operate 'under regulation of an appropriate authority' (not as suggested by the Marketing Committee *the* Authority) is probably well founded. One may particularly approve the intention to investigate the possibility of delivering wool which has not passed the auction system[19] and the obtaining of more complete information on the users of futures contracts.

The agnostic view on the relation between futures trading and price stability is probably reasonable. (The reviewer, however, would tentatively suggest that a futures exchange, by facilitating the expression of market sentiment, increases the frequency of price fluctuations, but, by facilitating rational stockholding, reduces the amplitude of fluctuations). The utility of futures trading, however, lies rather in the greater (though certainly not complete and at present costly [30]) price certainty it provides—to those who want it. This aspect (in particular the role of futures in improving planning by growers and in facilitating forward trading) might have been given more attention in the Report in assessing the need for supply management.

Grading

The Board is sceptical of the possibilities of moving towards a streamlined system of wool selling by description. On the one hand, the familiar Fabian cry of 'more research needed' is made (Vol. I-1, paras. 158-164). On the other hand, it is claimed that a sale by description would be yet another factor undermining the confidence of processors in wool (Vol. I-1, paras. 152-157).

One may readily agree that our knowledge of the relationship between the measurable parameters of the properties of greasy wool and processing performance is not 'complete' (Vol. I-1, para. 163). Some appraisal of the research that has been done (for instance [3; 5; 29]), might nevertheless have been expected. This could well have led to the conclusion that sale by description (of fibre diameter, yield, and district of origin) of some 'bread and butter lines' should be offered as an alternative service.[20]

Moreover, it is suprising that an organization representing producers themselves on the treadmill of technological change should so readily accept the resistance of middlemen to new techniques. It is implausible that users who are becoming increasingly used to the precise quality provided by synthetics and the trading of wool products on objective specifications will have no confidence in scientifically tested raw material.

[19] It may be noted that such a change would be facilitated by an extension of private buying, since there would then be little incentive for growers to use the futures exchange as a physical delivery market in times of high prices [8].

[20] It is accepted, however, that the feasibility of sale by description of all types has not been demonstrated. The more intangible qualities of substance are important at the quality end of the trade. Moreover (following Parish) because price variation in wool is largely explained by variation in quality, count (primarily), staple length, and colour [50; 13], we can not assume other differences in *horizontal* quality are not of importance to buyers. (*Horizontal* quality differences do not involve significant differences in cost of production and are not ranked similarly by all buyers.)

Whether the cost of widespread testing would, as suggested, be prohibitive (Vol. I-1, para. 158) is also debatable. McMahon has recently estimated pre-testing could be done at about $6 a lot (i.e. with present lot size, at less than half a cent a pound).[21]

The view that the present auction system 'affords the most effective and equitable method of the distribution of the wool clip as between users' (Vol. I-1, para. 73) seems unwarrantedly sanguine. A situation where in store costs account for about 30 per cent of the total marketing margin (Vol. I-2, p. 10) cannot be accepted without the most serious consideration of the necessity for the present degree of visual inspection. Greater use of scientific description would reduce the labour costs associated in multiple valuing and the movement of sample bales, economize on storage space, and facilitate the combining of lots (perhaps into containers at country classing centres).

Moreover, the present system of visual grading does not permit the efficient transmission of information between user and producer—the basic function of marketing [40; 49; pp. 8-15]. While present methods of estimating yield and fibre diameter are reasonably accurate *on average* (and therefore satisfactory to buyers), wools of unusual quality are incorrectly priced [56; 57; 59]. Thus production of unusually good wool (within a type)is discouraged and conversely.[22] Given the limited degree to which managers can change wool quality in the short run the efficiency loss to the industry may not be serious. However, the resulting inequity of the distribution of wool receipts among growers cannot be lightly disregarded.

Classing receives more detailed attention in the Report than auction typing (though the recommendation to extend provisional registration without examination if implemented would seem likely to devalue the stencil used to distinguish bales prepared by registered classers). In general, however, the attention given to grading is quite disproportionately scant.

Conclusions

The authors of the Report are to be commended on tackling some grass-root problems of reducing marketing costs and on making a serious attempt to give growers a better understanding of the marketing system. The answers suggested to the main questions posed, however, are hardly satisfactory. The general case for price stabilization is not well made, while the particular scheme of supply management proposed is unlikely to be the most efficient way of obtaining the benefits therefrom. The abolition of small lots is, of itself, likely to disadvantage many small growers, while the general benefits could be better achieved by more rational pricing by brokers. The associated scheme for price averaging is unlikely to be self financing. Plans to establish a market intelligence service and to give growers greater control over the assembly of wool are, in themselves, admirable, but not properly explained. Private buying has been appraised in a biased and irrational fashion in contrast

[21] Quoted in the *Sydney Morning Herald*, 11th May, 1968.

[22] Even within the existing system communications could be improved. More meaningful type names could be used, for example, on multiple code lines as suggested by Skinner [50]. Brokers also could give more detailed reports on the composition of wool cheques.

to the generally well reasoned analyses of forward contracts, futures trading and acquisition schemes. The Report may finally be faulted for not giving more serious attention to problems of grading, and to the performance of selling brokers and the International Wool Secretariat.

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