

Wool Selling Systems Review (WSSR)

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Summary points

- There is confusion in the debate over wool selling between wool price formation and the economics of wool selling, including in the WSSR Issues Paper
- The Review Panel should concentrate on wool selling
- Comparative analysis of marketing systems should be avoided
- More fertile avenues for investigation concern market and organisational impediments to the evolution of wool selling in the private sector
- Wool marketing in Australia was compromised by the politics of the reserve price scheme, especially the role of objective measurement
- Technical possibilities for wool measurement closer to the point of production should be examined

Introduction

The point of departure for this submission is the Issues Paper released by the Review Panel for the Wool Selling Systems Review (WSSR). A review of wool selling systems is appropriate given the significant changes that have occurred in the wool industry in the couple of decades since the demise of the reserve price scheme. In particular, these changes include a substantial reduction in the size of the wool industry and a dramatic contraction of early stage processing in Europe. China is now the dominant destination of Australian wool.

Implicit in the three objectives of the WSSR set out at page 3 are concerns that selling costs are higher than could/should be the case, that competition is deficient in wool selling and that woolgrowers are handicapped in making commercial decisions by a lack of transparency associated with the exchange of ownership between producers and wool buyers (usually an exporter, or early stage processor).

Coming to terms with these issues is not straightforward. Perhaps inevitably, there is longstanding confusion between the economic consequences of the price of wool for woolgrowers and the efficiency and costs of the marketing system necessary to transfer wool from producer to consumer, and money in the opposite direction. These days marketing channels are often referred to as a 'supply chain'. Whatever the nomenclature, another frequent mistake in discourse surrounding the wool industry is to believe that there is a unique and superior marketing system, or supply chain, just waiting to be found and implemented. The economics of agricultural marketing is subtler than that.

The confusion between wool price formation and marketing efficiency is evident at several places in the Issues Paper. The first thing the Review Panel therefore needs to do is decide its major direction.

Wool selling or wool prices?

Understanding supply and demand factors affecting the price of wool and its volatility is different from unravelling the economics of providing marketing services like selling. Australian wool supplies are determined by weather and the profitability of other agricultural activities, as affected by output prices and input costs. Demand factors include incomes in consuming countries, fashion preferences, the price of substitutes and so on.

Such issues need to be kept separate from the economics of selling *per se*. As a first step, the study of agricultural marketing (or 'supply chain analysis') requires consideration of marketing functions and marketing institutions, sometimes thought of as the 'what' and the 'who' of marketing. Put another way, there is a world of difference between competition in the wool market as it affects absolute prices, or the 'basis', and competition between marketing channels. There are many different ways of combining the exchange, physical and facilitating functions coordinating the wool market, and, in turn, influencing the logistics of wool.

The virtue of competition in markets is as much its role as a discovery procedure as it is a means of achieving economic efficiency in production and consumption. Thinking about how information is generated and translated into economic decisions is a useful way of contemplating agricultural marketing, particularly for a commodity like wool with its diversity and the presence of so much uncertainty.

Selling is an exchange function involving change of ownership, with all that that entails. Of special significance to selling is the marketing function of standardisation. Obviously, some method of grading and classification is essential to know what is being bought and sold, how the product might be used and what decisions are needed to bring forth supplies in the future.

The role of grading, classification and standardisation

It turns out that issues surrounding grading and classification of wool is key to the way the wool marketing system evolved in the past, and how it might evolve in the future. As is well known, wool is an extremely heterogeneous product at all levels: farm production, in early stage processing, during several stages of manufacture, and in eventual final consumption. Major changes in the way markets are organised have usually come from improvements in technology followed by increased specialisation in the performance of marketing functions and by extending trade. The link between the digital age and the associated revolution in logistics are there for all to see.

Traditional wool marketing systems depended on visual appraisal, with several characteristics used to sort wool into 'lots' for sale. The Issues Paper mentions at page 7

that the average lot size in Australia is approximately 5 bales, a result of the inherent diversity of wool and the fact that there are many small producers, including non-specialist producers for whom wool is an unimportant part of total farming operations. Lots of wool maintain their separate identity, and ownership, until the point of sale. In the modern era, measurement of some major wool characteristics of interest has emerged. Objective measurement of fibre diameter, a determinant of spinning performance and thus potential end-uses, is the most celebrated example.

Comparative analysis: a dead end in agricultural marketing analysis?

Wool is so different from other agricultural commodities that are commingled and lose their identity at the point of first receipt that the intention of the Review Panel mentioned at page 4 to engage in comparative analysis of wool selling systems with other commodities is probably misguided. In fact, wool selling in Australia can only be effectively compared with itself! It might just about be the case that investigation of wool selling in other countries could reveal some useful insights. It is more likely that any information gleaned from international comparisons would reflect differences in the institutional history of wool selling in other countries, so different from the Australian wool industry as to make the comparisons suspect.

It would make sense, however, for the Review Panel to consider carefully the pervasive effects on wool selling of the way objective measurement was introduced in Australia. This is because the push for objective measurement had technical and political dimensions, coinciding as it did with the era of gross intervention in wool marketing.

Wool marketing: commercial or political?

It is now only too clear that wool did not proceed down a commercial path for much of the last forty years. This would have been tricky enough in its own way. Rather the wool industry has been battered from pillar to post by pursuing a disastrous and ultimately unsuccessful political trajectory. There are many reasons why the wool industry came undone, some of them much too uncomfortable to contemplate. Perhaps, the divergent political and economic interests of specialist and non-specialist producers have not been given enough attention.

In the context of the WSSR, it should be recognised that all sorts of compromises were made to accommodate those interests who resisted the introduction of objective measurement, for both good and bad reasons. For example, private treaty selling was discouraged to gain favour with wool brokers, many of whom were unenthusiastic about the RPS.

Without pre-judging the results of any study of the whys and wherefores of objective measurement, it should be noted that the reserve price scheme was not perceived by its most influential backers as a conventional buffer stock arrangement, solely intended to stabilise prices through stock transactions. Instead, it was regarded as a step towards an acquisition scheme. In consequence, 'sale by description' based on objective

measurement was thought a necessary tool in the armoury of an acquisition scheme rather than a consequence of improved technical methods of grading and classification.

In the troubled history of regulation of the wool industry, there were in essence two overlapping strands: a set of issues concerning the volatility and level of average prices and measures designed to influence marketing costs. In some ways, the RPS and objective measurement have a shared interventionist path. Arguably, they both eventually endured the consequences that inexorably follow if political deals trump commercial decision-making.

The future of objective measurement

However, it would be less controversial for the Review Panel to investigate today's technical opportunities for wool measurement and description. Obviously, this is an area for specialist expertise. Nevertheless, technical issues determine the scale at which objective measurement should be applied, and its appropriate location(s) within the supply chain. It would be most unlikely if there had not been significant changes over recent years in measurement techniques and methods of transmission of information that would allow measurement to take place closer to the point of production. This could be especially important to larger woolgrowers.

A researchable question, but centralised wool testing may no longer be appropriate if cheaper measurement equipment is now available?

The writer has observed at first hand the marketing implications of the application of mobile phone technology to transmission of price information in developing countries with all sorts of consequences for the performance of other marketing functions, notably transport, storage and risk management. The point about the detail of such changes is that they are not just unknown, they are unknowable! As stated above, the biggest trap in agricultural marketing analysis is to try and prescribe the ideal marketing system in advance. Marketing systems need to evolve of their own accord as circumstances change.

In that regard, the last point made in the checklist at page 5 of the Issues Paper concerning 'organisational impediments' is apposite. This is certainly would be a productive area of investigation for the Review Panel. The same goes for the related point about market impediments. Unfortunately, many of the preceding bullet points are really in the domain of price formation not wool selling *per se*. Even worse, at a couple of points the term 'industry' is used in relation to aspects of wool marketing that *prima facie* should be the province of private players.

There are genuine collective goods that are of proper interest to industry organisations. Research and industrial relations spring to mind. Seldom is it the case that industry should have a major role when rapid economic changes are afoot in agricultural marketing. In such circumstances, there will be an inevitable mismatch between existing facilities, firms and institutions with what would be desirable in the future. If previous form is any guide, too much involvement by the organised wool industry runs

the serious risk that it will be overly protective of the *status quo*. By definition, emerging interests are unrepresented.

Concluding remarks

By way of conclusion, the wool marketing system was, and is, a classic case of where a large number of dispersed producers are connected over long distances in space and time to large numbers of consumers, via a complex array of marketing intermediaries. In theory and practice, these circumstances are best accommodated by the operations of the price system. Possible exceptions occur in the presence of natural monopoly, as can happen with information and storage. Any competition issues are best handled by the bodies set up for that purpose, not separate arrangements for the wool industry.

Furthermore, an extraordinary amount of public money was spent in the aftermath of the collapse of the RPS in the futile attempt to match up wool producers directly with end users. Few permanent benefits followed for predictable reasons. Nevertheless, it was consultants' heaven. No doubt a few lucky producers enjoyed the associated travel.