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THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

WOOL INTERNATIONAL AMENDMENT BILL 1998

EXPLANATORY MEMORANDUM

(Circulated by the authority of the Minister for Agriculture, Fisheries and Forestry,
the Hon Mark Vaile MP)

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GENERAL OUTLINE

The purposes of this Bill are to -

- prevent any disposal of Wool International stockpile wool before 30 June 1999; and
- to allow Wool International to support and meet costs in privatising the wool stockpile.

These purposes are effected by inserting new sections 20A and 22ZG into the *Wool International Act 1993*, and making certain related amendments as described in *Notes on Clauses* below.

In 1997 the Government passed the *Wool International Amendment Act 1997* providing for the liquidation of Wool International once its key functions of selling down the stockpile and retiring the associated debt had been completed. The current legislative framework governing the management of the wool stockpile provides for a debt retirement target of 31 December 1998, and a final date for stockpile disposal of the end of 2000. The current legislation also requires Wool International to dispose of stockpile wool at the rate of no less than 90,000 bales per quarter.

Wool prices have faced severe downward pressure in 1998 due to the Asian economic crisis, coupled with falling apparel demand in our key markets of Europe, Japan, China and Korea. In March 1998, the Government acted to address the exceptional combination of events facing the wool industry by extending the target date for Wool International debt retirement by up to six months to 30 June 1999. However, market conditions have now deteriorated further, and in light of the very difficult circumstances faced by growers as the new season wool comes on to the market, the Government decided that Wool International should be required to suspend further disposals from the stockpile until 30 June 1999.

While the suspension of stockpile sales is in place, the Government will commence steps towards privatisation of the stockpile to take effect from the conclusion of the stockpile freeze on 1 July 1999. Privatisation and repeal of the *Wool International Act 1993* will make target dates for debt repayments, stockpile disposal and equity distributions irrelevant. The constitution of the new entity will reflect the intention that its operations will be fully commercial, without encumbrances as to how the asset is to be managed in the interests of equity holders.

The Government intends introducing legislation to effect the privatisation of the stockpile in a future sitting of Parliament.

FINANCIAL IMPACT STATEMENT

There will be negligible impact on the Commonwealth from this legislation. Analysis of options for privatisation, and the implementation of the recommended option will incur costs to Wool International.

The suspension of stockpile disposals is likely to lead to additional costs for Wool International in relation to operational costs and debt servicing. The actual level of these costs will be dependent on any changes to Wool International's operations and interest rates. However, based on Wool International quarterly reports, these costs are currently estimated to be in the order of \$10 million per quarter. Wool International would meet these costs from reserves and borrowings secured by the value of the stockpile.

REGULATION IMPACT STATEMENT

Background

The wool industry is a major source of commodity export revenue for the Australian economy, generating up to \$4 billion each year. There are about 11,000 farms whose principle income is derived from wool production, with the total number of farms with significant wool revenue under 50,000, down from 80,000 farms at the time of the collapse of the Reserve Price Scheme in 1991.

To deal with the problem created by the overhang of stockpiled wool and the associated debt, the Government established Wool International in 1993 to dispose of wool from the stockpile in an orderly fashion. Wool International is required to sell stockpile wool in the range of 90,000 to 350,000 bales each quarter, with the aim of maximising returns to the stockpile's equity holders (wool growers who contributed to debt repayments), and minimising the impact on fresh wool sales. Wool International has made significant inroads into the stockpile and associated debt. Currently the stockpile has fallen to just over one million bales from an original 4.7 million bales, and the debt has fallen to around \$200 million from \$2.7 billion. At the legislated minimum selling rate of 90,000 bales per quarter, stockpile sales represent around 8 to 9 per cent of Australian wool sales.

Problem

Mainly as a result of the Asian economic crisis, there has been a marked deterioration in the market for wool in 1998 as customers reduced apparel consumption, particularly for higher priced items. This has placed pressure on wool grower incomes, leading to representations to the Government that Wool International stockpile sales were having a significant negative effect on the market. Prices have fallen from a peak of 722 cents per kilogram clean on 25 September 1997 to a low of 465 cents on 22 October 1998.

Many wool growers have expressed the view that continued stockpile sales in the current climate could only detrimentally affect the fresh wool market. Prolonged industry debate over how the stockpile should be managed, combined with a lack of

confidence by wool growers about the market prospects for wool, could result in an increasing number of growers leaving the industry. In addition to the negative impacts on individual growers and rural communities from these commercial failures, if a drastic cut in wool production capacity were to occur, it would result in supply problems for the wool processing sector. Once the apparel market recovers, supply shortages could lead to substitution of other fibres for wool. As textile manufacturers would not easily switch back to wool after such shortages, this could lead to a permanent loss of markets by the Australian wool industry.

Objectives

The objective of Government action is to help address the slide in wool prices, improve the financial position of wool growers and to encourage processors not to switch to competitive fibres. Suspending stockpile sales will take pressure off the fresh wool market and allow growers to release some of their wool stocks. This will allow improved income in the short term, and encourage maintenance of production levels.

The eventual privatisation of Wool International is intended to empower equity holders by providing them with the responsibility of making decisions on the direction of the organisation, without the intervention of Government.

Options

The options considered by the Government were:

- direct Wool International to sell wool at the current minimum legislative requirement of 90,000 bales a quarter.
- amend the *Wool International Act 1993* to lower the minimum quarterly sales requirement to a level below 90,000 bales a quarter, perhaps to a level sufficient to cover interest and operating costs (ie. 15,000 bales per quarter). This option was not supported because it was concluded a total suspension of disposals would have a more significant impact on market confidence.
- a complete suspension of disposals of stockpile wool until 30 June 1999 to remove market pressure caused by stockpile sales. It will also provide wool growers with the opportunity to improve their financial position by allowing them to sell wool from their privately held stocks and the current season's wool clip. This preferred option requires an amendment to the *Wool International Act 1993*.
- the Government, or a government associated agency or government established company, to purchase the necessary amounts of wool from Wool International to enable it to meet its current statutory obligations. The wool would be resold at a later date. It was concluded this option would be extremely difficult, time consuming and costly to implement, and could be wrongly interpreted as the Government reverting to market interference somewhat akin to the discredited Reserve Price Scheme.

- privatise the stockpile. While the freeze is in place, the necessary legislation could be prepared to implement agreed arrangements for privatisation and repeal of the *Wool International Act 1993* at the end of the freeze period. This option has been accepted.

Impacts

Business

The Government introduced and has supported the existing stockpile disposal regime agreed at the 1996 Wool Roundtables, because of the important benefits of certainty of supply and confidence it generated in the industry, particularly in Australia's overseas customers. However, the option of directing Wool International to sell at the legislated minimum was considered to have less positive impact on the wool market than a suspension of disposals, given the exceptional circumstances of the current market.

A suspension of disposals of stockpile wool is aimed at reducing the supply of stockpile wool onto the market. At present, wool growers have an historically high quantity of unsold wool (estimated at 992,000 bales in broker's stores, and around 285,000 bales on farm), slightly larger in size than the Wool International stockpile. Any suspension of disposals on stockpile sales could be expected to allow growers to increase the flow of wool from these grower stocks, and from the current season's wool clip. Thus any impact of suspension of stockpile sales on the availability of fresh wool is likely to be positive, in that it provides opportunities for increased wool sales from growers holding significant stocks of unsold wool.

Some wool exporters and processors have expressed concern about the additional uncertainty in the market caused by a delay in the final disposal of the stockpile. Some processors, including those represented by the International Wool Textile Organisation, have expressed concern at the implications of renewed Government intervention in the wool market, and the likely impact on future wool prices.

The option to privatise Wool International is attractive to many industry participants as it would place decisions on future management of the stockpile in the hands of a commercial board accountable to shareholders, and effectively remove Government from stockpile management issues. The industry would thus be encouraged to focus on the critical issues affecting the future viability of the industry.

In addition, privatisation would avoid debate about the adequacy and safety of bids under asset takeover. The Board of the new commercial entity would be expected to take commercial decisions in the interests of equity holders and would need to respond to the majority of equity holder interests. There would be no Government restrictions placed on the future business activities of the commercial entity.

Government

There will be little impact on the Commonwealth from these changes. Wool International will meet privatisation costs and additional interest and operating costs during the freeze period. Wool International's borrowings are guaranteed by the

Commonwealth. However, even at the current historically low wool prices, Wool International has sufficient asset backing to cover these borrowings and there is little risk of the guarantee being called upon.

The Government will incur costs in the assessment of options, and the development of a Bill to privatise the wool stockpile at the end of the freeze period. As occurred in other reforms to industry structures, it is appropriate that these costs be met by the industry, in this case, from the net assets of Wool International.

Removal of the Government role in stockpile management will alleviate any possible concerns of our trading partners that the Government may intervene in the wool market.

Consumers and the community

The Government anticipates that the freezing of stockpile deliveries will lend some stability to wool prices and improve grower confidence in the wool market. The quantity of wool on the market is unlikely to be affected by the suspension of Wool International deliveries, as private stockpile sales are likely to fill the gap. As raw wool forms a minimal component of the value of end products there will be negligible impact on consumers.

Should woolgrowers replace the stockpile sales with sales from private stocks as anticipated, the resultant increase in grower income will have positive flow-on effects in their local rural communities.

Consultation

The Government has consulted extensively with wool industry representative bodies, and a large number of individual growers have expressed support for the freeze, and the intention to privatise Wool International.

Correspondence and feedback since the announcement of the Government's decision indicates the diversity of views on the freeze.

Those opposed to the freeze generally argue that it will have no major effect on prices and will generate uncertainty in the market because of a change in Government policy. They include: the peak wool commodity body Wool Council Australia, several State Farmers organisations (New South Wales, Victoria, Queensland, and Tasmania), Pastoralists and Graziers Association of WA, our main overseas customers represented by the International Wool Textile Organisation, Australian Council of Wool Exporters, and a number of brokers and processors.

Supporters of the freeze generally believe that by allowing growers to sell more fresh wool and wool held in store, it will provide financial returns to growers at a time when it is greatly needed. The main sources of support are the Australian Stud Merino Breeders Association, Western Australian Farmers Federation, South Australian Farmers Federation, Australian Woolgrowers Association, and some individual processors and brokers.

There is greater support for the privatisation of Wool International than for the freeze of stockpile sales, although many agree with the view of the Government that privatisation of Wool International is unlikely to have a significant impact on the current poor wool prices.

Conclusion and recommended option

After a consultation process, consideration was given to a number of alternative courses of action. The Government has concluded that a complete suspension of sales of stockpile wool until 30 June 1999 would reduce market pressure caused by stockpile sales. It would also provide wool growers with the opportunity to improve their financial position by allowing them to sell wool from their privately held stocks and the current season's wool clip. The implementation of this preferred option requires an amendment to the *Wool International Act 1993*.

The Government has also concluded that, in consultation with industry and other interested parties, it will develop enabling legislation for the privatisation of the wool stockpile at the end of the freeze period, and repeal of the *Wool International Act 1993*. Privatisation will help focus the industry on developing long term strategies to underpin the future of the industry.

Implementation and review

The Government wishes to see amending legislation receive the earliest passage through Parliament, thereby allowing a legal basis for a suspension of sales to be implemented as quickly as possible. This may address the short term price decline, although demand building for wool remains a longer term issue.

The suspension of disposals from the stockpile will be monitored and reviewed through existing mechanisms, including Wool International quarterly reports; Wool International reports to unit holders; and ad hoc reports to the Government.

NOTES ON CLAUSES

Clause 1 - Short Title

Provides for the Act to be called the *Wool International Amendment Act 1998*.

Clause 2 - Commencement

Provides that the amendments to the *Wool International Act 1993* will come into effect on Royal Assent.

Clause 3 - Schedule(s)

Provides for the implementation of amendments to the *Wool International Act 1993* as set out in Schedule 1 of the Act.

SCHEDULE 1 - AMENDMENT OF THE WOOL INTERNATIONAL ACT 1993

Item 1 At the end of subsection 3(3)

This item provides for Wool International to assist in the privatisation of the organisation. This role is defined in Section 22ZG.

Item 2 Section 18

This item inserts a new defined term, *excluded period*. It is relevant to Item 5, which inserts a new section 20A which prevents WI from disposing of stockpile wool during the excluded period (other than honouring existing contracts).

Item 3 Section 18

This item inserts a new defined term *freeze commencement day*. It is relevant to Item 5, which inserts a new section 20A which prevents WI from disposing of stockpile wool during the excluded period (other than honouring existing contracts).

Item 4 Subsection 20(2)

This Section of the Act specifies the range within which stockpile sales must be made in each quarter. This amendment provides that this rate will not apply during an excluded period. There is no change in existing rates, except during an excluded period.

Item 5 After section 20

20A Restriction on disposal during excluded period

This item specifies the restrictions on Wool International's commercial activities that apply during the period of temporary prohibition of stockpile sales. It prevents Wool International from entering any new contracts for the disposal of stockpile wool during the excluded period. However, it does not prevent Wool International from

honouring any contracts entered into before the *freeze commencement day*, for example any undelivered sales or forward contracts.

This item does not allow Wool International to enter into forward contracts during the period of suspended stockpile sales for delivery after the end of the excluded period. This is in line with the expectation that enabling legislation will subsequently be introduced to privatise Wool International. The privatised organisation will then be responsible for decisions on stockpile sales.

Item 6 Subsection 22(2)

This item provides for the period of the suspension of stockpile sales to be included in the compliance reporting requirements of Wool International.

Item 7 At the end of Part 4E

22ZG Wool International to provide assistance in respect of its demutualisation

This item details the role of Wool International in the planning for privatisation of the stockpile. At the direction of the relevant Minister, Wool International is to provide technical support, information and financial assistance to the Minister, officers, agents or consultants of the Commonwealth appointed by the Minister, in planning and implementing the process to privatise the stockpile. Wool International would meet all costs incurred in this process and the eventual privatisation of the stockpile.

The relevant Ministers referred to are the Minister for Agriculture, Fisheries and Forestry and the Minister for Finance and Administration.

Section 58 of the *Wool International Act 1993*, which places certain conditions upon the Minister in giving directions to Wool International, will not apply to directions given under Section 22ZG.