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Reviews

Two Government Failures? A Tale of Sugar and Wool

Geoff Edwards*

A discussion is provided of policy developments and policy debate for the sugar and wool industries in 1992 and the first half of 1993. The discussion is set against a characterisation of the longer-term economic situations of the two industries. It is suggested, perhaps controversially, that government failure has been a longstanding feature of both industries. Understanding of the policy reform needed to remove economic inefficiency is better for sugar than for wool. However, the decisions taken on sugar policy in February, 1993 mean that incentives for wasteful use of resources are maintained. In the case of wool, the Garnaut inquiry faces a challenge in trying to come to grips, in a period of three months, with the major short- to medium-term problems of debt repayment and disposal of the stockpile, as well as the apparent longer-term problem of creating incentives to restrict wool exports to the optimal level.

Introduction

Readers of the *Review* in recent years have been treated to four overview assessments by Rolf Gerritsen and co-authors of developments in Australia's rural policy (Gerritsen and Murray 1987; Gerritsen and Abbott 1988; Gerritsen and Abbott 1990; and Gerritsen 1992). I suspect that only those who have attempted to prepare such an assessment appreciate how demanding the task is. Having undertaken somewhat similar tasks, it was with some apprehension that I accepted the editor's invitation to write a review of policy for a 1993 issue of the *Review*. With the idea of making the job more manageable, and of differentiating my review from those of Gerritsen, I decided to confine the review to developments in industry policy. Further reflection suggested that there might be advantages in concentrating on just two industries — sugar and wool — which were in the policy spotlight in 1992 and the first half of 1993. Although this approach means sacrificing breadth of coverage, it offers the possibility of looking at the two industries more closely than in a wider review, and of making some comparisons and contrasts between them.

Sugar was on centre stage in 1992 and early 1993 because of the Industry Commission's (IC) inquiry and the drawn out process of reaching policy decisions on sugar. The sugar policies of the Government and Opposition, both announced in the run-up to the Federal election held on 13 March 1993, received much publicity for several reasons: the clear need for major microeconomic reform in the sugar industry; the viewing of policy on the sugar tariff as an earnest of the Government's — and Opposition's — general policy of moving to low tariffs; strong differences of view within the Liberal/National Party coalition on sugar policy; and the existence of several marginal seats in sugar growing areas.

The year 1992 was not crucial for the making of wool policy in the way it was for the formulation of sugar policy. The big decisions on wool had been made in 1991. That year saw the decision to suspend and then terminate the buffer stock/reserve price scheme for wool. It also saw the restructuring of the Australian Wool Corporation (AWC), with the establishment of the Australian Wool Realisation Commission (AWRC) with responsibilities for disposing of the industry's wool stockpile and repaying the stockpile-related debt of 2.7 billion dollars. Rather, 1992 was the first year of testing for the policies set in place for wool in 1991. The testing was to be more severe in the first half of 1993, and that testing led to questioning of the direction of wool industry policy and to the announcement of another inquiry into the wool industry.

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Review co-ordinated by the Editor.

A feature of this paper is that it attempts to set the discussion of recent policy developments in the sugar and wool industries against a characterisation of the longer-term economic situation of the two industries. Readers who have only ten minutes to devote to the paper are directed to the characterisation — provided in the next section — and to the Concluding Comment. In between these sections there is a consideration of most of the major economic policy issues in the sugar and wool industries in 1992 and the first half of 1993.

A Study in Contrasts

The characterisation of the wool and sugar industries provided in this section is a summary assessment of the economic environment and performance of the two industries. The characterisation may be controversial, especially perhaps in the case of wool. It is suggested, however, that the picture presented is applicable to the wool and sugar industries over many decades and that it represents the underlying situation on which recent problems need to be superimposed. The characterisation is summarised in Table 1, and elaborated below.

The heavy regulation of the Queensland sugar industry is effected mainly under state government legislation. The assignment system for regulating cane growing and milling, the monopoly for the Queensland Sugar Corporation (QSC) in marketing raw sugar, and the two-pool system for distributing returns from sales of raw sugar to growers and millers are the creations of the Queensland Government. Of course, the form of the legislation establishing these regulatory features of the sugar industry was much influenced by the views of industry participants. The influence of the Federal Government on the regulatory environment of the sugar industry is exercised through measures to restrict sugar imports — a prohibition until mid-1989, and a tariff since then.

The regulatory arrangements in the sugar industry give rise to many inefficiencies: by restricting inputs of land they raise the costs of growing cane; by inducing more intensive production methods, they cause extra pressures to be placed on land used for cane growing; they prevent some growers who wish to grow cane from doing so, and prevent others from growing as much as they wish; they tax new sugar production in order to subsidise old — "peak" — sugar; they act as a disincentive to the development of an export-oriented refinery industry; they prevent growers, millers and other firms from seeking out and exercising marketing opportunities that they find attractive; and they remove competitive pressures from the QSC (ABARE 1991; Borrell, Quirke and Vincent 1991; IC 1992). The effect of the regulatory package is to prevent growers, millers, refiners and the QSC making the most efficient decisions on levels of production, location of production, production methods, sugar quality, marketing, refining and other value-adding activities. It is accepted in the sugar industry that Australia has little, if any, influence on world prices for sugar, so there is no terms-of-trade case for restricting production and exports (IC 1992). The Sugar Industry Task Force (1993) agreed with assessments by the IC (1992) and others that growth of the sugar industry has been held below the most efficient rate by regulation.

Table 1: Characterisation of the Sugar and Wool Industries

Issue	Sugar	Wool
Main regulator	Queensland Government	Federal Government
World market power	No	Yes
Incentives appropriate for efficiency	No	No
Size of industry	Too small	Too large

Traditionally the wool industry has not been subject to the heavy regulation experienced by the sugar industry. However, with the support of the wool industry, the Federal Government has imposed levies on revenue from wool sales to fund research, promotion, and activities of the buffer stock-cum-reserve price scheme; it has also made its own contributions to research and promotion from consolidated revenue.

The Australian wool industry, unlike sugar, has a substantial influence on world market prices (Connolly 1992; Chisholm, Haszler, Edwards and Hone 1993). It was the ability to influence world prices that made the reserve price scheme for wool possible. However, the idea of the buffer stock and reserve price mechanisms was not to take advantage of Australia's world market power by restricting market supplies: the idea, initially anyway, was to *stabilise* prices by removing supplies from the market when the world price was low and adding to supplies when the world price was high (Watson 1990a).

Prima facie, the possession of world market power — reflected in inelastic foreign demand for Australia's exports of wool — points to a requirement quite different from a buffer stock-cum-reserve price scheme to achieve a wool industry that makes efficient use of resources. That is, it suggests that Australia could benefit from restricting wool exports to a level lower than that occurring in a free market situation (Corden 1974; Chisholm *et al.* 1993). It is important to recognise that this potential gain from restricting exports exists on a long-term basis. It exists independently of a wool stockpile, and regardless of the level of world price: it applies in boom years as well as in years when the market is depressed. The argument for restricting exports rests on a divergence between the price of wool and marginal national revenue from wool. This divergence exists under conditions of less than perfectly elastic demand — not just an elasticity less than unity. On this argument, an appropriate policy for restricting wool exports, such as an export tax, is necessary for the existence of an efficient structure of incentives in the wool industry; otherwise the level of wool production and exports will be too high. If wool exports were restricted by means of an export tax it would arguably be desirable on grounds of fairness that part of the proceeds be redistributed to woolgrowers. To retain incentives appropriate for economic efficiency, any redistribution to woolgrowers would need to be made in a lump sum way.

Sugar Policy

In 1991 and 1992 the IC carried out an inquiry into the sugar industry, presenting its report to the Federal Government in March 1992. The report was strongly criticised by sections of the sugar industry and by the Queensland Government. The Minister, Mr. Simon Crean, then established a Sugar Industry Task Force to provide him with another view on appropriate changes in policy. The Government announced its decisions on sugar industry policy on 2 February 1993, the Opposition stated its policy on 15 February, and the Federal election was held on 13 March. Table 2 summarises the recommendations of the IC, along with those of the Sugar Industry Task Force, and the policy packages of the Government and Opposition.

The Industry Commission Report

The terms of reference for the IC's inquiry were broad, covering all arrangements subject to the influence of governments which affect efficiency in the production and marketing of sugar. The IC was asked specifically to report on the level of the tariff for sugar from 1 July 1992. The thrust of the IC's report was strongly deregulatory. The IC's recommendations and its assessment of the effects of implementing those recommendations are indicated in more detail below.

Assignment system

The IC recommended that the centralised assignment system, used to regulate the amount and location of cane growing and milling, be abolished after the 1995 season. There would then be no regulatory constraints on the amount or location of land that could be used to grow cane. Transitional arrangements were recommended from 1993; these would have ensured that the total area of assigned land increase by at least 5 per cent a year with half the increase allocated to new growers. To facilitate transfer of assignment the IC recommended that all

Table 2: Recommendations of Industry Commission and Sugar Industry Task Force, and Policies of Government and Opposition

Policy Instrument	IC	Task Force	Government	Opposition
Assignment system	End in 1996	Retain, with increased local autonomy	Retain, with increased local autonomy	Retain, with increased local autonomy
Compulsory acquisition/single -desk exporter	End quickly	No recommendation on acquisition. Retain single-desk exporter	Retain	Retain
Tariff	Remove quickly	No recommendation	Hold at $55/t until July 1997. Review in 1995-96	Hold at $55/t until 1994. Freeze at $15/t from 1995 to 2000
Two-pool payments system	Would end with acquisition	No recommendation. Some support for ending, with compensation	Reduce 12% price differential to 6% by 1995. Review in 1996	Abolish in 1993. Compensation of $41.5m
Bulk handling terminals	Assign shares to individual growers and millers	Transfer ownership to the industry. Manage as a single entity	Transfer ownership to the industry. Manage as a single entity	Transfer ownership to the industry. Manage as a single entity
Infrastructure development		Federal and state governments provide assistance for infrastructure development	Federal and Queensland governments each to provide $20m	Federal and Queensland governments each to provide $20m
Other	Lump-sum compensation of $47m for immediate removal of tariff assistance			Compensation of $84m from 1995 to 1999 for faster-than-normal tariff reductions

new assignment be freely transferable and that the transfer of pre-1993 assignment be made freer.

Compulsory acquisition
The IC recommended that compulsory acquisition of raw sugar by the QSC be ended. Growers/millers would then be able to market their own sugar within Australia or overseas as they thought best. The QSC could continue as a marketer of sugar, but it would have to win business by its competitiveness. The QSC would be allowed to acquire sufficient raw sugar to meet its long-term export contracts which run to 1997. Ending acquisition would be expected to drive sugar prices to around export parity, regardless of what happened to the sugar tariff.

Tariff
Because of its support for ending acquisition, the IC recommended that the tariff of $76 a tonne on raw and refined sugar be removed expeditiously. In the event that acquisition was retained, the IC recommended that the tariff be phased down to zero by 30 June, 1998, with no change from the previously announced tariff — $55 per tonne — to apply from 1 July, 1992.

One-off transitional payment
Because the immediate abolition of acquisition, as recommended, would reduce domestic prices to export levels forthwith, the usual phased approach to tariff reduction would not result in a phased reduction in assistance. The IC therefore recommended a single transitional payment to producers of raw sugar in lieu of a diminishing level of tariff assistance. The size of the estimated payments to producers (growers and millers) in Queensland would be $37 million and in New South Wales $10 million. Payments to individual producers would be determined by production of raw sugar sold for domestic consumption in 1989-90, 1990-91 and 1991-92. They would therefore not provide a price incentive to increase production.

Bulk-handling terminals
The IC recommended that ownership of the bulk handling terminals be transferred to individual growers and millers. At present the terminals and the land on which they are located are owned by the port authorities, and leased to the QSC for 99 years at peppercorn rentals. The IC estimated that cane growers would obtain an asset worth an average of $25,000 from this transfer, with mills gaining $1 million – $5 million. It saw more efficient pricing of terminal services as a benefit from the reallocation of property rights in bulk terminals.

Response to the IC Report

The IC's report was under attack even before it was tabled in Parliament. Upon its public release, it was criticised by the key farmer organisation, Canegrowers, and the Queensland Government for its alleged lack of understanding of realities in the sugar industry. The Queensland Premier, Mr. Wayne Goss, said he had "made it loud and clear to the Federal Government" that Queensland opposed the report, especially the proposal to remove the tariff in 1993 in exchange for a $47 million payment to the industry (*The Australian* 1 May 1992). Mr. Goss said the recommendations failed to recognise the steps taken to free up the industry in the 1991 *Sugar Industry Act*, which should be given a chance to work.

The immediate response to the IC's report focused largely on the tariff issue with the IC's proposals for deregulating production and, especially, marketing, receiving relatively little attention. There was a political storm surrounding the impending reduction of the sugar tariff from $76 a tonne to $55 a tonne on 1 July 1992. This reduction had been announced by the Federal Government in its March 1991 Economic Statement. The storm saw the National Party's Mr. Ray Braithwaite, the only Queenslander in the Opposition's front bench, resign from his shadow portfolio over his disagreement with the coalition's support for tariff reductions for sugar.[1]

Mr. Crean's response to the criticisms of the IC report was to make it clear he was not wedded to the IC line. In a joint statement with Canegrowers, Mr. Crean said: "The real issue is to develop a growth

[1] Mr. Crean offered an assessment of the National Party. "There are two wings of the National Party — one that will follow the Liberal Party blindly, the other that has not moved in 40 years". Mr. Braithwaite, he suggested, was an "unreconstructed protectionist", and "the first lemming (that) has already gone over the edge". (*Daily Commercial News* 30 April 1993).

strategy for the Australian sugar industry. I will have regard for the IC Report as a basis for discussion but I will not allow it to drive the agenda" (DPIE 92/32C, 5 May 1992).

The Sugar Industry Task Force

In April 1992, Mr. Crean announced a task force to help in developing the growth strategy for the sugar industry. The chairman of the task force was Mr. Brian Courtice, chairman of the Prime Minister's Country Task Force, the member for Hinkler, which includes the city of Bundaberg, and a sugar cane grower. Although a joint statement by Mr. Crean and Canegrowers (DPIE 92/32C, 5 May 1992) said that the first meeting of the task force would be held in mid-June, the names of the other task force members and the terms of reference were not announced until 23 July. The other members were: Mr. Harry Bonanno, chairman of Canegrowers; Mr. Brian McDonald, president of the New South Wales Cane Growers' Council; Mr. Rino Cargnello, chairman of Tully Sugar Ltd and deputy chairman of the Australian Sugar Milling Council; Mr. Bill Ludwig, national president of the Australian Workers' Union; Mr. Bill Bennett, deputy managing director of CSR Ltd; and Mr. Richard Brooks, director of Group Supply, Coca-Cola Amatil. There was no reason to think that any of the task force members would consider net gains *to Australia* an important criterion in assessing sugar policies.[2]

In announcing the team to work with Mr. Courtice, Mr. Crean said "consulting with industry was the cornerstone of his approach to long-term policy development for Australia's primary industries. 'The recent success of my consultations with the dairy and wool industries demonstrates what can be achieved by Government and industry when they work together to achieve a positive outcome'" ("Crean Announces Membership of Sugar Industry Task Force", Media Release DPIE 92/55C, 23 July 1992). In answering a question in the parliament, Mr. Crean said (Hansard, H.R. 25 November 1992):

> "The task force is working extremely well. It had intended to present me with a report earlier this week, but has sought additional time in which to do that because its members believe that they can get greater consensus amongst themselves. I think that is an admirable step forward, given that what we have done for the first time in this industry is to bring together the producers, the processors, the marketers and the distributors."

Notwithstanding the Minister's endorsement of consultation and consensus, it would have been apparent to him and his advisers that the disparate interests represented on the task force would not be able to reach agreement on preferred policies: some of them stood to gain from low sugar prices, and others from high prices. Why, then, was the task force set up? Did the Minister consider that the failure of the task force to reach agreement on acquisition and the tariff would give the Government more flexibility in making its decisions on sugar policy? Did Mr. Crean expect that a helpful consensus would be reached on issues other than acquisition and the tariff? Did the Minister wish to defer a decision on the IC report, perhaps hoping that an early election would precede the decision? Did he see political advantages in involving the main interest groups directly in an inquiry chaired by a member of the Government, even if they could not reach agreement? Did he wish to be seen to be implicitly criticising the IC by setting up another inquiry?

The different interests of task force members did indeed lead to a shortage of recommendations on key issues. On compulsory acquisition the task force reported: "The members of the task force have differing views as to whether it is in the industry's best interests for total acquisition of Queensland raw sugar to continue, whether there should be partial acquisition (of raw sugar for export), or no acquisition at all" (Sugar Industry Task Force 1993, p.7). The task force did agree, however, that a single-desk seller of Queensland raw sugar in the export market should be retained.

On the tariff, Canegrowers supported retention of the existing tariff, refiners considered a policy of zero tariffs on raw and refined sugar (together with effective anti-dumping measures) appropriate, and

[2] There are, of course, other criteria. Mr. Courtice urged the Government to make a decision which was "realistic", and to discard the IC recommendations as unrealistic: "I don't believe that bureaucrats and people who live in the leafy suburbs of Canberra could have any understanding of these issues." (*Australian Financial Review* 16 December 1992).

manufacturers using sugar opposed a tariff on refined sugar. Given this divergence of views, the task force contented itself with listing the following options for policy on the sugar tariff (pp. 26-7):

(i) Continue the tariff at $55 per tonne. This option would require continuation of acquisition of Queensland raw sugar by the QSC.

(ii) Pay a bounty equivalent to the tariff. This would not require acquisition.

(iii) Phase out the tariff.

(iv) Remove the tariff and make lump-sum compensation — the approach recommended by the IC.

On price pooling the task force accepted that "the 12 per cent differential between the prices for No.1 and No.2 pools in Queensland is an impediment to the growth of the industry and investment ..." (p.13). It also noted that the pooling arrangements hindered the provision of the option of producers determining their own prices — using futures markets, for example; this was an option which the task force supported. The task force rejected the argument, often made in the raw sugar industry, that the price differential between pools was justified by higher contributions to bulk terminal development by up-to-peak producers. The price differential between pools is set by legislation until the 1996 season, and the task force saw compensation of losing millers and growers as a necessary condition for eliminating the price differential. Despite acknowledging that the pooling system was an impediment to development of the sugar industry, the task force did not recommend changing the system. However, Canegrowers said it would support removal of the differential from 1 July 1993 if compensation of $52 million was paid to up-to-peak growers.

The task force accepted that the approach being followed to allocating assignment was constraining expansion of the industry. This had previously been denied by industry representatives. The task force recommended a significant reallocation from industry level to local level in responsibility for expansion in the area of sugar cane. However, coordination of the assignment system by the QSC as the single desk seller was seen as necessary for efficiency in storage and marketing.

The task force was asked to report on the potential for refined sugar exports. Its main contribution is contained in the following quotation. "Given the nature of international trade in both raw and white sugar, the refinery process is perhaps better viewed as the conversion of one commodity to another, rather than value adding. The task force noted that the cost of this conversion is not necessarily recoverable in the market place on a sustained basis" (p.34). This may have been a useful reminder to the Minister that activities supported in the name of adding value to resources can, in fact, be value subtracting! However, the task force did not make a significant contribution to developing incentives conducive to export-oriented sugar refining. This was because, as already noted, the task force members could not agree on recommendations about acquisition or the tariff, though present policies in these areas are impediments to developing refined sugar exports.

The Government's Decisions

Mr. Crean announced the Government's policies for sugar on 2 February 1993 ("Government Announces Sugar Industry Package", media release, DPIE 93/71). At that time the report of the Sugar Industry Task Force was not publicly available, nor had copies been provided to other government departments. Mr. Crean said in his statement that the package of measures had the support of the Queensland Government.

Mr. Crean announced that the Government would freeze the tariff at $55 per tonne for three years beyond the 1992-93 season, with a review to be conducted in 1995-96. Mr. Crean's statement gave the impression that the outcome of the review would depend on the outcome of the Uruguay round, though no rationale was provided for this. Compulsory acquisition of Queensland raw sugar by the QSC was continued, with a review as part of the Queensland Government's review of the *Sugar Industry Act 1991* in 1996.

The assignment system for controlling production

was retained. However, in line with the recommendations of the task force, decisions on expansion of the industry will be shifted substantially to the local level, and determined by negotiation between millers and growers. But given the continuation of the QSC monopoly on marketing, centralised control has been retained: "Local agreements will be amalgamated and co-ordinated by the QSC and approved by the Minister for Primary Industries who, through the Queensland Sugar Industry Policy Council, will ensure that the industry is able to develop appropriate export marketing arrangements and that the infra-structure is sufficient to cater for the anticipated production" (Media release, DPIE 93/71, 2 February 1993).

The Government was unable or unwilling to obtain the removal of the two-pool system for distributing returns to producers. The Minister was not willing to take up Canegrowers' offer to trade in the two-pool system for lump sum compensation. The decision announced was to phase down the 12 per cent price difference between pool 1 and pool 2 sugar to 6 per cent by 1995. Mr. Crean said the Federal Government supported subsequent elimination of the difference — to encourage expansion of the industry — and would be given an active role in its review by the Queensland Government in 1996.

The Coalition's Sugar Package

The Opposition's policy on sugar was announced by the Shadow Minister for Industry and Commerce, Ian McLachlan, and the Shadow Minister for Primary Industry, Bruce Lloyd, on 15 February 1992 ("Coalition Announces Sugar Package", Media Release, Shadow Ministry for Industry and Commerce). It was closer to the recommendations of the IC than was the Government's package. The main differences between the Opposition's policy and that of the Government related to tariffs and the pooling system. The coalition undertook to leave the tariff at $55 per tonne for the 1993 and 1994 seasons, and then freeze it at $15 per tonne from the 1995 season to 2000. Compensation of $84 million would be paid to growers and millers between the 1995 and 1999 seasons in lieu of the diminishing tariff benefit they would otherwise have obtained if the tariff had been reduced over the period to 2000. The Opposition undertook to abolish the pooling price differential in 1993. Compensation of $33 million would be paid to Queensland growers of peak sugar and $8.5 million to mills not expected to be able to benefit from increased production following the removal of the two pool system. The compensation sum for growers was said to be the discounted equivalent of the difference in the value of payments under the Government's previously announced phasing down arrangements and payments with immediate ending of the pooling differential. The Opposition supported continuation of the assignment system, saying there was agreement that this would not be used to constrain production. It also supported continuation of the QSC's monopoly on marketing raw sugar.

Assessment

The IC saw growth and development of the Queensland sugar industry being constrained by the industry's regulatory regime. Its recommended thorough-going deregulation of sugar production, marketing and trade was unattractive to cane grower organisations, some millers and the Queensland Government. Neither the Federal Government nor the Opposition were willing to introduce competition in the marketing of raw sugar. Without this change the starting point in pricing raw sugar to Australian refiners and other domestic users will continue to be import parity rather than export parity. The tariff adds further to domestic prices of raw sugar. The sugar industry, which exports around 80 per cent of its production, therefore stands out — along with the dairy industry — from other major rural industries in having a domestic pricing structure inconsistent with its trading status. While this situation remains, income transfers from domestic sugar consumers to producers will occur, and a disincentive will exist to develop value adding activities for raw sugar. The likelihood that Australia will become a significant exporter of refined sugar is reduced. Milling and other firms, in Australia and overseas, cannot use any special knowledge or cost advantages they possess to make marketing initiatives using Australian raw sugar. The QSC does not face the pressures to keep costs down that it would experience with competition in marketing.

The benefits to Queensland producers from the inward-looking policies for the sugar industry are relatively small. The tariff increased industry revenue by some 2 per cent in 1992-93, and the increase due to acquisition was about half that (IC 1992). The main gainers in relative terms from retaining the policies of compulsory acquisition of Queensland sugar and the tariff are growers and millers in New South Wales. They not only continue to receive the supported domestic prices on their entire output, but their incentive to increase production and take profitable domestic sales from Queensland is retained.

While compulsory acquisition of raw sugar by the QSC, and the tariff, work to raise domestic prices, the two-pool payments system taxes new sugar production and subsidises old peak sugar. Thus, new entrants to the industry and established producers expanding their production receive less than the export price for their production. The reduction in the price differential for the two pools from 12 per cent to 6 per cent by 1995 will reduce but not remove a disincentive to expand production and to the movement of young and innovative producers into the industry.

On the production side, the assignment system has been made more flexible in recent years, and the more decentralised decision-making that will occur under the package agreed to by the Federal and Queensland governments should reduce the extent to which industry output is constrained. However, there are reasons for thinking that the efficiency of production cannot be as great under even a fully decentralised and flexible assignment system as under alternative systems. Theoretical considerations and experience with acreage set-aside schemes overseas and hen quotas in Australia make it clear that unit costs are increased when the use of one input into production is restricted. The substitution of fertilisers, chemicals and water for land in sugar production in response to the assignment system makes costs per tonne of sugar higher than they would be with no constraints on the input mix. The higher costs include on-farm costs arising from more intensive use of land by cane growers. Extra pressures on land and water off-farm is another cost of the land assignment system.

Wool Policy

Since the abandonment of the reserve price/buffer stock mechanism in 1991 the Government's main concern about wool industry matters has been the repayment of the stockpile-related debt, which it guarantees. Divergent views have been expressed on how this might best be done to minimise the impact on woolgrowers' incomes.

Repaying the Debt by Taxing Wool and Selling Stocks

Aside from the sale of AWRC assets in such forms as land and warehouses, there are two ways that the wool industry can pay off the debt associated with the stockpile. One way is to sell wool from the stockpile and apply the proceeds to debt reduction. The other way is for funds to be extracted directly from wool producers. The AWRC component of the Wool Tax is one form of direct extraction.

When wool is sold from stocks the price of wool is reduced. The size of the price reduction depends crucially on the elasticity of demand for wool — or, more strictly, on the price flexibility. The lower price can be viewed as a tax on current wool production. The Wool Tax also reduces the producer price for wool — though, unlike sales from the stockpile, it results in an increase in the price paid by buyers. Through their effect on the producer price of wool, stock disposal and the Wool Tax can both be expected to induce a supply response: that is, to cause wool production to fall. Many studies find elasticities of supply in the range 0.04 to 0.45 in the short and medium terms, which are most relevant in considering debt repayment strategies (Chisholm *et al.* 1993).

Recognising that selling stocks and extracting funds directly from producers represent alternative ways of taxing producers to reduce the industry's debt leads naturally to considering whether one way is better than the other. Bardsley (1993, p.14) wrote as follows:

> "What is the optimal mixture of taxation and sales? The first and most important point to be made is that it does not seem to matter a great deal which instrument is emphasised. The main determinant of wool industry incomes (apart from the weather and the

> strength of demand) is the rate at which debt is repaid. Fiddling with how it is done, by changing the mix of taxation and sales, has only a relatively minor effect.
>
> Having said this, changing the combination of taxation and sales does have some effect, and it is worthwhile getting it right. Simulation results suggest that the optimal tax rate is likely to be in the region of 8 to 12 per cent. Increasing the Wool Tax to this sort of level would allow the stockpile to be sold more slowly while still meeting the debt repayment commitments. Research suggests that the combined effect of these two changes would increase the income of wool growers. Despite this fact it is probably not feasible to increase the tax. At the very least it should not be lowered any further".

Bardsley's finding that a wool tax in the range 8 to 12 per cent would maximise woolgrowers' incomes while discharging their debt is based on relatively high values — around unity — for the elasticity of demand for wool. If the elasticity of demand is less than unity, as the published research suggests it is, especially in the short and medium runs which are most relevant to evaluating stockpile disposal policies (Connolly 1992; Chisholm *et al.* 1993), wool industry gross revenue is reduced by sales from the stockpile. It would then be better for woolgrowers for debt repayment to be financed solely from the Wool Tax, implying a higher rate of tax than suggested by Bardsley. If the stockpile can be sold for non-conventional purposes without affecting the market for new wool adversely — see later — woolgrowers could gain from a policy of zero stockpile sales onto the conventional market even with an elasticity of demand significantly higher than unity.

The AWRC was initially given seven years to sell the 4.62 million bales of wool it acquired on 1 July 1991 and to repay the debt. The Commission made better-than-expected sales in 1991-92, disposing of 538,000 bales, about 12 per cent of the initial stockpile. However in 1992-93, when the international economy was depressed and wool prices were low, little wool was sold (about 120,000 bales). In 1991-92 the debt reduction program was changed from an annual to a cumulative basis. This meant, with the large over-achievement of the debt reduction target in 1991-92, that repayments would have remained ahead of schedule even if no sales had been made from the stockpile in 1992-93.

The AWRC has the objective of managing stockpile sales "to the extent possible to avoid unduly depressing wool prices" (AWRC 1992, p. 17). These words are ambiguous. Do they mean not reducing prices *by* an unreasonable amount, or not reducing prices *to* an unreasonably low level? It appears that the AWRC is required to place substantial emphasis on the latter interpretation. The guidelines provided to the AWRC by the Government require it, subject to meeting the stipulated debt reduction requirements, "to avoid selling large quantities of wool at times when the market is significantly below the level that becomes its mid-term trend" (Commonwealth of Australia 1991, p.3). This approach appears to enjoy wide support in the industry. Is it sensible?

The answer depends heavily on the elasticity of demand for Australia's wool. There are two points. First, as already noted, if the elasticity of demand is less than unity, gross revenue from all wool sales is reduced by selling wool from the stockpile in competition with new wool. Second, whether the price-depressing effects of stockpile sales are less when the market price is high (or rising) than when it is low (or falling) depends on the relative values of the elasticity of demand in the two situations. With identical values of the elasticity of demand under conditions of high demand and price and low demand and price, the absolute reduction in gross wool revenue is larger if a given amount of wool stocks is added to the market when the price is high than if they are sold when the price is low (Chisholm *et al.* 1993).

On the basis largely of stockpile disposals in 1991-92, Mr. Crean announced that the AWRC component of the wool tax would be reduced from 8 per cent in 1991-92 to 4.5 per cent in 1992-93 ("Crean Announces Wool Industry Development Package", Media Release DPIE 92/43C, 25 June 1992). The Minister realistically pointed out that the rate of tax might need to be increased in future should "adverse circumstances" occur. He also made a question-begging statement that seemed at the time ill-advised and that seemed increasingly so as the months passed and the wool market weakened: "On the basis of current market assumptions there

is a 90% chance that the effective rate for the AWRC will not need to be increased above 4.5% in the future." Whose assumptions was the Minister referring to? What was their basis? Watson (1992b, p.7) said the lowering of the tax after one year "suggests that political judgements, rather than pure commercial judgement, are still important in the affairs of the wool industry". It is probably widely accepted that political judgements *should* influence the wool tax, and that the level of incomes in the wool industry is one factor that should guide the judgements.

Notwithstanding the strictures of Bardsley (1993) and others, there was in fact pressure in early 1993 to further reduce the Wool Tax. The Wool Council of Australia (WCA) lobbied the Government to remove the 4.5 per cent debt servicing component (*Weekly Times* 7 April 1993). According to the *Weekly Times* (21 April 1993), a confidential report prepared by John O'Connor, General Manager, Market Information and Planning with the AWC, concluded that the 4.5 per cent AWRC component of the Wool Tax was not important for meeting the debt repayment program. The *Weekly Times* had O'Connor saying: "Under most reasonable assumptions, the AWRC will be able to meet its debt repayment guidelines even with little or no wool tax income." It would be interesting to know whether the confidential report attempted to reconcile support for relying on sales of stockpiled wool for repaying the debt with an elasticity of demand for Australia's wool of -0.5 to -1.0 assumed in a non-confidential paper by O'Connor (1993)! Meetings of woolgrowers called for removal of the debt servicing tax. Former Prime Minister Malcolm Fraser was reported as saying that woolgrowers had no confidence in leaders of the WCA and industry leaders (*Weekly Times* 21 April 1993). Alan Bowman, president of the WCA, seemingly relying on the same "reasonable assumptions" as O'Connor, said the WCA was proposing that the projected surplus upon disposal of the stockpile — scheduled at the time he spoke for 1998 — be returned to growers immediately in the form of removal of the debt servicing tax (*Weekly Times* 7 April 1993). It is reasonable to suppose that the AWRC would have opposed removal of the Wool Tax and, indeed, recommended a tax higher than 4.5 per cent for 1993-94. AWRC Chairman, Mr. David Clarke, said diplomatically that with hindsight the tax of 4.5 per cent in 1992-93 may have been too low (Clarke 1993a), and he pointed out that an implication of a tax of 4.5 per cent in 1993-94 could be an operating deficit for the AWRC of $60 million to $120 million (Clarke 1993b). Mr. Crean said that removing the debt levy was "not terribly realistic" and he accused the WCA of walking away from an agreement when the tax was lowered in 1992 that it would have to increase again if the situation worsened (*Weekly Times* 7 April 1993).

The discussion above might be summarised as follows. The wool industry sees the Wool Tax reducing woolgrowers' current incomes, and would prefer to rely on sale of the stockpile to repay the debt. The Government, more concerned about making progress on debt repayment while the market remains weak, insists on a significant contribution from the Wool Tax. Neither has shown concern that the price elasticity of demand for Australia's exports of wool might be less than unity, so that sale of wool from the stockpile reduces gross and net revenue of the wool industry.

Restricting Production and Exports

Perhaps the relevance of price inelastic demand for wool exports *has* been recognised by wool industry leaders in the context of the relationship between the level of wool *production* and price. Under the influence of strong world demand and/or high reserve prices, wool production in the three years 1988-89 to 1990-91 averaged 1042 kt. Industry leaders have expressed concern at the way wool production has held up since 1990-91. Mac Drysdale, Chairman of the AWC, told woolgrowers at the industry's annual meeting in early April 1993 that production needed to be cut by up to 20 per cent (*Weekly Times* 14 April 1993). Drysdale did not say how much of this reduction might be expected to follow from present low prices. No action was mooted to bring about a supply cut additional to that resulting from present prices. Mr. David Clarke, Chairman of the AWRC, said in his review of 1991-92: "Some decline from the continuing high levels of shorn wool production of 750-800 million kilograms will be needed, alongside high levels of trade clearances. This remains

an issue of concern for the future" (AWRC 1992, p.3). A study by Hassall and Associates commissioned by the AWRC concluded that farm cash flows in the wheat-sheep and high rainfall zones of mainland eastern Australia would be highest if wool production fell 25 per cent from 1991-92 to 1993-94. This would involve major shifts to wheat and beef production (AWRC News Release, 6 July 1993). The Hassall study may have had more to do with demonstrating to directors of the AWRC that wool production was falling significantly than with informing woolgrowers of profit-increasing opportunities.

The support by industry leaders for cuts in wool production has been in the context of improving wool prices in the short to medium term, allowing wool stocks to be disposed of on a stronger market. While this is sensible in terms of obtaining the highest return to the AWRC from sale of stocks, it is not clear — as noted above — that it generates the highest incomes for woolgrowers. With inelastic demand for wool, the marginal revenue from selling stocks is negative, regardless of whether the price of wool is 400 cents or 800 cents per kilogram.

Restriction of wool production and exports on a *long-term* basis to improve resource use has not been on the wool policy agenda. This is despite the seeming fact that, with less then perfectly elastic demand — not less than *unitary* elasticity — for Australia's wool, restricting exports is warranted independently of the existence of a stockpile problem. However, while such a policy could be efficiency-increasing, it could — as with the restriction of wool exports by means of an export tax — necessitate lump sum redistribution to woolgrowers if the policy were to be one that woolgrowers did not regret. There is normally no problem-free way of making lump sum redistributions. But in the present circumstances of the wool industry there is a seemingly attractive possibility. Until the stockpile-related debt is discharged, proceeds of an export tax could be applied to reducing the debt. Indeed, Bardsley (1993) makes the point that the current debt-servicing tax is similar to an export tax with the revenue hypothecated for growers — that is, for reducing the wool industry debt. This line of thinking might appear to make the current debt realisation tax, and indeed a substantially higher tax, attractive to woolgrowers. Perhaps the most obvious reason why the tax might be found unattractive — apart from failure to understand the implications of downward sloping foreign demand — is that the wool industry does not accept that it will have to repay the debt.

Minimising the Cost of Wool Marketings

The wool industry and the Government have been preoccupied with the problem of the stockpile and the associated debt. They have shown no interest in the question "what is the least-cost mix of current production and stock disposals in providing any given level of market supplies?" This question was not addressed in the Vines report (Committee of Review into the Wool Industry 1991). Several economists have noted that stocks represent a low-cost source of supplies since costs do not have to be incurred to produce wool already in store (Watson 1992; Hertzler 1993; Bardsley 1993). An implication of this line of thinking is that it would be better to eliminate part of wool production than to destroy stocks. An export tax would be an efficient way to cut wool production. A wool tax of the current form is another way. However, the demand side must also be considered. Even if the stockpile is the least-cost source of wool supplies, the wool industry will lose from the sale of these stocks with inelastic demand.

Lateral Thinking about the Stockpile

Suggestions for burning the wool stockpile have come from several sources — usually with no regard to the anti-inflammability characteristics of wool! On his recent visit to China, the Prime Minister raised the possibility of a joint venture to make low-cost woollen garments, using Chinese manufacturing capacity and wool from Australia's stockpile (*The Age* 25 June 1993). Of the many unanswered questions concerning Mr. Keating's proposal, perhaps the most important is how would disposals from the stockpile be prevented from impacting adversely on sales and prices of new wool? I would sooner take the brief arguing that the wool industry and Australia would benefit from burning the stockpile than one seeking to establish that they would gain from a stockpile deal with China, or any other country!

An alternative approach to disposing of the stockpile was suggested by Chisholm *et al.* (1993). This approach involved denaturing the wool to render it unsuitable for its conventional uses, and selling it by tender. Chisholm *et al.* argued that this approach would quarantine the stockpile from the normal wool market, allowing the best possible return to be obtained from it without reducing the return to the wool industry and to Australia from sales of new wool.

The Policy Statement of 28 April 1993

Federal Cabinet made some important decisions on the wool industry on 28 April 1993 ("Federal Government Approves Wool Package", Media release, DPIE 93/23C, 28 April 1993). These decisions included:

- moving from the program of scheduled debt repayments to a less specific indicative approach and removing the need for the AWRC to make any sales from the stockpile in 1993-94;
- extending the time for repaying the debt by one year to 1999;
- providing up to $45 million of extra funding for assistance to woolgrowers through the 'exceptional circumstances' provisions of the Rural Adjustment Scheme;
- retaining the Wool Tax, including the debt servicing component, at its 1992-93 level; and
- announcing another inquiry into the wool industry, to be chaired by Professor Ross Garnaut of the Australian National University.

The terms of reference for the new review of the wool industry were broad, covering: the determinants of international supply and demand over the next decade; factors affecting the profitability of Australian wool production; and the effectiveness of current structures for wool marketing, promotion, research and development, management of the wool stockpile, increasing value added to wool in Australia, and facilitating more active and innovative marketing. Restriction of Australia's wool exports is not included explicitly, but is included implicitly under factors affecting profitability. Mr. Crean gave the review team an idea of his own thinking in the following assessment ("Federal Government Approves Wool Package", Media Release DPIE 93/23C, 28 April 1993):

> "There has been an important change in the wool industry culture since the Reserve Price Scheme was removed. The client oriented, demand driven approaches that are vital to the future of the industry are emerging. Individual growers, brokers, private sellers increasingly understand the need to service their clients requirements — the old commodity culture is fading. We need to develop and promote our product; the world's textile industry must know that its our product they are using; a quality, highly specified and guaranteed Australian product".

The other members appointed to the Garnaut committee were Mr. Rodney Price, Chairman of the Australian Wool Industry Council and Chief Executive of Pioneer International, and Mr. Stephen Bennett, Founder and Chief Executive Officer of Country Road Australia. With only three months to report to the Minister, Garnaut and his team face a formidable task. They will not be informed to the extent that IC inquiries are by submissions from interested groups and individuals; there will be only a few weeks for the preparation of submissions. There will not be IC inquiry-type opportunities for individuals and organisations to comment openly on the submissions of others or on a draft report. Although the period for the preparation of the report is short, those who are interested in its contents perhaps should not assume that they will know soon after its completion. As already noted, the report of the Sugar Industry Task Force (1993) was not released until two months after the Minister received it, while a report on value adding for wool, presented to the Minister on 18 January 1993 was not released until 5 July1993 (Wool Processing Task Force 1993).

Concluding Comment

The tale of sugar industry policy in 1992 and 1993 is one of a strong economic case for sweeping deregulation being made and rejected. The case was made by ABARE (1991), Borrell *et al.* (1991), the IC (1992) and others, and rejected by powerful interests in the sugar industry and by the Queensland and Federal Governments. The industry opposed deregulation because that would have redistributed income from producers of raw sugar and, within the raw sugar industry, from influential

traditional growers.

The policy response on sugar was a nibble at microeconomic reform, whereas the critics of sugar policy held that a large bite was necessary. With regulation other than by means of the tariff being in the domain of the Queensland Government, the Federal Government lacked the ability to achieve directly substantial reform in the sugar industry. With an election approaching, the Federal Government was unwilling to incur the budgetary costs necessary to persuade the industry, and hence the Queensland Government, to accept the comprehensive deregulatory package recommended by the IC. The Opposition was willing to go further down the deregulatory route, at greater taxpayer cost, but it too was not willing to end the QSC's monopoly in marketing raw sugar. The case for major microeconomic reform in the areas of sugar marketing, price pooling, tariffs and probably, despite improvements, the assignment system, remains. These further reforms will almost certainly have to wait at least until the review of Queensland's *Sugar Industry Act 1991*, in 1996. Is it possible that deregulation will be looked upon more favourably then than in 1993? Arguments for change are sometimes won over a long period. Industries Assistance Commission reports in the late 1970s and early 1980s are credited with contributing significantly to the deregulation of the domestic wheat market in 1989 (Whitwell and Sydenham 1991). Perhaps the announcement that "The Industry Commission report recommending total deregulation was buried forever ..." (*Canegrower* 22 February 1993, p. 5) will turn out to have been premature. However, the Federal Government will need to consider the use of carrots and sticks to improve the chances of achieving substantial reform in the industry following the 1996 review.

In the wool industry, 1992-93 saw a battle between the industry and the Government over the means of paying the stockpile-related debt. The industry wanted to rely totally on selling the stockpile, while the Government insisted on retaining a Wool Tax (AWRC component). Despite strong evidence supporting price inelastic demand for Australia's wool, neither the industry nor the Government appeared to be concerned that selling wool from the stockpile could reduce total gross revenue from wool. Nor did industry leaders acknowledge, or the Government point out, that the Wool Tax, by reducing production, would increase the price of wool — resulting under inelastic demand in higher incomes for woolgrowers than if the debt were repaid from stockpile sales.

The collapse of the buffer stock and reserve price scheme for wool was due partly to mistakes in the Government's intervention in this industry. However, it has been suggested in this paper that longer-term inefficiencies in the wool industry are caused by the *absence* of continuing Government intervention to reduce wool exports. The merits of restricting wool exports on a long-term basis have never been properly assessed. This may be because there has never been a comprehensive, thorough and open inquiry into the wool industry. Watson (1990a, p. 3) has argued that the wool industry is insular in its outlook and "would benefit from an open inquiry process, such as the wheat industry has had in recent years." Even though the sugar industry has a reputation for managing information closely, several detailed inquiries, which took a national interest perspective, were conducted in the last decade (IAC 1983; IC 1992; ABARE 1991; Borrell *et al.* 1991). Knowledge of the policy changes needed to improve economic efficiency is better for the sugar industry than for the wool industry. Admittedly, this is due partly to the fact that it is easier to prescribe efficiency-enhancing reform in the sugar industry — remove the policy-induced distortions — than it is to answer the complex questions about how best to repay the wool debt, what to do with the stockpile and whether to restrict exports of wool. But it is also due, in part, to the lack of adequately resourced, no-questions-barred, open investigations of the wool industry. The time constraint faced by the Garnaut inquiry ensures that the group will find it difficult to give the attention that is warranted to the key economic issues of how best to deal with debt repayment, disposal of the stockpile and the creation of incentives for producing a wool clip of optimal size. The task is likely to be made more difficult by pressures from the wool industry to devote substantial attention to less important matters such as organisational arrangements in the industry and promotion.

Rolf Gerritsen titled his last review "Labor's Final Rural Crisis". To the surprise of many besides Gerritsen, Labor won the 1993 election — though Brian Courtice, member for Hinkley and Chairman of the Sugar Industry Task Force, lost his seat. Since that win, the word 'crisis' has been applied to the state of the sugar and wool industries, among others. A crisis — a turning point followed by recovery or system failure — is by definition of short duration. A policy *failure*, on the other hand, may be long-lasting. From the view of achieving the huge potential for microeconomic reform in the sugar industry, the crisis was the period of lobbying and consultation during which the policy package of February 1993 was being formulated. The economist's assessment has to be that the crisis gave way to continuation of the longstanding policy failure in the industry, though some improvements in policy occurred.

The wool industry is still experiencing the consequences of the policy disaster of the late 1980s that forced the abandonment of the reserve price scheme. The absence of measures to prevent too much wool being produced and exported by Australia seemingly represents a more longstanding policy failure. There will be a period of policy crisis as the Garnaut group prepares its report and the Government develops its policy response. If the inquiry points the way to recovery from just one of these policy failures, and if the Government acts on the recommendations, the policy crisis will have been worthwhile.

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