



COMMONWEALTH OF AUSTRALIA

# Official Committee Hansard

## SENATE

RURAL AND REGIONAL AFFAIRS AND TRANSPORT  
REFERENCES COMMITTEE

**Reference: Operation of the wine-making industry**

MONDAY, 27 JUNE 2005

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## SENATE

### RURAL AND REGIONAL AFFAIRS AND TRANSPORT REFERENCES COMMITTEE

Monday, 27 June 2005

**Members:** Senator Ridgeway (*Chair*), Senator Heffernan (*Deputy Chair*), Senators Buckland, McGauran, O'Brien and Stephens

**Participating members:** Senators Abetz, Allison, Boswell, Brown, George Campbell, Carr, Chapman, Colbeck, Coonan, Crossin, Eggleston, Chris Evans, Faulkner, Ferguson, Ferris, Greig, Harradine, Hutchins, Ludwig, Knowles, Lightfoot, Sandy Macdonald, Mackay, Mason, McLucas, Nettle, Payne, Robert Ray, Santoro, Tchen, Watson and Webber

**Senators in attendance:** Senators Buckland, Ferris, Heffernan and Stephens

#### **Terms of reference for the inquiry:**

To inquire into and report on:

The Australian wine making industry with particular reference to the supply and purchase of grapes and the relationships between independent growers and wine makers in the current market.

Specifically, the Committee will be focussing its inquiry on the following key areas of the wine industry:

- a) The size and nature of the winegrape glut, and the producers' inventory levels;
- b) The structure of the industry and how this impacts on the relationship between growers and producers; the nature of the contractual agreements between them; the implementation of quality benchmarks and whether these can be standardised in an industry-wide code of conduct;
- c) The adequacy of the terms and implementation of the *Trade Practices Act 1974* in relation to winegrape growers; and
- d) The need for a national grape growers' representative body, the powers that it might have, and the means by which it might be funded, including any possible role for Government in overseeing a industry levy.

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**Committee met at 8.31 am****PATRICK, Mr Victor John, Director, Viticulture, Fosters Wine Estates****CLARKE, Mr Antony, Policy Analyst, Winemakers Federation of Australia****STRACHAN, Mr Stephen Francis, Chief Executive Officer, Winemakers Federation of Australia****YOUNG, Mr Douglas Arthur, Policy Director, Winemakers Federation of Australia**

**ACTING CHAIR (Senator Heffernan)**—I declare open this public hearing of the Senate Rural and Regional Affairs and Transport References Committee inquiry into the winemaking industry, with particular reference to the supply and purchase of grapes. I welcome all here today. The committee has authorised the recording, broadcasting and rebroadcasting of these proceedings in accordance with the rules contained in the order of the Senate of 23 August 1990 concerning the broadcasting of committee proceedings.

Before the committee starts taking evidence, I place on record that all witnesses are protected by parliamentary privilege with respect to their submissions and evidence to the committee. I remind witnesses that parliamentary privilege does not extend to statements repeated outside the committee's proceedings. Any act by any person which may disadvantage a witness on account of evidence given by him or her before the Senate or a Senate committee is a breach of privilege. While the committee prefers to hear all evidence in public, the committee may agree to take evidence confidentially. If the committee takes confidential evidence it may still publish or present all or part of that evidence to the Senate at a later date. The Senate also has the power to order the publication of confidential evidence. The committee would consult the person concerned before deciding whether to publish confidential evidence.

I welcome the representatives from the Winemakers Federation of Australia and from Fosters Wine Estate. I note that we are holding this meeting in the ancient and royal original parliamentary building, in which no doubt over the years there have been many lies told. Would you like to make an opening statement and then we will go to questions?

**Mr Strachan**—I would like to table a short presentation. We have put a confidential submission in to the inquiry. The only reason we have done that is that the deadline, as you know, is at the end of this week and we are still waiting for board sign-off on it. It will not be confidential once we have had that resolved. I want to cover a few points in my introductory comments and then we can get into more detail as we go through. It is certainly no secret at the moment that the wine industry in Australia is going through quite a difficult period. We had a period of very significant growth through most of the 1990s where we saw significant vineyard plantings and we saw grape prices rise to historically high levels. In addition to those factors, which have contributed to some of the difficulties that the industry is facing at the moment, we have also seen the rate of plantings in Australia replicated in a number of our international competitor countries, such as the United States, Chile, Argentina, South Africa and parts of France and Italy. So what we are seeing in Australia is not entirely inconsistent with what has been going on in the rest of the world. We have seen a number of factors that are also making trading conditions difficult. One of those is the retail consolidation of the alcohol sector. Another

one that is specific to Australia is the appreciation of the Australian dollar. So there are a range of factors that are contributing to quite difficult times in the wine industry at the moment.

At the bottom of the first page of the print-out we gave you, the third slide in that PowerPoint presentation is a good summary of where the industry has come from and why we are facing some of the difficulties that we are today. The bar chart shows the rate of plantings through the 1990s up to 2004. What you can see is that, typically, up until about early 1990, we saw plantings that averaged under 3,000 hectares a year. But as prices increased—shown in the line chart—we saw a substantial increase in grape plantings. That increase peaked at about 16,000 hectares in a year, in 1999. In the three years of 1997, 1998 and 1999, we saw the area planted with vineyards increase by about 35 to 40 per cent in Australia, which is a massive increase in the space of three years.

In hindsight, I suppose it has become very evident that the industry—whose success is based on the sale of branded wine—has not been able to convert that level of increased production into branded wine sales as quickly as we would like. As a consequence of that very significant increase in plantings, we are seeing what is, essentially, an oversupply in the marketplace of a number of varieties of wine—particularly red varieties where the plantings were the most dominant.

The issue is not only one that is affecting grape growers; it is equally affecting the wine sector. The second chart on the second page shows our stocks-to-sales ratio. It shows that winery stocks have increased to a ratio of about two litres of stock for every litre of sales on a per annum basis. The industry's comfort level is about 1.5 to 1.6. What that graph essentially shows is that we have seen increase in stocks as a result of this increase in supply. For a number of years now, the industry has been in a situation where the stock level has certainly been above what we would prefer to see.

The graph of our export performance, on the top of the next page, is probably the most telling of the slides that we have here. It shows Australian exports by price point for FOB exports. The first set of columns is for wines that are \$2.50 and under per litre; the next set is for \$2.50 to \$4.99, then \$5 to \$7.49, then \$7.50 to \$9.99, and then \$10 and above. The graph shows that the concentration of Australian wine sales is in the below \$4.99 FOB level. It also shows that we have consistently had very strong growth in that sector of the market for five years. The most telling part of this graphic, though, is that in price points above \$5 FOB we have essentially seen a marketplace that is static. For about three years we have seen no growth in export sales in that sector of the market. That is also the sector of the market where we saw a higher relative upswing in terms of planting through the late 1990s. The rule of thumb is that the grape growers in the cooler climate regions, like the Clare, the Barossa Valley and Coonawarra in South Australia, will typically be aiming to have a sustainable business that will see their wine sold into those higher price categories. What we are seeing is that those higher priced categories are not growing and, therefore, the oversupply that we have seen for grapes and wine is most acute in that sector of the marketplace.

I will go through a couple more slides and then we can hand over to questions. I will talk very quickly about the vintage in 2005. Because of the plantings that were coming through and the peak of those plantings in the late 1990s, our industry had been anticipating that production would increase essentially every year through the early part of this decade. We were anticipating

that this year we would see production ease or perhaps go back slightly because the rate of plantings through the late 1990s slowed into the early part of this century. What happened this year is that we had a very high-yielding year, as we did last year. So we have had two high-yielding years. It would be our view that unless we have another high-yielding year next year—and there is no certainty of that—we would not see record levels of production in 2006, because the rate of plantings that had peaked in the late 1990s has certainly slowed.

So the challenges that the industry has been under for this period have been quite acute, but there are some signs that around the corner—and who knows how far away it will be—there might be some easing in terms of supply. We still have strong growth internationally in terms of export sales and modest growth on the domestic market, so, provided that supply does not increase significantly and provided that our sales continue to increase, we now have an opportunity to work through the surplus that is sitting in our tanks. It is difficult to see that that will happen overnight, and I suspect that we will not see a whole lot of change in the 2005 financial year and ahead of the 2006 vintage. Depending on how large the 2006 vintage is, there is some hope that we will work through a significant proportion of that oversupply over that period. Those are my introductory comments. We are happy to take questions on any part of that or any part of our submission.

**ACTING CHAIR**—Thank you. How much has the excess growth of vineyards been driven by tax considerations?

**Mr Strachan**—If you look back at the slide on the first page that tracks plantings and prices—and this is an issue that gets raised frequently—

**ACTING CHAIR**—And, I might add, the value of the dollar at the time.

**Mr Strachan**—The concessions obviously had an impact, but I think the level of impact that they had on the industry is massively overplayed. I think the fact that prices were so high—and prices were high, in part, because of the level of the Australian dollar at that point—was ultimately the reason why people came into this business. You can see in that graph that, when prices went up, the plantings went up; when prices went down, the plantings went down. The concessions came in, from memory, in about 1993, so there is quite a lengthy period when the plantings were relatively low—around 1993.

**ACTING CHAIR**—Do you have a graph in today's money, to track the dollar?

**Mr Strachan**—The Aussie dollar? There is a graph here—

**ACTING CHAIR**—One that tracks the price in Aussie dollars versus the real price.

**Mr Strachan**—No, all we have is the exchange rate with the UK pound and the US dollar. That is on top of page 4. It does not track it against grape prices. To answer your question: it has had an impact, but I do not think it is the major impact. I think prices are the major impact. I would also add that the concessions were brought in as part of a range of reforms that were brought in in 1993. Those reforms were trade-offs against the significant tax increase that was put in place at the time, which you would be aware of.

**ACTING CHAIR**—If it is supply and demand, which you say it is, plus market consolidation, could it also be poor legal advice and loose contractual arrangements?

**Mr Strachan**—The way I look at it is that it happens in markets where you have long lead times in production, but it is probably what economists call ‘naive expectations’—that is, people react to prices that are in place in the year they plant their grapes. With the benefit of hindsight, we should all have anticipated that prices would come back from the high levels that they were at. It is evident from the statistics that a lot of people were not anticipating that.

**ACTING CHAIR**—How much did the industry warn the growers of that?

**Mr Strachan**—In terms of the prices coming down? I do not think anyone foresaw it.

**ACTING CHAIR**—Not even the industry leaders—the smart commercial operators?

**Mr Patrick**—The other factor that influenced the rate of plantings was the 2025 document *Wine in the Future* from 1996, which suggested that the industry required 40,000 hectares of vineyard to be planted between 1996 and 2023. A very clear message went out to the grape-growing community that there needed to be expansion but that expansion should take place over a very long period of time. What happened as a reaction to the pricing was that that 40,000 hectares was planted in a space of five years, rather than 20 years.

**Senator BUCKLAND**—Remind me who initiated this 2025 initiative.

**Mr Strachan**—That was a Winemakers Federation initiative. While it is on the table, I will defend it. That was a document that the industry put out that captured the essence of what the wine industry stood for and articulated what was possible in terms of the wine industry’s achievements. The wine industry has demonstrated that it has been able to achieve it. I guess the point is—and Vic makes the point—that the marketplace reaction to a whole range of factors, including *Strategy 2025*, happened too quickly. We saw plantings go in too quickly.

**Senator BUCKLAND**—You put a vision out that you want 40,000 hectares of grapes planted. What precautions did you take so that you would not get this massive planting all at once rather than over a period of time to cope with the market?

**Mr Strachan**—It is not something we have control over. We articulated a vision for the industry for 30 years—

**Senator BUCKLAND**—You articulated a vision for the industry—

**Mr Strachan**—For 30 years.

**Senator BUCKLAND**—For 30 years. Surely if you articulate that—and you are the peak body, I assume; you are saying you are—how can you not have control of that, or put information out—

**Mr Strachan**—How could we? The decisions that are made by people who plant vineyards are made by them. It is free enterprise.

**ACTING CHAIR**—I suppose what Senator Buckland is saying is: did you blokes have the capacity to track what was going on in the industry at the time and so perhaps issue a market warning or something?

**Mr Strachan**—Sure. We were tracking it, and when we released the strategy we articulated the time periods at which it needed to happen. The reality is that the marketplace reacted a whole lot quicker than that.

**ACTING CHAIR**—And you didn't pick it up?

**Mr Strachan**—We picked it up a year and a half later, when the statistics came through from the ABS. I guess 2025 is part of the reason this happened, but vineyard prices had doubled in the space of five years—

**Senator FERRIS**—And the dollar was low.

**Mr Strachan**—and the dollar was low. There were a whole lot of contributing factors.

**ACTING CHAIR**—The dollar was down to the high forties at one stage.

**Mr Strachan**—Fifty cents against the US. Vineyard operators—we will have some come up and give evidence later—were making very good returns through that period. So it is not surprising that we saw investment come into the industry during that period.

**ACTING CHAIR**—But at the annual winemakers' conference, or whatever it would be, did anyone go around saying, 'Hang on. There are going to be too many grapes in a year or two'?

**Mr Strachan**—Probably from about 1998 or 1999, words of caution started to come through. So it has not been an irresponsible approach from the Winemakers Federation. We were anticipating 3,000 or 4,000 hectares of plantings a year—perhaps in a big year 5,000 or 6,000 or 7,000 hectares. When we saw 15,000 hectares come through, the warning bells started to come up.

**Senator FERRIS**—But, Mr Strachan, if you look at the export growth at that time, there was no reason not to remain optimistic. I can clearly remember all of this happening because I had a great interest in it, as a South Australian. The growth in export sales was exponential with the plantings. It was only after the dollar started to go up and a couple of other things happened that we started to get the demand-and-supply curve out of kilter.

**Mr Strachan**—Absolutely.

**Senator FERRIS**—You can see it here.

**ACTING CHAIR**—That is a fairly comfortable sort of expression, because anyone worth their salt can track and predict the dollar. It is the same as when wool was \$1,000 a kilo. We knew it was not going to last, old mate.

**Mr Strachan**—Absolutely. If anyone can predict the dollar, can they please tell us, because it is a major issue for our industry.

**Senator BUCKLAND**—This came after a period when there was quite substantive vine pulling, didn't it?

**Mr Strachan**—Yes, in the late eighties.

**Mr Patrick**—The vine pull scheme was in 1985.

**Senator BUCKLAND**—I am the first to say that all industries should have visions and forward planning—I have no criticism of that—but I am a bit concerned about who was consulted and taken into your confidence in coming up with this strategy. Was government involved? Were the growers involved? What part of the industry was involved?

**Mr Strachan**—If you recall, there was in 1995, I think, an Industry Commission report into the wine industry. There had been an expectation from the industry that the Industry Commission report at that time would release a vision for the Australian wine industry. It had a range of recommendations, none of which were a vision for the Australian wine industry—and, nor, in my opinion, should government be setting a vision for the Australian wine industry. We then set about articulating our own vision, a process which took about a year and a half to put together. The consultation phase went through that whole year and a half. Growers were certainly consulted through the process. There would have been about 100 people who contributed to the development of *Strategy 2025*. A very significant consultative process was undertaken.

We are talking here about a 30-year vision. This is an industry that has enormous lead times. It is a minimum of four years from the time you plant to the time you see the grapes mature and come through as processed wine. It can then take another two or three years before that wine reaches a level that you are satisfied with in terms of the markets you are looking at. So we are talking about six- or seven-year lead times in this industry. For that reason, we set out a 30-year vision. For a whole host of reasons, we surpassed it well ahead of our expectations in terms of the performance against the export parameters of plantings and so forth.

**ACTING CHAIR**—When does that the tax advantage peak for that non-productive period? You have four or five years where there is nothing coming into the tin. What does the tax treatment of nothing—

**Mr Strachan**—You write off from day one. Under the former arrangements you write off your vineyard plantings over four years from day one. The accelerated depreciation or the concessions did not apply to all aspects of the planting. Some of the costs were written off on an annual basis—labour and so forth—and other costs like irrigation were written off over a three-year period. It did not capture the whole of the vineyard planting but, for what it did capture, it was four years. Now it is out to 15.

**ACTING CHAIR**—Yes, normal rates of appreciation.

**Senator FERRIS**—I want to go back and pursue this issue of plantings. How many new entrants are there in the market per year now?

**Mr Strachan**—I can only tell you about the new wineries entering the market at the moment. I am not sure about grape growers. It had been running at about 200 per year but it is down to about 100 per year. The reality is that we do not need any new brand owners in the industry at the moment. The marketplace is already very crowded. Most small and new wineries—or at least those that do not have any brand recognition in the marketplace—are finding it extremely difficult to find a route to market. For a lot of them, the traditional route to market, though supermarkets, large retailers and so forth, is essentially cut off to them. Based on our surveys, 40 per cent to 50 per cent of small winemakers—with a turnover of less than \$5 million a year—are making losses at the moment, and a big part of that is their inability to find a route to market for their wine.

**Senator FERRIS**—If you were talking about the depreciation policy of 1992-93 as being a signal, it is not working as a signal, is it? That is clearly not a signal, in the sense that, now that the depreciation policy has been removed, there are still 100 or 150 new entrants into the industry.

**Mr Strachan**—Absolutely.

**Senator FERRIS**—If you look at the graph, the real growth in plantings actually was in 1997-98 and the first significant drop was in 1998-99, which was when the dollar dropped, as I recall. Rather than the depreciation policy being the price signal, it seems to me that it was in conjunction with the dollar, and that was the price signal.

**Mr Strachan**—It was grape prices, which were influenced to a large extent by the dollar.

**Senator FERRIS**—In the search for the villain, the South Australian Farmers Federation submission says, on page 3:

Clearly, the implications of these enormous increases in plantings should have been taken into account at that time when considering the possible continuation of policy measures such as accelerated depreciation that favoured vineyard expansion, and when evaluating the longer term implications of investment decisions.

Clearly, the investment decisions are made by private enterprise, so I am not quite sure how you prevent people from doing something on private land that they might want to do. I am trying to really nail down this issue of depreciation because some of us felt quite strongly about it at that time, as you might recall; nevertheless, it was a policy for probably 10 years. I just want to make sure that we have advice on the record, from you perhaps, Mr Patrick—with all your years of experience in this industry—regarding the extent to which you thought it was a market indicator or a market incentive.

**Mr Patrick**—Obviously the major driver was the continuing growth of Australian exports overseas at quite different price points to what we are enjoying today. I think that is No. 1. The accelerated depreciation policy probably enabled traditional grape growers to expand to meet those market expectations, which was a plus. It also encouraged an enormous number of new entrants into the industry. Those new entrants were people who had previously, I guess, enjoyed the same sorts of benefits in the softwood industry and the hardwood industry. The funds were redirected out of those growth industries into the wine grape industry.

**Senator FERRIS**—So they were people who may not have had a long-term commitment to the industry?

**Mr Patrick**—They were people who did not have a long history in the industry. They were essentially new investment vehicles driven by people who had had a long experience in corporate agriculture but in a different field.

**ACTING CHAIR**—They had to hunt a new lot of bunnies.

**Mr Patrick**—Hopefully, they left the milky doe.

**Senator FERRIS**—I want to pursue one other aspect of this. If you had wanted to communicate with grape growers at the time, how would you have done so, given that the grape growers have really never had an effective peak body?

**Mr Patrick**—I think the industry continued to communicate with the grape growers. After *Strategy 2025*, two or three other documents were produced to explain what was happening, and I think they were still optimistic as far as the industry was concerned. There were certainly a number of articles published to say that the production growth was starting to look as though it was growing at a faster rate than the export growth.

**ACTING CHAIR**—Did you blokes put out a document to that effect?

**Mr Patrick**—No. I am not part of the Winemakers Federation of Australia, but the major companies certainly were communicating with their grower base regularly about these sorts of themes.

**ACTING CHAIR**—The difficulty with that of course is that there has been such a large addition to the grower base. The industry has been growing by another 200 or 300 vineyards or whatever a year. They would not even know they were there.

**Mr Patrick**—The only way we could influence that was either by reaching some sort of contractual agreement with the people who were proposing to do these developments or warn them not to. In a lot of cases, our organisation made it perfectly clear that we had our future supply in place and we did not need extra.

**ACTING CHAIR**—So that is pretty well documented, is it? Could we be provided with that documentation?

**Mr Patrick**—There are several publications that we could produce.

**Senator FERRIS**—Just to reinforce the point about this: as you say, there are still a large number of people entering this industry every year, despite the depreciation policy having ended. Clearly, those people do not have contracts. Contracts are now an endangered species in the wine industry, as we have heard in other places. These people are taking a double risk, if you like, in that they are entering into new plantings and a full market. They do not have the fall back—if they decide not to make and try to retail their own wine—of selling their grapes.

**Mr Strachan**—I would like to make one other point. In 2000 we released a document called *The marketing decade*. That document was a recognition of the rate of plantings that had gone into the industry. It clearly articulated that the industry's priorities needed to shift from vineyard plantings towards marketing so that we could sell the wine that was being processed. That document essentially covered the issues that we have been talking about here today. It put out some quite significant warning bells about what would potentially happen if we were not able to achieve the sales growth that we, as an industry, coveted. I have to say that in hindsight it has proven to be very accurate. But we did do that, and that is an example of how we were addressing those issues as we went through.

Another point I would like to make is that we talk here a lot about what industry peak bodies do, but parallel to that—and probably at least as important or even more important—is the relationship that wineries have with their grape growers. As you would be aware, we have some fairly large companies in this industry. In that company base we have a whole lot of grape growers. I do not know how many grape growers you have, Vic, but there would be quite a few.

**Mr Patrick**—I think it is 1,275 at the moment, with the new amalgamation.

**Mr Strachan**—They are very tight relationships where we are seeing companies articulating what their expectations are of grape growers and very robust discussions and ultimately agreement about the way forward. But they are relationships that fit outside of this industry peak body relationship. That is very important in terms of the grape growers and the wineries moving forward so that the wineries can achieve the marketplace outcomes that they want to achieve in terms of the specifications of the grapes that they are sourcing.

**Senator BUCKLAND**—Still on the question of the contracts: Mr Patrick, you mentioned that you now have 1,275 growers as your base. What is the contractual arrangement that you have with growers? What is the difference between a large grape grower, who has several hundred or a thousand acres, and a grape grower who has 20 acres?

**Mr Patrick**—In our case the relationship is essentially the same. We have a number of different contracts that were written at different periods in the history of the industry. A decade ago most of them were written around what was called a weighted district average price. That was essentially a price that was calculated post vintage. It related to the tonnage that came in from a particular region, taking into account the various different quality parameters of the grapes that were received for different end users. At one point in time that was an indicator, if you like.

In the nineties there were also a number of industry meetings where recommended prices were set. They were a result of discussions between the grape-growing industry and the winemaking industry. That changed in the later nineties to a recommended range of prices. That promoted mediocrity in the industry because, with the weighted district average price, the grower who was concentrating on producing volume benefited far more than the person who was producing quality. At that point in time most of the major companies changed their contractual procedures to reward the grower who produced the level of quality that was required by the company to satisfy a particular price point in the market.

**Senator BUCKLAND**—Is it a standard contract with all growers? I understand the quality question and I agree that that would be the way to go. Are contracts signed each year with the producers? Are the contracts annual?

**Mr Patrick**—The contract lengths vary depending on the grower, on the variety, on the region and on the relationship between the grower and the off-taker. Generally they are four years in duration with a period of renewal 12 months before the final year. During the early nineties some of them were for as long as 15 or 20 years. That was brought about because the people who were proposing the developments needed bank finance. Bank finance was not available unless there was a long-term contract.

**ACTING CHAIR**—Have the 20-year contracts stood up?

**Mr Patrick**—There are some still running. They are starting to mature now because most of this took place in the mid-nineties.

**ACTING CHAIR**—If you had one of those 20-year contracts, would it be for a fixed tonnage?

**Mr Patrick**—I cannot speak for all companies, but ours were basically for a fixed tonnage.

**ACTING CHAIR**—What do you do with the excess tonnage? For example, with the excess tonnage this year, would you say, ‘We really do not want it but we will take it off your hands’? Does that become the price of excess?

**Mr Patrick**—We did not pay excess.

**Senator BUCKLAND**—What about in years where you have had an excess?

**Mr Patrick**—We had an excess in 2004. That did not relate to contracts that were written on a tonnage basis. There were some contracts in the mid-nineties that were written on an area basis rather than on a tonnage basis.

**ACTING CHAIR**—It sounds like wheat.

**Mr Patrick**—Australian agriculture is as good at estimating yield as Australian marketing people are estimating sales.

**ACTING CHAIR**—That really means predicting the weather.

**Mr Patrick**—That sort of thing. We cannot estimate yields on our own vineyards at a much more accurate level than about 15 per cent plus or minus. When you have a year like 2004, which was an extraordinarily big year, the area contracts are based on the fact that the company has to take all the produce that comes off that area. The tonnage based contracts are based on a fixed tonnage.

**ACTING CHAIR**—What proportion of the suppliers are in what I call ‘the bunny market’? There is a guy at Braidwood now who has had a bit of publicity in the last day or two. He was

selling sheep and the buyer did not want all of them, but he said, 'I'll take them off your hands.' The bloke said, 'No; I'm going to shoot them so that you don't take down the price for every other person in the district and they have to give their sheep to you.' So he shot them instead. What proportion of supply in the market is at a giveaway price created by the excess?

**Mr Patrick**—That is a very difficult question to answer because we do not really play in that part of the market. Under the Beringer Blass banner, we produce roughly 40 per cent of our requirement from company owned vineyards and we have roughly 40 per cent contracted. There is always an annual balancing component which you need in periods of short vintages.

**Senator BUCKLAND**—You have 40 per cent contracted. Is the other 60 per cent is just spot market type of—

**Mr Patrick**—No. The spot market would be less than 20 per cent.

**Senator BUCKLAND**—How do you make up the other 40 per cent, if you have 40 per cent contracted?

**Mr Patrick**—Forty per cent is from the owned vineyard, 40 per cent is contracted and 20 per cent is in the annual purchase arrangements, which is not necessarily grapes; it could be bulk buying from other companies.

**Senator BUCKLAND**—How binding are the contracts you sign? If you were to sign to take 20 acres from me, would you have to take them or are there let-out clauses in the contracts?

**Mr Patrick**—In the 40 years I have been in the industry, I cannot remember walking away from a contract.

**Senator BUCKLAND**—I see. Do you know the answer to that question, Mr Strachan?

**Mr Strachan**—It depends on what is written into the contract.

**Senator BUCKLAND**—So it is not standard across the industry?

**Mr Strachan**—It is up to the companies and the grape grower to agree on the contract. Walking away from contracts, which gets some press from time to time, is not an industry norm or standard practice. Contracts are binding by law and wineries honour them. On occasion wineries seek to renegotiate them, which is, of course, quite legal and quite appropriate.

**Senator BUCKLAND**—During the growing season?

**Mr Strachan**—Sure. If you have a 10-year contract, you might choose to renegotiate at any time during those 10 years. But the bottom line is that the grower does not have to renegotiate it if the grower does not want to.

**ACTING CHAIR**—Wouldn't it be a poor business decision to spend hundreds of thousands or millions of dollars without a cast-iron contract?

**Mr Strachan**—It might be, yes. In today's environment, I think that not having a contract would be a very poor business decision.

**ACTING CHAIR**—What proportion of the industry did that?

**Mr Strachan**—It is difficult to say. I would speculate that Vic's model is fairly close: maybe one-third, perhaps a bit less, is winery vineyards; one-third is under contract; and one-third is on the spot market. But I do not know that with any certainty.

**ACTING CHAIR**—I have one more question, and that is: what is your relation to Vic Patrick?

**Mr Patrick**—That has been asked a few times. I am the lover; he is the fighter!

**Senator BUCKLAND**—I will go off the subject of contracts for a moment. We were talking about the markets earlier on. A graph on the top of page 3 of your print-out is about export performance. It says that the lower end of the market—the cheaper or 'Geoff Buckland' type wines—does better with the growth. Is that lower end of the market more vulnerable to imported wines?

**Mr Strachan**—No. When we say 'lower end of the market', we are talking about brands like Yellow Tail, Jacob's Creek, Lindemans and those sorts of brands, which have been the absolute backbone of Australian exports for a decade. This is where Australia has consistently proven that it is internationally competitive. It is as vulnerable to exchange rates as any part of the marketplace, but I would not see that as being vulnerable to imports at all.

**Senator BUCKLAND**—Where are we more vulnerable to imported wines?

**Mr Strachan**—It would be the top end, but I do not see the Australian wine industry as being particularly vulnerable to imported wines.

**Senator BUCKLAND**—I was recently at Beringer Blass, in California, which was a wonderful experience. My very limited palate for wines demonstrated that, certainly in the mid-range—and I guess that is where you go into that third group: the premium wines—there is no question that Australian grown grapes that are made into wine are far superior. I do not know if that is just me or whether it is a bias from being Australian, but I just wonder what impact that would have on the overall market. Mr Patrick was talking about the quality of grapes—and I think that that is where it has to go, the same as any product. Does being more insistent on quality in any way disadvantage growers, and small growers in particular?

**Mr Patrick**—We are talking about two things. We are talking about quality and style. What the United Kingdom market wants and what the United States market wants can be quite different in terms of style. The United States market tends to trend towards higher sugar levels, so the wines are fruitier and easier to drink—less traditional. The European market tends towards those more austere characters that have been traditionally produced in Europe. It is a bit like coffee beans: some people prefer one sort of bean; others prefer something different. I think the main influence on that growth in the bottom end of the market has been the fact that the appreciation of the Australian dollar did not allow the industry to hit the \$10 price point, which

was the glass ceiling, so you tended to have wines that were of the same quality suddenly going through that \$10 barrier and the general consumer said, '\$10 is the limit. That's what I am going to pay.' So it has promoted growth out of the warm inland regions and made it more difficult for the cool climate premium areas.

**Senator BUCKLAND**—I know where I want to go—and I am probably doing it very poorly—and one day I might get there.

**ACTING CHAIR**—You had better hurry up, son!

**Senator BUCKLAND**—Okay. If you have got somebody on a 20-acre block—which a lot of the growers have; a lot are still on 20 acres—and the industry says it wants quality, are the contracts varied to allow for the lower tonnages that will be produced?

**Mr Patrick**—Once again I cannot speak for everybody, but ours certainly are. They are based on a quality assessment that is made by a winemaking panel post vintage, so that the people who produce grapes that go into higher priced wines will be rewarded for those.

**Mr Strachan**—There is a lot of debate about quality in this industry, and the push is coming from wineries in certain areas as to what I call 'specification'. For our industry it is absolutely critical because it is about having a sustainable industry in the long term. A sustainable industry will only exist if we are internationally competitive in the marketplace. As to being internationally competitive, it does not matter what price point you are talking about; we have to consistently overdeliver and we have to consistently ensure that our quality improves. That is what is going on at the moment and, in my opinion, that is therefore in the best interests of wineries and grape growers.

**Senator STEPHENS**—I am very interested in the industry, and I thank you for the submission, which was a quite useful starting point. Can I ask a really basic question first of all. You are a federation of Australian winemakers. As a starting point, can you explain to me the structure of your federation and where your representatives come from?

**Mr Strachan**—I should have explained that. There are 2,000 organisations in Australia that call themselves wineries. A winery essentially is a brand owner. They do not necessarily have the physical infrastructure. The Winemakers Federation of Australia represents 500 wineries, or brand owners. Those 500 produce between 90 and 95 per cent of all of the wine that is sold either in Australia or offshore. There is a group of what you might term 'boutique wineries' for whom we, because we are a business focused organisation, do not hold a lot of relevance. We have a national structure that gives small winemakers and large winemakers an equal say on our board, so in that sense we are truly representative. We also have state associations that are affiliated with our organisation as well, and there is a quite comprehensive federal structure that exists in the wine industry from regions to states and to the national table. In addition to that, it is worth making the point that wineries also grow grapes. Most wineries in Australia have vineyards. Twenty-five per cent—I think I said 30-odd per cent before; it is probably closer to about 25 per cent—of the vineyards in Australia are actually owned by wineries, who are ultimately our members.

**Senator STEPHENS**—Can you explain to the committee how your organisation actually participates in national policy development around your industry?

**Mr Strachan**—We are the peak industry body representing wineries, so anything that has policy relevance to a winery in Australia potentially is something that we will be involved in. As I said earlier, we have state associations in each state of Australia. Those state associations then come up through one of our electoral colleges onto our board. Any issue that is relevant to a winery can either come up directly to the Winemakers Federation through its membership base or through a state wine industry association. It is then addressed around the board table, as in any peak industry body. We have a voting structure that needs 80 per cent to pass a vote and, if it is agreed, we take it forward as a policy initiative.

**Senator STEPHENS**—And engaging with government?

**Mr Strachan**—It is something that we do on a regular basis. Taxation has been the main core area that the federation gets involved in, historically. More and more, though, we are getting involved in matters to do with health and social responsibility, environment, wine tourism, a whole range of agricultural matters and the trade portfolio, which is an area where we have a very strong, close working relationship with the government.

**ACTING CHAIR**—Do you think there should be a grape growers' federation of Australia?

**Senator FERRIS**—Of course there should.

**Mr Strachan**—We are actually in negotiations with the grape growers on that matter at the moment. It is my view, and the view of our board, that we would be a more effective lobby group and more effectively represent the interests of the whole wine industry if we had grape growers as part of our structure. There was a meeting held about four weeks ago where the grape growers agreed to set up a peak national body, which we think is a major step forward. Concurrent with that, we are holding talks with them to see if we can set up a national body that represents wineries and grape growers. There is quite a deal of goodwill around the table to see that happen, and the potential for that happening in the next two years is quite high.

**Senator STEPHENS**—Going into the points that you make in your submission and looking at your summary, you say calls for government intervention, mandatory codes of conduct and an end to speculative vineyard developments are not warranted. I am interested in understanding how your organisation, through your state bodies, engages with state and territory governments on issues like regional development policy and the encouragement, at state levels, of expansion of regions into wine growing.

**Mr Strachan**—That is really a state issue. It is done quite effectively through our state associations with their state governments. In terms of demarcation, we essentially rule the line there. We do not tend to get involved in those state development issues. Because we are a national body we deal with national issues and the states, if they want to influence those national issues, have the opportunity to do so.

**Senator STEPHENS**—Do you send market signals around the issues of your industry that would be considered by the state organisations?

**Mr Strachan**—Absolutely. The states sit around our board table, so they are part of the agenda that we move forward on. We have regular communication with the state associations. It is a very robust network and works very effectively. But, because the state issues are state issues, we tend not to get heavily involved in those specific matters.

**Senator STEPHENS**—Your submission argues very strongly that there should not be any intervention by government in the industry and that we should leave it to the market. Would you like to comment on the article written by Paul Clancy in the *Wine Industry Journal* which describes what he calls:

... a ‘race to the bottom’, with some wine producers taking advantage of the surplus to purchase grapes at \$150 per tonne and making wine which sells in our export markets at the bottom end of the *Popular Premium* price points.

He makes a suggestion here. He says:

A correction in the fruit supply and demand balance will assist in addressing the problem but it is not a long-term solution. The radical last resort solution is, of course, a funded vine pull scheme.

Which you argue against. He continues:

A significant change in grower/winery fruit contracts needs to be structured so that in times of oversupply, surplus fruit does not become a free market commodity attracting the bottom-feeding sharks. For example, an integrated hectare/tonnage contract at sustainable prices, might allow a grower to turn his surplus back into the soil and deny the predatory opportunists access to cheap fruit. For cheap fruit not only destroys the grower, it clearly destroys markets and undermines profitable price point sectors for wine producers.

Do you have any comment to make on that?

**Mr Strachan**—The way I look at it, it comes down to where the risk lies. Essentially, what that is arguing is that the winery ought to take on the risk for what is speculative investment for grape growers, and I just do not agree with that. I think if grape growers wish to speculatively invest in vineyards then they take on the risk and I do not see why a winery ought to do that.

**Senator STEPHENS**—Or taxpayers.

**Mr Strachan**—Or taxpayers, for that matter. I do not agree with it, but I agree with some parts of the sentiment, and that is that the wine industry’s future is very much in branded wine production and, if we are going to be a sustainable industry, we need to be selling branded wine. If we are in the international bulk wine market then someone in the supply chain is not going to be making money; it is not a sustainable part of the business. Our industry’s objectives have to be about securing a future for branded wine producers, and therefore the grape growers and others in the supply chain who fit into that.

But, once again, getting back to the fact that we have up to a seven-year lead time in this industry, you do get market signals wrong; it goes with the territory. Because of that, we need to have a system in place where that fruit can be processed, even if it is at a price that is below the long-term sustainability for growers or wineries. The alternative in the last 12 months for a lot of fruit that was processed at very low prices would have been for it to sit on the vine. I, for one,

would rather have a system where the grower and the winery can negotiate a price where at least there is a return for both parties if they are able to sell it internationally, let us say, as bulk wine or processed into brandy or whatever. Once again, I think it comes back to market forces in allowing the market to sort it out. I do not see any merit in having an intervention where wineries are forced to take on an additional risk, because I think it will undermine the pricing system that operates between growers and wineries for the vast bulk of the marketplace.

**ACTING CHAIR**—You do not think the bloke at Braidwood should shoot the sheep; you think he should give them to the abattoir?

**Mr Strachan**—Yes.

**ACTING CHAIR**—I do not agree with you.

**Senator FERRIS**—One of the possibilities to solve this problem is to increase export demand. Could you take us through the likely prospects of that? In particular, could you record for *Hansard* Tesco's experience, which is pretty frightening in its long-term possibility for increasing sales through big supermarket outlets in the United Kingdom and Europe?

**Mr Strachan**—Vic, you might want to jump in on some aspects of this. I think the only answer is to increase demand; that is where the bottom line is for our industry. In terms of demand, the first point to make is that we are still seeing growth on the domestic market and we are seeing double digit growth on export markets. So, whilst the industry is going through a difficult period, it is an industry that is growing and I think most people would want to be in an industry that is growing. As an industry we need to be more successful in some of those higher price points because, in terms of long-term sustainability, the oversupply that exists in Australia is most acute for growers who are producing higher priced fruit for \$A15-plus bottles in the retail marketplace. So that is where our big challenge is.

From an industry perspective, there is a fair bit that has been happening over the last 12 to 18 months in trying to secure greater access to international markets, and that ranges from participation in free trade agreements with China and other markets—Thailand, for example—working very closely with the Department of Foreign Affairs and Trade and looking at addressing tariff barriers in those markets, to a major initiative that the industry has adopted in rebranding what is essentially Brand Australia. We had a launch of Brand Australia at the London wine trade fair in May this year. So there is a whole lot happening there in our marketing activities to try to create more opportunity for our wine offshore.

To get to the Tesco point—and it is an issue that we are seeing with a large proportion of our retailers—we are seeing strong demands for what essentially is buyers' own brand. What that means is that the retailers are extracting the extra margin for the brand and so the wine industry is not extracting it, and that is a big issue for our industry at the moment. We are seeing a very high concentration of the retail market in the UK, and the result is that you tend to see margins go from wineries to retailers. We are seeing very strong trends towards that as well with our major two chains in Australia. So these are very big challenges for our industry, and the future for us is to try and ensure that we have stronger brands in the marketplace so we can get some franchise for those brands.

**Senator FERRIS**—The country where there are huge untapped opportunities for wine is, of course, Russia. I happened to be in Russia recently when the Austrade show was on. I must say I was disappointed—and I have written to you about this, Stephen—about the extent to which the Australian wine industry participated in that program. If you have a look at the demand for wine in Russia it is huge, and I am wondering whether you have got a strategy—and Mr Patrick might like to comment on it—to try to tap into the increasing market for wine in Russia?

**Mr Strachan**—Unfortunately—and you would be very familiar with this—stretching limited resources across an international base is very difficult. I was at a meeting with the Wine Export Council recently where we were talking about our Asian strategy, and the point was made very strongly by a couple of people at the table that the eastern European markets are markets where there is a traditional wine culture so we do not have to go in and create it, and there may well be many more significant opportunities in those markets. So it is an area that at the company level is being addressed. At the industry level it comes down to our limited resources, and we are probably doing it in a very limited fashion.

**Senator FERRIS**—I want to see if Mr Patrick wants to make a comment on that. I did invite him to do that.

**Mr Patrick**—I am essentially a viticulturist, not a marketing person, but I must admit Russia is probably not on the top of the pile when it comes to where Fosters Wine Estate expects to grow the market in the immediate future. Obviously the United Kingdom, Europe, the United States and Asia are the key focus points, but I would imagine that the marketing people will look at any potential market with a view to serving it. The issue will probably be the same as it is in Asia at the moment: there will still be growth at that lower, popular premium end of the market rather than at the premium, ultrapremium and superpremium end.

**ACTING CHAIR**—How did Fosters Wine Estate build itself up? Was it by takeovers or ploughing up fields and planting grapes?

**Mr Patrick**—Fosters purchased Mildara Wines in 1996, or Mildara Blass as it was called. They then expanded into the United States with the purchase of Beringer. I cannot remember the exact date but it was two or three years after that, and now they have expanded again with the purchase of Southcorp.

**ACTING CHAIR**—Did they pay too much? How much does a bad corporate decision at the top level impact on the grape grower, and how much do you smother that in the grape price?

**Senator FERRIS**—It depends whether you are a shareholder.

**ACTING CHAIR**—You do not have to answer that but it is a fair question, because it exercises the market's mind. In other words, if you have got market consolidation of Woolies and Coles then you have got winery consolidation. How much does a half-smart treasury decision in either of those organisations impact on the price of grapes because you have made a poor corporate decision?

**Mr Patrick**—No, I would defend the corporate decision. If Australia wants to have a globally significant group of companies, and they want to retain head offices in Australia, someone in

Australia has to have the intestinal fortitude to get off their backside and do it. Fosters have shown that intestinal fortitude. They certainly did not buy Beringer to shrink the market. They purchased Beringer to grow the Australian export market through a company that had sophisticated distribution channels in the United States. I guess they also wanted to diversify their agricultural risk by going into a different hemisphere to protect the shareholders to a degree.

I guess the current purchase of Southcorp essentially is to do the same thing—to develop an organisation that will have global strength, that has global distribution, that intends to grow the market, and I am quite sure that the people who made the decision expect one and one to make 2.5, not 1.5. The whole object of the exercise is to produce premium Australian wine through sophisticated marketing and distribution channels so that we have a globally leading organisation in the wine industry.

**ACTING CHAIR**—On a really still night, you can hear a bloke up on the Gold Coast laughing because someone paid too much for his business and he is up there developing now. I wondered how much that impacted down the chain. I thank you for your time, patience and consideration.

[9.39 am]

**ROBERTS, Ms Kris, Acting Director, Grape and Wine, Department of Primary Industries and Resources, South Australia**

**SHILLABEER, Mr Michael, Executive Officer, South Australian Wine Industry Council, Department of Primary Industries and Resources, South Australia**

**ACTING CHAIR**—I welcome the Department of Primary Industries and Resources, South Australia. If you would like to make an opening statement—the briefer the opening statement the better—we will then go to questions. It looks like you have some stuff you might like to table.

**Ms Roberts**—Yes. I have the report on the impact of current pricing trends of the Riverland region, which is on our public web site. Also, I have copies of the document on the wine partnership that exists between the South Australian wine industry and the South Australian government.

**ACTING CHAIR**—Thank you very much.

**Ms Roberts**—On behalf of the South Australian government, I would like to thank the committee in inviting us to provide evidence to this hearing today. I am the Acting Director of Grape and Wine for Primary Industries and Resources South Australia. I will refer to this through the hearing as PIRSA rather than reciting that again. I would also like to introduce to you one of my team, Michael Shillabeer, who is the Executive Officer to the South Australian Wine Industry Council. The South Australian Wine Industry Council is a council that is chaired by the Premier, the Hon. Mike Rann, and consists of four to five state ministers, key industry representatives from Constellation and Foster's, plus other small winemakers.

A formal submission will be made by the South Australian government addressing the majority of the issues in the committee's scope of inquiry. Hopefully, we will have that submitted to the inquiry as soon as possible. I am not sure that we will make the deadline on Friday, as we have to go through cabinet for any formal submission. I would like to have that noted.

Today I want to talk about the report you have already received. The basis of the formal submission will be the report on the impact on the Riverland region of current grape pricing trends. This was prepared by PIRSA as a result of a meeting held in February 2005 between the Riverland Winegrape Growers Association and the Premier, the Hon. Mike Rann, and other South Australian government ministers. I believe that some of you are already aware of the report and I have brought some additional copies. The report was confined to an economic impact analysis of grape pricing problems and did not address in detail the social impacts or assess the extent or causes of any underinvestment in vineyard planting for wine processing capacity. As a follow-up to the release of this report a number of workshops have been held. These workshops have been designed to assist growers with the cost issues associated with grape production in the current environment and to allow growers the opportunity to develop and

consider options for the future. The South Australian government and the Riverland Winegrape Growers Association are currently working together to develop and implement these options.

One of the report's main objectives was that winegrape growers understood the global context of the wine industry: the Australian wine industry's role and their role as the winegrape grower within this global market—the scope of this report was only the Riverland region. This was a very important objective: they needed to understand the problem and to take ownership to develop appropriate strategies and actions. This will be done collectively by the grape growers in partnership with the South Australian government. This reinforces the concept of the partnership that the South Australian government has with the South Australian wine industry.

Why did we do it? The grape growers groups have expressed concern that very competitive pricing has led to lower price points. We heard about some of that in the previous presentation. The concern amongst many growers is that they believe there has been undue emphasis on price discounting and, in particular, the bulk export of what is, essentially, commodity wine. This is undermining the reputation of Australian wines. These growers fear that the thinner margins available in this environment, will exacerbate the downward pressures on all grape prices and threaten the livelihood of independent growers, especially those with smaller holdings. Those were the reasons why we were asked to undertake an economic analysis.

The concerns raised three groups of issues: the increasingly competitive global wine market, which Stephen spoke about earlier; the exchange rate fluctuations that are here and now and that we are not in control of and an optimal wine marketing strategy. There are problems in matching wine grapes supply with demand in the context of vineyard planting cycles and seasonal variations in harvest volume and quality. There is also the consequent role of warm inland regions, such as the Riverland, acting as supply buffers in the Australian wine market. If you are familiar with the wine industry you will know we have cool climate regions and warm climate regions. In regard to the Riverland, it is acting as a supply buffer. We have excess supply from cold climate regions and we are seeing that shift into the warm climate regions. The Riverland is recognised as a supply buffer.

Our findings include recognition that Australia's role as a major wine exporter means that it cannot expect to be immune from global wine-market pressures. The current level of international exposure and the provision of increased sales make wine producers in Australia increasingly vulnerable. Wine production is very fragmented compared to other consumer goods but in retailing, in most countries, a handful of large supermarket chains sell the majority of wine, which is chiefly one of the most profitable categories. We talked about the retail consolidation in chains such as Tesco, Coles and Woolworths. This means these chains want to deal with fewer sellers, each with large wine portfolios, to reduce transaction costs. Retailers are placing a great deal of pressure on their wine suppliers for more promotions, quicker delivery, better inventory management and lower prices. This process of adaptation is central to the issues now confronting the Riverland and the wider Australian wine industry.

Consolidation in production is being driven by the consolidation in retailing of alcoholic beverages. Margins are thinner for wines priced under \$10, which Stephen talked about earlier. Australian winemakers have a competitive challenge in the form of the strengthening Australian dollar. These issues are real and Australian winemakers and grape growers are not immune from these pressures. The Riverland is no exception. The report comprehensively addresses

oversupply issues and the production costs of grape growing within the Riverland region. The report found Riverland growers' costs of production have been higher than the average price per tonne for the past five years. More than 60 per cent of the Riverland's 1,300 growers have properties of less than 10 hectares and the report found these smaller growers most difficult to manage. Smallholdings' production costs were calculated for the report to be more than double of those of broadacre operations. Analysis in the report also found the per tonne cost of production for premium varieties in a small vineyard to be \$763 per tonne, while a 600-hectare vineyard's costs were \$330 per tonne. So we saw that about 800 holdings with, on average, fewer than 10 hectares had production costs in excess of \$763 per tonne. If you take a 600-hectare vineyard, costs were reduced to \$330 per tonne. Fewer than 4 per cent of all vineyards in the region have an area of greater than 30 hectares. So the report shows that there are a number of growers in the Riverland region that are hurting.

We took the report from a global perspective, put it into a national perspective and took it down to a regional base. It was based on economics, so we did a lot of number crunching to try and understand why there were these impacts on the Riverland growers and that was one of the major outcomes. The report included a number of potential strategies for consideration. It included the South Australian government, in conjunction with grape growers and wine producers, reviewing a piece of legislation, the Wine Grapes Industry Act, to ensure that it provides a responsive business and regulatory environment for the wine industry. The South Australian Wine Industry Council will continue to monitor grape-pricing trends for all South Australian regions. In addition, a representative of the Riverland wine grape industry will be invited to join the South Australian Wine Industry Council.

There also are a few other strategies recommended in the report. These included collaborative marketing structures. Examples exist with CCW and the Riverland and Barossa Valley estates. These structures have two functions: they can help address an imbalance of market power, which we spoke about earlier, and reduce transaction costs for the winery through the purchase a large quantity of grapes via one transaction, reducing production costs. The other option was the syndication of production from numerous farms under one management unit. We have seen these sorts of units being used in the citrus industry. Property consolidation was another recommendation. Some growers may decide to consolidate property and grow holdings in order to take advantage of the economies of scale that have been demonstrated.

These strategies have all been shown to generate advantages to producers in situations similar to those now faced by Riverland growers. Implementing them requires a combination of analytical and negotiation skills, patience and enthusiasm for collaborative endeavour. In addition, nine workshops were held with grape growers in various Riverland townships. These workshops provided growers with an understanding of the report. Furthermore, it provided them with an opportunity to discuss the proposed strategies and to develop and work through their own proposed strategies. The South Australian government is now working with the Riverland Winegrape Growers Association to develop the findings of the workshop into a next stage.

Finally, I would like to make some additional comments on the inquiry's scope and key areas, which have not been included in the Riverland report. In respect of contractual arrangements, the South Australian government is supportive of fair and reasonable contractual arrangements between growers and producers. The development of the joint industry and Partnering Australia program identifies the roles of both industry and government within this strategy, so we will

work together with the industry through this process. I would like to make clear what the South Australian government's role is: we facilitate, coordinate and collaborate, but the major ownership of these issues is the wine industry's. The South Australian government supports the implementation of quality benchmarks. While this is considered to be an industry matter, the government of South Australia would be prepared to approach the issue of implementing quality benchmarks in a partnership approach. The South Australian government will continue to work with winegrape growers, assisting with progressing any changes to the Trade Practices Act. The national grape growers representative body supports the creation of a national body representing grape growers. Stephen has outlined the initiative by the Winemakers Federation of Australia to look at a national forum. We would support that.

On one of the other issues that was raised, I want to bring to the committee's attention that South Australia has a piece of legislation called the Primary Industries Funding Schemes Act 1998—and I have a copy of it here—that allows the industry to seek from its members a contribution, which is administered by our minister, the Minister for Agriculture, Food and Fisheries. The legislation allows that money to be spent on strategic initiatives and planning. So we already have a piece of legislation that allows the industry to look at a contribution—I do not like using the word 'levy' as it is not a levy—towards strategic planning for the industry.

**Senator FERRIS**—One of the interesting points arising from your presentation this morning is the identification of the cost of production of small vineyards in the Riverland area and the comparatively small return on those properties in terms of the variety of grapes they grow. What do you see as being the likely outcome for the growers? I have just had a quick look at your objectives. Whilst they are commendable, they do not really address the outcome for those people, given that the cost of production is high, returns are low and there is no likely change in that situation.

**Ms Roberts**—I think the workshops were a part of the process. We did the economic study to understand why they were hurting and it clearly showed why. The workshops were held with 200 winegrape growers. We analysed that data. It is not for government to make a decision about what an individual needs to do, but there was an acceptance by those winegrape growers that they needed to reassess their future.

**Senator FERRIS**—So part of your process is to help them do that?

**Ms Roberts**—We have regional development boards within the states. We have the Riverland Winegrape Growers Association, which has been a fantastic body throughout this process. We would assist growers in making that decision if it were to exit the industry.

**Senator FERRIS**—Or consolidate?

**Ms Roberts**—Yes, we would facilitate that and work with the industry in looking at—

**Senator FERRIS**—I think you were here when I asked the question of the Winemakers Federation of Australia about export growth. To what extent are you working on that strategy as well?

**Ms Roberts**—We clearly leave export growth to the national body, the Winemakers Federation.

**Senator FERRIS**—It is actually the Australian Wine Export Council.

**Ms Roberts**—Yes. A minister or our Premier will go and represent the wine industry overseas, where we can as a government, but basically most of the major export strategies are left to the industry. It is not government's role to take those up.

**Senator FERRIS**—I accept that it is not government's role, but clearly that is one of the outcomes. The graphs that were supplied by the Winemakers Federation show that low cost wines are an area of significant growth, so it may be the opportunities for the Riverland lie with increased export growth. In the proposal you have put to us this morning are you looking at that? That is clearly a significant option for growth.

**Ms Roberts**—I see the government's position as addressing impediments to that growth. In the partnering strategy we will work with industry to ensure that those impediments are addressed whether it is through regulation, natural resource management—for instance, we have major issues with water—some of the on-ground issues that will hinder growth. That is the guts of that partnership. I think it underpins it.

**Mr Shillabeer**—The South Australian government also works for the South Australian Wine Industry Association to develop an export program for South Australian wineries of various sizes to try and provide them with the large marketing infrastructure that so many of the larger companies have but that, due to the cost, are unavailable to small producers.

**Senator BUCKLAND**—I attended a meeting in Berri recently regarding the grape growing industry, in particular, but there were winemakers there as well. There was some talk there of growers on smaller properties pooling resources such as machinery. What role has PIRSA had in that?

**Ms Roberts**—As I said, we took that further in the workshops and we currently have a workshop report we are working through. But we would insist on providing some support and doing some analysis of that data. The regional development boards may also work with us on that.

**Senator BUCKLAND**—It was reported to me, and it was said at that same meeting and on a number of other occasions, that if a contract is maintained—that is, if you sign a contract and it is honoured right throughout its life—a winegrape grower on, say, 20 acres can make a reasonable living, and that it is when the contract is not honoured that difficulties arise. Do you know the incidence of contract not being honoured?

**Ms Roberts**—No. We did not go into analysing what was in contract and what was out of contract. But it would be the exception that growers on less than 20 acres—if you are talking in acres—would be making money currently within the Riverland, making a profit. But bear in mind that in our economic study we did not take into consideration off-farm income. Some grape growers in the Riverland may have another source of income.

**Senator BUCKLAND**—For wine growers who are doing it reasonably tough, what assistance does PIRSA offer through its government links?

**Ms Roberts**—I guess we will be there to provide them with information and to assist them with making some decisions about their future. Like I said earlier, the role of government is about facilitating and consultation. So we will continue to give that level of support, as we have with this study and the workshops. We have also developed some work with focus groups. We will continue working with the winegrape growers in the Riverland.

**Senator BUCKLAND**—During its history, PIRSA, regardless of the government of the day, has been very proactive in helping its sectors. Has there been any consideration of developing strategies for smaller landowners to increase the size of their holdings—that is, assuming their neighbours are willing, and things like that? I know that happens in part. Also, has PIRSA considered helping wine grape growers change to other types of industry—that is, growing something different? I am suggesting not that we all go out and plant almonds or olives but that we look at alternatives.

**Ms Roberts**—I think that is our next stage. Now that we have the workshop outcomes, we will work with the grape growers in having a look at what this actually means and what is the next step forward: the options for them. We will be active, and it will not just be primary industries; we will also be bringing in the Office of Regional Affairs, another government agency, so we can work together on this.

**Senator BUCKLAND**—Does PIRSA work in conjunction with the CSIRO in looking at that area of conversion to other income streams?

**Ms Roberts**—We have not, to date, although we have a good partnership existing with CSIRO on other activities within primary industries. I know they did some social impact studies earlier on, and we have drawn on the Bureau of Rural Sciences document and its social atlas and things like that. We most certainly will engage them through this process.

**Senator BUCKLAND**—You talked about the levy earlier on.

**Ms Roberts**—Contribution.

**Senator BUCKLAND**—Contribution; tax—I do not really mind what it is called, for the purpose of this hearing.

**ACTING CHAIR**—Governments call it a levy and oppositions call it a tax.

**Ms Roberts**—Under this act it is a contribution, because the industry contributes to this.

**Senator BUCKLAND**—On what basis? How would that work?

**Ms Roberts**—Currently it works under the Primary Industry Funding Schemes Act. The Riverland Winegrape Growers Association is funded through the contributions they seek from grape growers. That is an example of how it is working. It is clearly defined that it must be about strategic planning for that industry. We have this in other areas: our livestock industries, where

they levy or seek contributions from the industry. The industry actually collects the money, but it is up to the minister as to how that money will be spent. Generally it is within a strategic framework.

**Senator BUCKLAND**—Does PIRSA have any monitoring role in the nature of contracts that are signed between—

**Ms Roberts**—No.

**Senator BUCKLAND**—None at all? Having said that, to your knowledge is there a mechanism for growers or, indeed, wine producers to appeal or have reviewed the nature of the contract if one feels aggrieved by the other?

**Ms Roberts**—I understand that recently there was a clause. I am not familiar with the contracts. That is something that government does not have any relationship with; it is between the winemaker and the wine grape grower. I am aware that there are clauses that can be readdressed through that process.

**Senator STEPHENS**—Thank you for both of your documents, which are very useful. I have just been skimming through *Wine: A partnership 2005-2010*. I will just ask you a couple of questions. The first is in relation to the comments you make on page 11 about potential impacts of climate change and global warming on the industry. You flagged that as a concern. How is the South Australian government considering the impacts of these issues in the broader scheme of things, within the National Water Initiative? Is it considering whether or not there are any potential impacts or proposed impacts on the industry?

**Ms Roberts**—There is an Office of Sustainability within the South Australian government. Climate change and other sustainability issues are being addressed by that group. The South Australian government is very aware of these longer term impacts such as climate change and water impacts. It has been quite responsive and proactive in looking at those longer term impacts, especially in agriculture. There is also a summit that SAFF, the South Australian Farmers Federation, is leading within the next few months to have a look at the future of agriculture and issues such as this. That will be done jointly with primary industries.

**Senator STEPHENS**—That is interesting. You also raise in the partnering strategy section, section 2, a few issues that are very much the focus of this inquiry. In section 1 you raised the issue of skill shortages and training needs. Are you able to comment on where that kind of research is up to for this part of *Strategy 2025*?

**Ms Roberts**—In regard to the partnering strategy, we undertook a gap audit. We did a desk audit of all existing wine industry plans. Through that gap analysis we identified that there were areas between government and industry where we could work jointly together. I have talked about impediments to growth. We identified that these gaps were things we needed to address to ensure the sustainability and the international competitiveness of the South Australian wine industry. As a result of that, task groups will now address those gaps and priorities. So we will have a task group to look at skills and a task group to look at infrastructure for the wine industry in this state as well as natural resource management. We have task groups that will be dealing with these issues and industry and government will jointly address those priorities.

**Senator STEPHENS**—You talk about *The marketing decade* document in section 2, ‘Audit and analysis’. The key issues that we have been talking about this morning are really the issues that you have in your dot points. The first dot point asks:

- Is there an opportunity to link South Australian wine with the development and marketing of other brands that are uniquely South Australian, for example in the food and tourism sectors?

This would be, quite specifically, part of the South Australian government strategy. The second dot point asks:

- How might better transmission of market signals for quality, style and price specifications to South Australian grape-growers and other supply chain partners be facilitated?

This seems to be the crux of the whole inquiry with which we are involved. Can you advise the committee on how the partnership is responding to that very important fundamental issue about the wine industry?

**Ms Roberts**—In my opening statement I talked about the industry understanding the problem. Stephen elaborated about the market signals and market forces. One of the key challenges for the wine industry and grape growers is to understand their position within the world market and to understand that they are a part of a global market and that they need to respond accordingly. To me, that is about the transmission of the market signals for that quality and style. Also the South Australian government, in collaboration with the industry, have just funded a \$9.5 million wine cluster centre out at Waite which would build up research and development for the industry and so we will better respond to those market signals. The government’s role is clearly to have the information and data available to assist the industry through this process. When I say ‘assist’ it is perhaps about making better decisions on their future.

**Senator STEPHENS**—Is PIRSA actually providing that kind of fundamental information to growers and potential growers?

**Ms Roberts**—I think that is one of the outcomes that will come out of what we have done in the Riverland. I have had a lot of interest from other regions in South Australia and outside South Australia—in the Riverina and so forth—in the knowledge and the data we have collected. I would hope that we would continue to update and provide that information. I think Stephen did highlight though that it is up to the grape growers and the people within the wine industry making their own decisions about their own level of investment. I would like to think that there are tools available for them to make better decisions into the future, whether that may be benchmarking tools or the other tools which are available.

**Senator STEPHENS**—In terms of any potential industry rationalisation structural adjustment, are you able to comment on whether the South Australian government anticipates that that there may be some industry rationalisation?

**Ms Roberts**—If there is any rationalisation or exiting, it will be an industry decision to do that. We will certainly support them through that process, looking for other opportunities if that is the case. If they are exchanging into some other agricultural practice, whatever that may be, we will assist with providing information through that process. But ultimately it will be up to the industry to make those decisions into the future.

**ACTING CHAIR**—So do you think people should shoot the sheep or give them to the abattoir?

**Ms Roberts**—No. I have a very positive approach to most things, so I think it is something on which we can work on together in partnership.

**ACTING CHAIR**—They should not dump the grapes; they should give them away! Thanks very much.

[10.12 am]

**SANDOW, Mr Tracy David, Clare Region Grapegrowers Association**

**VINE, Mr Tren, President, Clare Region Grapegrowers Association**

**PECH, Mr Leo Walter John, Vice Chairman, Winegrape Section, South Australian Farmers Federation**

**ACTING CHAIR**—Welcome. Would you like to make a brief opening statement?

**Mr Pech**—I have been in the industry full time for 53 years and I have experienced many changes—from the high excise on the brandy industry to the change from fortified wines to table wine, from a period where we were importing more wine than we were exporting, to the situation we have at the present time. My involvement in the industry over 53 years has been as follows. I have been involved in wine improvement from day one. I helped to compile evidence to a royal commission into the wine industry in 1965. I chaired a committee that looked at the viticulture reconstruction of Australia and gave evidence to the IAC in 1975. I am responsible for the wine grape utilisation survey.

**ACTING CHAIR**—So you have had a fair bit to do with the industry.

**Mr Pech**—I was also involved in the inquiry into the industry in 1985 and I actually negotiated the vine pull with the Commonwealth government in October 1985. I will not go into the detail of all the activities that I have been involved in. When viewing the industry over the past 50 years the challenge before us has never been equalled. My organisation and I support entirely the article you have in front of you by Paul Clancy. He has the ability to put it in a more professional manner than I have.

At the present time, we have a situation of very high wine stocks. My calculations, and those of others in the industry, are that on 30 June it will probably be 2.13 years. The ideal for the industry is probably 1.63 years, comprising 1.4 for whites and 1.75 for reds. Therefore at present we have an oversupply of a million tonnes of fruit in the winery as wine, which probably equates to 700 million litres of overstock. How long will it take for the sales to be higher than the intake, to work this stock out and enable the prices to come up a little so the industry will be viable? With our currency the way it is, and I will not go into details, I think we are a long way off.

One point that has not come out so far this morning is the factor of tax incentives of section 75AA of the Income Tax Assessment Act 1936—as we know, the tax incentive for planting extra vines to service the industry. The simple fact is, it was brought in by the Labor government for a four-year period, which I supported; but it was continued by the Liberal government after that, which we found very surprising. When you have got an environment of a tax incentive, high prices for fruit and low currency, the combination of the three makes it inevitable that you will have an explosion in the industry. I clearly remember sitting in on a meeting of the Premier's committee in Adelaide, warning industry of the three factors concerned. I said, 'What happens if our currency goes up?' I was downed by the comment, 'Why do you have to be pessimistic; we

will deal with that problem when it arises.' Well, I am still waiting for the industry to deal with that issue. I and my organisation believe that the tax incentive should have been removed eight years earlier. We lobbied the federal government—I have had many discussions with Senator Jeannie Ferris about this—to remove the tax incentive. In their wisdom, the government only removed it at the end of September 2004. That is the situation we find at the present time.

I do not want to be pessimistic entirely; I want to end up on a positive note also. When I look back at the organisations that I have been involved in over the years, which include the South Australian wine grape industry advisory council—and John Kerin had a wine grape industry advisory council which ran for three or four years—I believe that now we need to again assist the industry out of the situation it is in. We need to have such an organisation, which should comprise four growers and four winemakers—one from the Wine and Brandy Corporation, one from the GWRDC. None of those persons, that is the four growers or four winemakers, should be executive officers. The organisation would guide the industry out of this very awkward situation.

If our dollar remains roughly where it is, I believe we cannot maintain a 14 per cent expansion of export as we have at the present time. If this happens, the implications will be horrendous for the industry. That is my judgment after being in the industry for 53 years. That is why I believe the industry needs a structure of that nature. The proposed structure that is suggested will not give a balanced approach or balanced information to the Commonwealth as is required by the situation we are in. Thank you.

**Mr Vine**—I will make a brief statement. Whilst the Clare Region provides less than two per cent of the national production, our winemakers win about 20 per cent of the show medals. The strong message from these statistics is that the region generally produces top quality fruit from low-yielding vines for production of wine for the upper end of the market. The growth in the export market has been in what are called popular premium wines. These are wines that have been traditionally produced from fruit grown in the inland regions such as Riverland, Sunraysia and the MIA, with labels such as Jacob's Creek, Nottage Hill, Banrock Station and Yellow Tail.

There has been considerable leakage of fruit coming out of contract in the cool climate regions into these lower price points, hence the lower price structure available to growers. Prices have often been as low as \$300 a tonne. With our fixed cost of production at about \$6,000 a hectare and cropping levels at an average of eight tonnes a hectare, the break-even point is at about \$750 a tonne. This allows no income for the growers or the servicing of debt. We are unable to increase cropping levels. We either dry grow or do supplementary irrigation, so the vine is unable to carry an increased crop—the fruit will not ripen. The dilemma of the industry is: where is it heading? With the growth in the industrial type wines, the medium to upper ranges are being dragged down to a point where the industry globally could be stigmatised and from which we may not recover.

This inquiry is going to end up with a strong message. It is going to be \$US12 a bottle for cool climate region wine. That is where we need to be for the survival of cool climate regions, their growers, their small businesses and their communities. How is that achievable? The relaunching of Wine Australia will help, but the merging of some of the major players sends a message that they are at best struggling in this market under the burden of the wine equalisation tax. We would like to see some assistance given to the industry through either a softening of the tax or an

allocation of, say, 10 per cent of tax collected to assist in the promotion of brand awareness in existing and developing global markets.

**ACTING CHAIR**—Is the bottom line that there is too much supply and not enough demand? It obviously has to be export driven.

**Mr Vine**—I think it is certainly export driven, yes.

**ACTING CHAIR**—This has a familiar ring to it. I can remember the debate surrounding orange juice concentrate when our 20-acre orchards could not compete with 20,000-acre orchards from Brazil. Is this the same message?

**Mr Vine**—No, I do not think so.

**ACTING CHAIR**—Should we shoot the sheep or give them to the abattoir, as it were?

**Mr Vine**—I do not think it is that desperate yet. I think it is a marketing issue.

**Senator FERRIS**—Mr Pech, you and I have talked about this issue for many years now. Can you take me through the increasing plantings in that period of time in the area where you live in the Barossa. Can I draw to your attention, as the Winemakers Federation did this morning, the graph that shows that although the subsidy—the incentive—came in in 1992, the increased plantings did not really take off until about 1996. To what extent did they take off in the Barossa? How much more did you plant? How much did you expand your vineyard? What sort of lead did you give to the Barossa area as a cautionary note in overplanting?

**Mr Pech**—The first comment you made was very interesting. When a tax incentive is announced by government, it takes industry a while to get into action. You first have to buy land and order the planting material, which will then only be available to plant the following year. It is a huge time scale. This is something that Treasury officials could not comprehend when we were having discussions with them.

With regard to the second part of your question, I am doubtful whether I expanded after 1992. I have got 160 acres of vines. The size of the vineyard has nothing to do with the state of the industry. Because I have studied management, I believe that is an efficient economy of scale. If I were to expand, I would have to expand to 300 acres because I believe 200 acres is a non-economic unit. I think roughly 150 acres compounded onwards.

**Senator FERRIS**—We heard from the previous witness about the difficulty of the small 10-acre blocks in the Riverland. What I am trying to establish is your role as an industry leader in trying, albeit that there was no national body, to sound a cautionary note to some of the new entrants into the industry from that period when, if you look at the graph from the Winemakers Federation, there was a really big take-off in plantings—from 1994, peaking in 1998. Clearly that was also to do with the exchange rate of the dollar and so on. What happened in the Barossa? Was there an immediate entry of new people who had no background in industry? How did that work in your area—because I know that you know it intimately?

**Mr Pech**—First of all, I would like to correct the first statement you made. We did have a growers' federal council, which dissolved roughly two years ago. So we did have an active federal organisation lobbying the federal government. I personally, through the federal council, endeavoured to see Peter Costello for a seven-year period. He still has not had an appointment with us, while winemakers could get an appointment at call. I feel it was appalling to ignore a national organisation we had. Of course we were not a wealthy organisation. I was chairman of that for two years only, because of the amount of personal income I had to put in to actually fill that position.

The second point I would like to make is that our region and Coonawarra, McLaren Vale and probably the Clare Valley expanded at the end of the tax incentive. Had the tax incentive been removed at the time it should have, as I suggested, we would not have the problems in the cool regions that we have at the present time.

**Senator FERRIS**—Go back to my question about the Barossa. What happened in the Barossa? I am trying to get a case study because everybody talks about the national statistics. You know your area; you have been there for 50 years. Can you tell me how many new entrants came into your area, what happened, what did they plant, how was there advice given and did you have some sort of a regional body which was keeping an eye on this?

**Mr Pech**—We have a regional organisation and we normally hold a public meeting in February, just before harvest. Warnings were put out, but our region expanded mainly because of the irrigation infrastructure that we achieved through the BIL scheme. The western end of the valley expanded only because of this irrigation scheme, which was at the end of the period.

**Senator FERRIS**—In hindsight, was that irrigation scheme and what it encouraged wise?

**Mr Pech**—Yes, it was wise, though perhaps not to the full extent. You must bear in mind that the bore water is very salty. The run-off from the hills—I have a dam also—is twice as salty as the Murray River. Therefore, the future of my region would have been at stake without this water coming in.

**Senator FERRIS**—That might have helped the process, in the sense that the expansion rate might not have been as great.

**Mr Pech**—There are hectares involved, and the tonnage we produce per hectare is very small compared with other regions.

**Senator FERRIS**—In this article by Paul Clancy which you have given us and which I gather you are in agreement with largely—

**Mr Pech**—Yes, I support it.

**Senator FERRIS**—he talks about a funded vine pull scheme. Are you in favour of that?

**Mr Pech**—I believe we are not at the stage where we need a vine pull scheme. I believe we need a structure to advise the government of the state of the industry every four or six months on how the next 18 months are expected to evolve, and that will depend a lot on our currency. The

answer to your question is: no, not at the present time, but the possibility in the future may be there.

**Senator FERRIS**—Given that there are 100 new vineyards coming on line every year, they are clearly not listening to market signals, are they?

**Mr Pech**—I do not agree with that entirely. There are also other incentives around that distort the industry's situation. You must not lose sight of the time scale: if you decide today to invest in a vineyard, you have to purchase land, get the rooted vines and then plant them. You may have planted one or two years out of a five-year program; your irrigation and everything is set up for the full unit and you must complete the program. I believe we will see a fall-off in hectares planted because so many schemes are being implemented to the full extent.

**Senator FERRIS**—There are so many vineyards for sale that you would not really need to establish a new one.

**Mr Pech**—There are two different types of personalities involved here: one is the investor who does not understand the industry; the other is an individual who has his property for sale—probably a person like me—whose family has been involved in the industry for years. My family has been involved for probably 130 years.

**Senator BUCKLAND**—Just carrying on from that last issue that Senator Ferris raised: you say that you do not think it is time for mass vine pulling, but what about the need to regulate plantings? Do you think there needs to be more regulation to control this; and, if so, how would you do it?

**Mr Pech**—I could not complete the comments that I intended to make, but one of the concepts that my organisation and I have pushed for a long time is a registration of vineyards. If you read our evidence, you will see that we have a register of vineyards in South Australia, and the Phylloxera and Grape Industry Board is finding that it is six per cent out. For the rest of Australia, there is no regulation of that nature. We suggest it could be 10 per cent out; it may even be higher. I do not think you can control the planting of vines, but we strongly support the registration of vineyards so that the statistics can be as accurate as possible and the industry can make a judgment accordingly.

The second aspect of a registration of vineyards is that we would know exactly where the vines are in Australia if a vine health issue occurred such as the citrus canker or the vine rust in Darwin. We were fortunate in being able to convince the federal and state governments to conduct an eradication program and we have been able to hold vine rust in that area, but in the event that it moves out of the Darwin area we do not even know where the vines are. We strongly support a register of vineyards, and that is one of the issues that the wine grape industry advisory committee should first look into.

**Senator BUCKLAND**—We know, because it has been quite public, particularly in South Australia, that there is a lot of work being done by Riverland grape growers with PIRSA to address the problems of the industry. Is that occurring to any extent in the Clare Valley?

**Mr Pech**—In my region—

**Senator BUCKLAND**—Let me just put on the record—I probably should not put it on the record, actually—that I have a bit of a taste for Clare Valley red, so I have an interest there.

**Mr Pech**—We have discussed the concept with our people. The problem is we do not have the economy of scale. Riverland produces roughly half a million tonnes a year, give or take a little bit. In the Barossa Valley we probably produce 70,000 to 80,000 tonnes a year. There are subregions within our region and not all people think alike. Therefore, if we were to get a levy, the levy would have to be high to make it viable. That is the problem that we have.

**Senator BUCKLAND**—There was mention made of the number of vineyards for sale at the moment, but do you, or Mr Vine, have any idea of what the actual exit rate from the industry is at the moment in your region?

**Mr Vine**—There are vineyards on the market but they are not selling. They are very difficult to sell. People are hanging in there at the moment but it depends on how lenient the banks are going to be. There have not been any for sales at this stage that we are aware of.

**Senator BUCKLAND**—I think that answers the question. I will need to provide someone with further questions because we do not have the time. The other issue I would like your comments on is in relation to the joining of wine grape growers with the Winemakers Federation of Australia. Do you have a view on that?

**Mr Pech**—Yes, I have a positive view on that. We, the South Australian Farmers Federation, do not support the concept of a regional to federal organisation. We feel it is not effective. It should be from a region, to a state, to a federal organisation. However, we have been outvoted and we will support the concept. But my 50 years in the industry tells me absolutely clearly that that is not the way to go. A top body representing the winemakers and the growers is a very interesting concept. The proposition is to have three electoral colleges of winemakers and one of the private growers. Our voice will lose its effect. Therefore, I state: for the federal government to get a clear picture of the state of the industry, it needs the concept that I have stated today—a wine grape industry advisory committee representing the two parties concerned and the Australian Wine and Brandy Corporation and, of course, the GWRDC. I believe that is the ultimate structure that is required for an adequate balanced informer to the Commonwealth.

**Senator BUCKLAND**—Is there any difference between contracts that might be agreed upon, signed or whatever, in the Riverland and contracts in the Clare Valley, to your knowledge?

**Mr Pech**—No. I think the problems of contracts will remain. I have had discussions with the ACCC on the issue. They suggested that we set up a joint industry organisation to look at the relationship between the growers and the winemakers. It so happened that I was the first chairman of that committee for a two-year period. I think the barriers are not as strong but, let us be honest: when there is an oversupply of fruit, what can the wine companies do? I am sympathetic to the situation they find themselves in. There is just too much fruit out there. I must say, also, that where there is a contract for a particular price and the winery finds they do not have a market for that product at that price, what happens? The growers have to sacrifice part of that price, which is in the contract, to assist in funding to process the fruit. So, at the end of the day, what is the strength of a contract? I am willing to come to Canberra to give you evidence anytime at my expense.

**Senator BUCKLAND**—It would be awfully hard to swallow if the break-even point is \$700 and you are getting 300 bucks for a tonne of grapes. That is my only comment on that. I think that is terribly unjust.

**ACTING CHAIR (Senator Stephens)**—Thank you, gentlemen, for your evidence today. Senator Buckland has indicated that he may put some questions on notice to you, but we have not yet defined a return time for them. We did not really get to the issue of quality criteria and assessing the quality of grapes, which has been raised in several of the submissions to the inquiry. Perhaps it would be useful if we were able to place some questions on notice to you about those.

[10.44 am]

**FORTUNE, Dr James (Jim) Alan, Executive Director, Grape and Wine Research and Development Corporation**

**STRACHAN, Mr Stephen Francis, Chief Executive Officer, Winemakers Federation of Australia**

**ACTING CHAIR**—I welcome you and thank you for agreeing to appear before the committee. Dr Fortune, I now invite you to make an opening statement.

**Dr Fortune**—The key reason for the Grape and Wine Research and Development Corporation submitting information to the committee is that we are very centrally placed in the industry. We have three key stakeholders—the Australian government, winemakers and grape growers—and we are one of the few organisations that receive funds from all those groups, so we have a very strong obligation to deliver on their behalf. That is an obligation which in statute we take very seriously but in practice we also take seriously by very close interactions in and amongst the industry. So with a matter of industry concern like the present situation, principally relating to pricing, the corporation felt it was fairly important to respond to this committee with information in relation to what it sees as its inputs.

In summary, the areas that we have addressed are the terms of reference that are particular to the corporation. In commencing, with regard to the current situation in terms of supply and demand, the corporation is involved in a range of investments for gathering information in and about the grape and wine industry, in terms of both domestic markets and international markets. It works in partnership with a range of organisations, particularly with the Australian Wine and Brandy Corporation, to ensure that all that data is widely disseminated and available to industry. That is published, it is discussed in industry committees like the Knowledge Development Advisory Committee, and I would indicate that one of my reasons for inviting Mr Stephen Strachan to participate in this session is those shared industry committees that we all participate in—grape growers, winemakers and the R&D corporation and other interested parties—to ensure that industry has an overall context for the delivery of information. We invest heavily in information and, as part of that, we expect that people are applying that to their business processes and business development opportunities.

The second area to address is the relationship between growers and producers. We recognise that there are both commercial and social aspects to that, particularly in small and moderate sized regional communities. The key area where the corporation operates is again through programs like RITA, the Regional Innovation and Technology Adoption program, where there is encouragement with regional and local groups to access corporation funds for targeted purposes in and around those areas. The second area is provision of information where they can engage in discussion and dialogue around pricing strategies, and in that area the corporation invests heavily in measurements of quality. Historically, there have been a limited range of quality attributes that have been available for use in pricing consideration, and we work constantly, particularly with the Wine Research Institute, to ensure that a better array of those methods is available. Part of that is the key issue of testing the methods before they are useful in a commercial environment.

We did not respond to issues in regard to the Trade Practices Act because they are outside our general overview.

On the need for the organisation of a national grape growers representative body, in terms of the discussions, the corporation is extremely aware of the current industry negotiations that have been supported by the Australian government, and it has been very supportive of the process and involved in tracking its development. For the corporation, that tripartite mix of growers, winemakers and the Australian government contributing to our strategic development plans and overall investment direction is absolutely critical, and the closer that dialogue is, the better. If that is supported by industry structures then we see that as a positive. On that note, I will conclude.

**ACTING CHAIR (Senator Heffernan)**—From the point of view of the Grape and Wine Research Development Corporation, has the economic side as much as the science side of planning been pretty ratty? In other words, is it a bit of a fantasy thing to think you are going to have a 10-acre orchard that is going to pay?

**Dr Fortune**—From the corporation's point of view, one of the things that is quite extraordinary about the industry is how fast it has grown over a 10- to 12-year period. That has involved an enormous amount of investment by growers and winemakers in the process. It would be presumptuous to say that they have not put a lot of business planning into that process. Obviously, in some cases the skill of applying that business planning varies somewhat, and it has been apparent in recent times with pricing that there are people who are on the small end of the scale with production of grapes who are finding the trading conditions very severe.

**ACTING CHAIR**—Should this not have been predictable, given that in the old days, when it was a regulated industry, a 60-acre rice farm still required a tractor, a header and a whole lot of overcapitalisation? Orange juice concentrate from Brazil involved a similar argument. In the grape industry, should we not have learnt from all of that?

**Dr Fortune**—I think Mr Pech, in his evidence, commented on some sort of optimum unit for managing a grape operation. Many people in the industry understand that fundamentally. If they wish to take on the capital or labour cost burden of expanding, then there are probably targets that they have to achieve. Very obviously, as the industry has grown so rapidly over a number of years, that has indicated there are a large number of people that know and understand that business planning.

**ACTING CHAIR**—What proportion of the industry participated in the dream and fantasy of growing grapes versus the business decision that it was likely to be a good livelihood?

**Dr Fortune**—I would only be speculating, but the fundamental is that during very rapid growth—and with growth still above 10 per cent per annum—there are obviously a lot of people that examine it as a fairly routine part of their own business and business opportunities. That would be everybody from very small growers to large investment companies.

**Senator FERRIS**—I do not know that I have too many questions, because it seems to me that the problem has been very well defined this morning. The solution is clearly to increase export demand and, until we hear from the Wine Export Council, I am not sure where we go with the

answers to that. I think the evidence we have had this morning has been very clearly able to delineate the problem. I do not have any questions. I think the evidence is substantial.

**ACTING CHAIR**—I will ask a thing that I have always been curious about, given the part of the shop that I shop in. It has always fascinated me what the economic breakdown of a \$6 bottle of wine is—between the glass, grapes and transport. Do you have those sorts of figures?

**Dr Fortune**—Those sorts of figures are available, and I might defer to Stephen Strachan to see if he remembers them from some of the winemakers.

**ACTING CHAIR**—It might be interesting for the committee, and the community at large, to understand how that all happens in the supermarket—in contrast to a bottle of wine priced at \$10, \$15 and \$50.

**Mr Strachan**—The two largest components are the retailer's margin and the government tax level. It goes down from there. We do have that figure and we can provide it.

**ACTING CHAIR**—So it is possible to do that without a loss?

**Mr Strachan**—Yes. If you look at where Australia's comparative advantage is in the world at the moment, it is around that \$6 to \$8 bottle of wine. Most of the evidence demonstrates that we are world leaders in that sector of the market.

**ACTING CHAIR**—So that is the market demand, but what does that mean the price of grapes has to be to make those sums add up?

**Mr Strachan**—Not \$150 per tonne—it can be somewhat higher than that. What I am saying is that it is a sustainable part of the business.

**Senator BUCKLAND**—It always fascinates me that when there is a glut the price does not actually drop on that \$6 or \$15 bottle of wine; it seems to stay where it is or go up a little bit. That is just a comment. Is it reasonable to hope that refining the measures of quality will limit the disputes between growers and wine producers?

**Dr Fortune**—I would be speculating on the disputes, but it gives them a better information base from which to work.

**Senator BUCKLAND**—Do you as an organisation get involved in any of the contractual disputes, particularly when it comes down to the assessment just prior to harvest and then later on during the production process? There seems to be a difference of opinion between the people who select what grapes go into what wine. Do you ever get involved in that?

**Dr Fortune**—Not in a direct sense. As indicated, we are most interested in making sure that, if there are new techniques available for quality measures, they are sufficiently robust before they enter the marketplace.

**Senator BUCKLAND**—I notice that there are vineyards developing in the mid north and in the lower Flinders Ranges. In fact, I have just bought a whole lot of posts from a vineyard that

was under development at Port Germein that never went ahead. Do you get involved in assessing the value of grapes or the possibility of grapes being of sufficient quality for winemaking in regions where there is no sustainable water supply?

**Dr Fortune**—Again, not in a direct sense, but it is one of the areas that interests us. If people are starting to produce fruit in areas that have very difficult growing conditions, then potentially their demand for information goes up. The consistency of those information messages is fairly important to us. As indicated, the expansion of the industry into new areas and new regions has been very driven by individual assessment of the business opportunities.

**Mr Strachan**—Can I just add that there are any number of viticulture consultants who people can call on to get that information, so it does exist.

**Senator BUCKLAND**—Mr Strachan, this morning when you were here with Mr Patrick in your other capacity, I mentioned having visited the Beringer Blass facilities in the United States. You rightly pointed out that there is a desire for sweeter wines. In the organisation that you are with now do you look at what people's palates might be in the future? Is there a trend to sweeter wines here, or do you find that American wines may be more acceptable in Russia—where Senator Ferris has been recently—or Japan? Do you follow this and work with growers in developing the wine varieties?

**Mr Strachan**—There are two answers to that. One relates to our application for a cooperative research centre for wine. I might let Jim talk about some of the key things we were trying to achieve there. The second point is that, for the winery, the retailer is the gatekeeper as regards the consumer. The winery has a relationship with the retailer and therefore, by proxy, the consumer. Wineries are very focused in those areas. There are a lot of great things happening at the winery level in trying to interpret what consumers want. If you look to the success of Yellow Tail, it is a very good example of a winery that was able to understand what the consumers wanted in a particular market—that is, the United States. So there is a lot of that happening. At the industry level, it is an area where there is quite a lot of focus. Perhaps it is better for Jim to comment on that.

**Dr Fortune**—Mostly during 2004, in the planning process for the CRC for Wine that was not successful, there was a lot of engagement across industry. The key focus is that in this industry we are all ruled by the consumer. Increasingly, that consumer operates in an international marketplace. If we do not understand the drivers and signals coming from them very clearly and very early, then either we do not take the opportunities or we leave ourselves exposed to competitors that do understand that part of the process. So at present, both from an R&D perspective and an industry interest, those areas of activity have very high priority. Having said that, there are parts that the industry as a whole can share and there are consumer activities that we know are quite sensitive, commercial interests of individual companies. We have to respect some of those.

**Senator BUCKLAND**—I notice that Banrock Station are one of the larger wineries that do not do pruning. Their claim is that it makes absolutely no difference to the quality of the grape if the vine is not pruned but that there is a great deal of cost involved in the pruning process. Is this something that the corporation is trying to develop further just to save costs?

**Dr Fortune**—We have quite significant investments in the area of viticultural practice and it is an ongoing process. In some cases and in some environments it is very much an individual decision as to how they approach the general management of their vines. Sometimes that decision is made in consultation with support they receive in interactions with their wine companies. It is not a ‘one answer fits all’ situation but because of that variation the research focus is very strong in areas of viticultural practice. One of the spectacular strengths of the Australian industry is that, while we may be under pricing pressure at the moment, Australians do know how to produce a tonne of fruit at a relatively low cost and that can only make the environment for some of our international competitors increasingly tough.

**Senator BUCKLAND**—For a long time I have been trying to convince my wife of the merits of Banrock practices in relation to the few vines I have at home, but it has not worked. To get a quality of wine that is more acceptable and therefore more marketable, do you think that the joining of grape growers with wine producers will have benefits? Earlier this morning Mr Strachan told us that they were talking to growers. Do you think that will have benefits for the industry as a whole?

**Dr Fortune**—Because we work with the groups fairly continuously we do not necessarily regard them as being in one place or another; rather we regard them as part of the industry as a whole. From a personal perspective and based on how the corporation operates, we do not see walls between growers and winemakers—it is one industry. I think increasingly the industry is also sharing the vision that it is the world consumer who is the real driver of the system and if we can share information about that world consumer in a common environment then there is a much better chance for faster and more effective communications.

**Senator FERRIS**—The graph presented earlier looked at the increased demand for the lower price range product. How difficult is it for you to get research and development technology accepted by those people, given that they are, relatively speaking, making a reasonable dollar at that lower end, if the cost of production is also low? Is getting technology transfer into that lower end of the market a difficulty for you and how do you go about doing it?

**Dr Fortune**—Taking a step back and looking at the growth of the industry, the biggest issue has been attribution of where the benefit and the knowledge has come from. Over a 10-year period we have dealt with people who are staggeringly efficient at putting new vineyards in the ground, managing them and producing quality outcomes. All of that drive has come from the information base that underpins the Australian industry. They are drawing from R&D outcomes continuously. Some of those are directed towards very low costs of production and very efficient production systems. Some of them are directed much more towards quality outcomes. The system tends to bifurcate in those two directions: we go for highly differentiated markets or we go for an ability to take costs out of the system and produce an excellent quality at those lower price points.

**Senator FERRIS**—What about that technology transfer being interactive? Do you have field days? How do you go about it? Is it a thing they take up if they want it and if they do not they do not take it up? Do you actively go out and try to bring that about?

**Dr Fortune**—There is a range of extremely active processes, frequently involving regional organisations and groups. As indicated before, we have a significant program called RITA—

Regional Innovation and Technology Adoption. That came in about five years ago when it was recognised that the corporation investment was focused on industry as a whole—national outcomes—but it recognised and acknowledged that there were quite unique regional demands.

A RITA investment typically involves coinvestment between the corporation and a regional group across Australia. They may target a particular area of interest to them in pest management or local management, and they arrange field days and other operations. Equally, over the last seven years in particular, the corporation has had a significant investment with the CRC for Viticulture, which has a major platform associated with extension and adoption programs. There are a range of activities in that area, like research-to-practice, that bring new research opportunities to the attention of growers—again, delivered on sites in regional areas. I think it is important to note that some of those activities have been extremely well supported by the very large wine companies, often in terms of giving access to vineyard areas and supply-chain information around those production cycles.

**ACTING CHAIR**—They say that a good, big footballer will survive better than a good, little footballer. Will a good, large-scale grape grower survive better than a good, little grape grower?

**Dr Fortune**—I always have difficulty with the scaling. I have been in primary industries in Australia all my life and the term I dislike most intensely in that environment is ‘get big or get out’. In commercial practice there are some realities about size and being able to maintain a sustainable operation. We have seen that very clearly over many years, particularly in areas like the Riverland where there is net migration of families because there were no opportunities for all the family members to stay in primary industries at that level and so on. When it comes down to saying which of the little ones may not make the grade compared to the ones that have a very good commercial model operating that is where putting a set point on the scale becomes difficult.

**ACTING CHAIR**—Georgie Gregan survives! Thank you very much for your time.

**Mr Strachan**—Thank you.

**Proceedings suspended from 11.07 am to 11.22 am**

**HESKETH, Mr Robert William Cameron, Private capacity**

**ACTING CHAIR**—Welcome. Would you like to make an opening statement, do a bit of poetry or do a song-and-dance routine?

**Mr Hesketh**—I will do all that. I have been associated with the wine industry since 1960. Just to put that in perspective for the fun of it: there were 152,000 tonnes of grapes processed in Australia in 1960 and, as you know, there are now something like two million tonnes. Furthermore, in those days the industry was largely a fortified winemaking industry, not a table-wine industry. I have run companies that have serviced the wine industry with materials and equipment. I have judged wine for many years. I have built vineyards in Australia and built vineyards in France. I have operated an export wine business to the United States in the middle eighties. I was the inaugural chairman of the Wine and Brandy Corporation when it was established in the mid-eighties, a position I held for five years. I am here out of my belief in the necessity to see that the long-term issues that face the industry are addressed.

**Senator FERRIS**—I would be interested in your view of what is happening right now. I know you are a very experienced person in this industry. I think you have been here for some of the evidence this morning. Could you give us a perspective on how you see the problem and what you see to be the solution. Is it the dollar? Is it overplanting? Is it increasing exports, and, if it is, where is our best chance for those export increases? Do you have any comments on the supermarket consolidation, both here and internationally? I know that is a lot of questions.

**Mr Hesketh**—It is a lot of questions, and I will start with the easier end first. There is no glut of grapes, in my opinion. There is certainly a supply and demand imbalance at the moment, but, in my view, there is no glut. I keep a record of the amount of wine we need to meet our forward projections based on the way the world is going and I have kept them for 15 or 20 years. I will just refer to my notes to tell you what those records show at the moment,

To tell you how this record is arrived at, I pretend I own the industry and at 30 June I have a total industry stock of so much. I deduct the sales, both export and local, and I see how much stock there is before vintage each year. The reason for that is the amount of material that is available before vintage affects the decision as to how much you are going to take to meet your requirements 18 months out. My record shows we had 283 days of stock of white wine before vintage 2005, at the current rate of sales, and we had 512 days of stock of red wine. These stock numbers are quoted to you in various different ways but, as a business, in my view that is the right way to get it. To put that 512 days of stock in perspective, in 2001 we had 601 days of stock. If you take the view that 512 is a bad number—I do not think 512 is a bad number—then the position in 2001 was a good deal worse. To put it in perspective again, the lowest number that I have seen in my life in the game was just under 400 days of stock of red wine. Of course, the days are dependent on the going rate of sales. I calculate the going daily rate of sales in the six months preceding vintage. I find it a very useful number because it then allows me to go out and do whatever trading I am doing in the wine industry and say, ‘The industry is a bit oversupplied, or it is a bit undersupplied,’ or whatever. I think the premise of saying, ‘Goodness me, we’ve got to have a Senate inquiry into the wine industry because there is a glut of grapes,’ is not right.

**Senator FERRIS**—Let's move on to my next question, which related to increased demand and whether you see it being domestically centred or internationally centred. If your answer is internationally centred, where do you see the growth markets?

**Mr Hesketh**—Let's not be under any illusion here. If the rest of the world stops drinking our wine, then you and I cannot drink it in a fit. We are well past that day. I have not looked at the recent figures but probably 60 per cent or thereabouts of our production is now going overseas. Australia cannot possibly consume it if others do not. If for some reason someone said that drinking Australian wine gives you leprosy, we would be in diabolical bother. We would have thousands of hectares to pull out tomorrow. But that is not a realistic scenario and not one I would even think about suggesting. We have to go on assuming that the world is a sane place and that our wine is of sufficient quality versus price to continue its place in the market and that we will continue to grow. You need to remember that you are making a 10-year investment in it each time you do anything—at the minimum you are making a 10-year investment, probably nearer to 40 years—so it is a pretty serious decision. On a world scale, Australia consumes somewhere around 20 litres a head of wine, which is a reasonable figure. It is not very high.

**ACTING CHAIR**—That is per year, is it?

**Mr Hesketh**—Yes, per head per year. But the French do 50 or 60 litres a head. The Americans do seven or eight, or some low number like that. By the way, the French figure is half what it was 20 years ago. So we are doing all right as far as consumption goes. We are not going to solve the problem in Australia, but it is not a problem.

**Senator FERRIS**—So where do you see the opportunities for growth for Australia's exports of wine?

**Mr Hesketh**—Australia has gone this far because we provide consistent quality at the right price. It is well marketed, well supported and consistent in quality. Any marketer will tell you that, if you keep doing those things properly, keep supporting the market and producing good quality at the right price, then your market is reasonably assured—and 'reasonably' is the best thing you can say. We are a global, branded, grocery type of product at the moment and that requires constant attention to detail, to price, to everything else.

While we are on that, that is why the grape price-winery use argument is so important. A wine company changes its retail price point in America or the UK at its peril. You do not change your price point. If you put it up a dollar, your sales will go to hell. So with a strong brand overseas you have got to maintain that price point and that quality. It is useless saying that everyone should get more for their grapes because we have got to do something, because you cannot do it. If the currency changes, you have got to live with it.

**Senator FERRIS**—If you were a betting man, would you say the Wine Export Council is better placed to try to encourage our Asian neighbours to drink more wine, or should we try to capitalise on the Eastern European increased level of wealth in, say, the Baltic nations and perhaps Russia to try to increase wine consumption for our Australian product there? I am just trying to see where we are going to solve the problem with increased international demand.

**Mr Hesketh**—Where do we start? The really big picture is: can a capitalist wine industry model that says it has got to work on supply and demand and profitability—public companies trying to make returns and so on—survive against the subsidised model of Europe? You have to understand that our competitors in Europe are some of the most heavily subsidised people in the world. It is one of the oblique lessons, I hope, that comes out of your investigations. Whatever we do, we must not walk down the European road of subsidies to growers or winemakers or anyone else. Let the destructive force of capitalism get loose and people who deserve to go broke go broke and the rest of us get on with our lives.

We built a big vineyard in the south of France and we built a brand out of it. We soon learned that in France our competitors did not farm grapes and make wine—they farmed subsidies. The government spends millions. You have heard, or you will have seen in the paper, that above 40 per cent of the European Union budget goes in agricultural support. In France the local growers we used to deal with and became friends with told us that about 12 per cent of that budget per annum goes in some form or other to the wine industry. It is an awful lot of money.

**Senator FERRIS**—Should we be trying to penetrate those European markets to increase demand?

**Mr Hesketh**—If you believe that the capitalist model can defeat the subsidised product of Europe, then the whole world is our market and we need to concentrate on those markets that produce a good return, which broadly speaking are the UK and the USA, and take markets of opportunity as they arrive. This leads me back, importantly, to where we started, which was that if we are going to develop these markets we must always have more product than we are selling. So, speaking as an Australian, a bit of surplus of wine is very good for the industry. Maybe it is not much good for the grower or the marketer of the wine, but in terms of developing markets if you do not have the grapes you cannot have the wine; and if you do not have the wine you cannot build your market.

**ACTING CHAIR**—Is this different from beef and wheat?

**Mr Hesketh**—I think the time lags are longer.

**ACTING CHAIR**—But it is the same market?

**Mr Hesketh**—It is a global market; we have got to be in it. But if you have not got the wine you cannot sell any.

**ACTING CHAIR**—Who is ‘we’?

**Mr Hesketh**—‘We’ is the industry.

**ACTING CHAIR**—‘We’ grew grapes in France.

**Mr Hesketh**—That was me. Sorry, that was a private company that was eventually taken over by Southcorp.

**ACTING CHAIR**—Were you eligible for their subsidies, given that you were a French wine grower?

**Mr Hesketh**—We were, but we declined to take them on the grounds that we wanted to be able to thumb our noses at them if we felt like it.

**ACTING CHAIR**—Wouldn't the difficulty be, though, that because there is a subsidy built into their financial plan, the capital price of the land and everything else gets distorted?

**Mr Hesketh**—Distorted? When we went to buy land we were buying about 200 hectares. It is hard to get 200 hectares because everyone has got a farm about 5 hectares in size. But, forgetting that, the price for the land was the price of the vine pull scheme. It had nothing to do with capitalism at all. The grower who had a vineyard for sale said, 'I can get about \$10,000 per hectare'—I think it was about that; do not hold me to it; it is just the exercise that it is important—'so we are not going to sell you this land for anything less than \$10,000 because we can get 10 grand from the government and have the land.'

**ACTING CHAIR**—Isn't the point to give people a bit of heart; that because of the subsidies regime their capital regime is corrupt and you may well still be able to compete, even despite the subsidy. Our land at bloody Balranald, I can assure you, is not worth anything like that.

**Mr Hesketh**—But you have not got any subsidy underpinning it, I trust.

**ACTING CHAIR**—Yes. But the capital expenditure is a lot less as a result.

**Mr Hesketh**—Here is another example for you. Because there are farming subsidies, and because there is overproduction as a result of that, in the bulk wine trade, which I have dealt with in Australia and in France—this is where wine changes hands in big volumes between companies—the price of the wine bears no relation to its quality. It becomes, in effect, the subsidised price of the raw material. All this is, I hope, giving some weight to my evidence that government intervention in the wine industry is, in my view, a pain in the neck.

**ACTING CHAIR**—Didn't we learn that from the wool reserve scheme?

**Mr Hesketh**—I would have hoped so, yes.

**ACTING CHAIR**—I would have thought that we did.

**Mr Hesketh**—In my time in the wine industry—which in viticultural terms is not that long—I have seen white wine booms, red wine booms, demand for grapes, no demand for grapes, being screwed by the retailers and boom times which do not last as long as the down times. As far as I am concerned this sort of time is just normal. This is how it has always been: tough. That is what happens. That is life.

**Senator BUCKLAND**—Before I ask any questions I will put on the record my interest as a grape grower: I declare that my three vines are no threat to the growers or to the wine producers.

**ACTING CHAIR**—I can top you, son: I have one grape vine and I have never pruned it.

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**Senator BUCKLAND**—I put that on the record because it might have been unclear earlier. In your opening remarks you mentioned there was a supply-demand imbalance but not a glut. Could you expand on that a little?

**Mr Hesketh**—I would say that the industry is short of grapes when there are about 450 days of red wine in stock before vintage. Now we have 512 days of stock before vintage 2005. You could say that is an imbalance but it does not strike me as catastrophic at all. As I pointed out, in 2001 we had 602 days of stock. I can see why people are hurting and why some people have not sold their grapes but, putting on my Australian wine industry hat, it is not a glut.

**Senator BUCKLAND**—I do not for one moment question how authentic your figures are, but does the average fellow growing grapes understand that?

**Mr Hesketh**—I am sure they do not. Firstly, as far as I know I am the only one who keeps the figures this way. The industry keeps figures which talk about it in general terms—not days—and they compare it with times in the past. As far as I know, I am the only one who keeps figures on an estimate of the stock before vintage.

**Senator BUCKLAND**—Your method or theory seems to make a lot of sense if it is right—and I make no judgment on that. Have you ever been asked to provide that data to any organisation or body?

**Mr Hesketh**—I make money out of it, so I do not want to.

**Senator BUCKLAND**—I accept that.

**Mr Hesketh**—To explain—

**ACTING CHAIR**—You can tell him to pull his head in.

**Senator BUCKLAND**—I think he did.

**Mr Hesketh**—At one point I had a reasonably extensive wine brokerage business where, in selling between Mr Southcorp over here and Mr Orlando over there, I would be moving wine around the industry. As an independent broker in the middle of those people I thought it important that I knew more about the supply and demand position than they did. They only see their sales and their stock position whereas if I am going to be a good arbiter in deciding what the price is I ought to know what the overall position is. I developed the method some years ago for that purpose.

**Senator BUCKLAND**—In earlier evidence today from the wine federation they produced a series of what would be overheads if we had the facility. The lower end of the market, that is the cheaper wines, seemed to be performing particularly well and there were quite substantial increases in sales volume and dollar value. As we get into the more expensive wines, which I have never been near, it really drops off and sales volumes or performance are very much lower. Do you think as an industry we should be looking to develop that upper end of the market to value-add to what we already have? We have a great wine industry. I do not think that can be

disputed, but we tend to be getting a reputation, rightly or wrongly—and it may be just my own observation—of being low- to middle-range producers as far as quality is concerned.

**Mr Hesketh**—You have the wrong information. Just to talk briefly to the issue of profitability, the most profitable segment of the industry, if you measure cases sold by gross profit per case, is around the \$10 to \$12 retail price point. That is where the most dollars by cases come out. But all of that is meaningless in the sense that this is just capitalism at work. If you are giving people good quality wine at the right price, they will buy it, and I do not think there is anything more mysterious about that. I do not think we should be saying to ourselves, ‘We’re only going to make \$20 wine’ or ‘We’re only going to make \$6 wine.’ We should make it where we can be profitable and go ahead and do it. The UK market, for example, is something I knew about a few years ago. The figure that sticks in my mind is that 80 per cent of the wine sold in the UK was less than £3.50p, which is \$7 or \$8 or something like that. The great bulk of the market in terms of volume sold was below £3.50p in the UK. By the way, Australia does not feature much in that segment; Australia is in the segment from £3.50p to £5. Australia’s export per litre price is quite strong on a world scale. The French have a higher one, mainly because it is all champagne—not all, but the price is lifted by champagne.

**Senator BUCKLAND**—I think you were here earlier today, so you would have heard some discussion about the contractual arrangements between growers and winemakers. Do you have any views on that, if you have any knowledge of that? Do you think there are any difficulties in those contracts that could reflect on the overall marketing of our wine? Could you also comment on the possibility of the wine grape growers joining the Winemakers Federation?

**Mr Hesketh**—By way of amusement, in France they talk about a binding contract being an invitation to open negotiations; a lot of our contracts are really that. The short answer for your committee would be: an associate of mine, Mark Swann, got a Churchill scholarship four or five years ago to study pricing mechanisms and grape contracts around the world. As part of the Churchill scholarship he did a report, and he told me that he would be willing to supply it if the committee would like to see it. I would suggest that you get your research department to give him a call and I am sure he would give it to you. The general conclusion of it was that our contractual arrangements were certainly up at the top of the contracts around the world in terms of good sense and reliability and so on. We are not falling over badly on that side at all.

As to industry politics and grape growers and winemakers, the Wine and Brandy Corporation that I chaired in the mid-eighties had grape grower and, in those days, cooperative representatives. I have to tell you it was a total waste of time. People took entrenched positions, voted out of their loyalties, or whatever it was, without a common sense of where the industry was going and what it was doing. It was generally a useless situation.

I think the relationship between growers and winemakers has improved immeasurably since that time. Certainly, the pressure of the imbalance at the moment has caused some of those relationships to be put under a fair bit of stress as the big companies try and get out of them or adjust them. As a general observation: if I were a grape grower, I would like to belong to an organisation where I had some influence with what happened and, if I were a winemaker, I would like to belong to an organisation where I had some influence. We can sit and talk and argue on that basis, if we are going to, but I would not recommend putting the two together in one.

**Senator BUCKLAND**—As an old unionist who went through amalgamations, I think I understand where you are coming from.

**ACTING CHAIR**—What percentage of the market supply is contracted and what percentage is not?

**Mr Hesketh**—The short answer is: I do not know.

**ACTING CHAIR**—Not even a hint of an idea? It leads to the question: how much do the winemakers rely on the ‘bunny’ end of the market, as I call it—the uncontracted end of the market—to make their sums add up? Would it matter to the industry if people who were not contracted, and who obviously take the advantage or disadvantage of the market of the day, did not supply grapes and just ploughed them in—in other words, they shot their sheep instead of giving them to the abattoir?

**Mr Hesketh**—At the moment, I do not think the wineries would mind very much, but they would certainly mind in three or four years time.

**ACTING CHAIR**—What do they do with the giveaway-priced grapes?

**Mr Hesketh**—I will use a hypothetical case. If I were running a wine company at the moment, I would want to have about 60 per cent of my fruit assured and buy 40 per cent on the open market. I would take my pain when the shortage was on and get the benefit when it was not. That sort of number worked pretty well for many years. The structure of the industry now is such that some companies own practically no big vineyards and some, like Southcorp—now Fosters—own a considerable number. That is just the way they have chosen to run their business. You would not be surprised that during the mid-nineties the contractual amount went up rapidly. But now it is going down rapidly.

There was one company this year, for example, that had some sympathy with growers who could not sell their grapes, so they said, ‘We will take the contracted amount—even though we don’t want it—but we will not take another tonne.’ One grower told me of how he delivered his contracted amount, and another couple of tonnes, and they put it straight in the bin and drove it back to him.

**Senator FERRIS**—One of the quite disturbing pieces of evidence this morning came from the Winemakers Federation, who told us that there are still at least 100 new small vineyards coming on line every year. What would your advice be to those people, and does it concern you that the increase is still taking place despite all the market signals being in a different direction?

**Mr Hesketh**—I think it is wonderful news; the more the merrier, as long as no-one stops them going broke. If they want to go broke, then let them go broke. I do not care how many winemaking businesses we have that take a small amount of wine from 100 acres of vineyards and sell it direct to someone around the world without joining the ranks of Coles or a retail chain. I do not find it disturbing at all; I think it is great. The more the merrier.

**Senator FERRIS**—What about the concentration of retail sales—45 per cent now—from Coles and Woolworths? Is that of concern?

**Mr Hesketh**—Absolutely; but I do not know what you do about it. Of course it is a concern. It is a concern in that the Trade Practices Act, I think, says that the sellers cannot act in concert in going to Coles, but Coles have sufficient muscle to effectively act in concert against the sellers. But that is our law, and we have to live with it. The industry cannot do anything about Coles and Woolworths getting more powerful. I do not think it can, anyway.

**Senator FERRIS**—What about the possibility of an increase in cellar door sales through wine tourism? Is that an answer to some of it?

**Mr Hesketh**—No, it does not make any difference. I think the web will make a very good difference for those people. The ability to sell cases of wine over the web to people throughout Australia at competitive prices is a good thing, and that will be a growing segment of the market. It is going to take a few years, but it is a very good way to go. One of the worries is that someone will try to put a restriction on that. There are plenty of wine distribution companies that will not let their clients offer their wine over the web.

**ACTING CHAIR**—Thank you very much.

[11.56 am]

**LEWIS, The Hon. Peter, Private capacity**

**ACTING CHAIR**—Welcome, Mr Lewis. Would you like to make a brief opening statement to respond to the written submission you made this morning?

**Mr Lewis**—There is an enormous problem confronting the Australian wine industry in general and the South Australian wine industry in particular. The prospect of an oversupply on the domestic market will be no less serious, though, for the wine industry in the other states. The means by which we can address the problem is to make it possible for the plethora of small producers that have emerged over the last two decades since the vine pull to more effectively market what they produce rather than succumb to the pressure that will be applied to the price structure by the large corporations to drive those small producers out of business.

Those small producers who crush less than 20 tonnes average 13 tonnes each and number 112 in South Australia and 1,458 nationally. Those producers who crush between 20 and 99 tonnes average 60 tonnes each and number 143 in South Australia. Their tonnage is 8,580. The number in that category nationally is 667, with an overall tonnage of 40,020. Wineries producing between 100 and 500 tonnes average 300 tonnes each and number 88 in South Australia. Their tonnage is 26,400. The number of producers in that category nationally is 317, and the tonnage they crush is only 95,000. Those producers who crush between 500 and 999 tonnes average a tonnage of 750. They number 29 in South Australia, with a total of 21,750 tonnes. There are 72 producers in that category nationally, with a total of 54,000 tonnes. Wineries producing between 1,000 and 2,500 tonnes have an average tonnage of 1,750. The number of producers in South Australia is 12, and the tonnage they produce is 21,000 in total. Nationally there are 42 producers in that category, with a total of 73,000 tonnes. The total tonnage crushed by those small wineries in South Australia is 78,290 tonnes, out of a total crush of 617,000 tonnes. So there is a great number of them, but they are not a significant part of the total production. That is the problem. That is reflected again nationally, where the tonnage is 270,000 tonnes. Again, the relationship is just under one to nine.

**ACTING CHAIR**—So 80 per cent of it is produced by 20 per cent of the growers. What is the go?

**Mr Lewis**—It is not the growers so much as the winemakers in this case. If the small producers continue to try and rely on the domestic market, they will go broke. The manner in which the large corporations—wittingly or otherwise, and I believe it is unwittingly—will survive is by the way in which they segregate the product they are selling into those parts of it which are able to attract a higher price internationally as well as nationally. It will be the world market that holds their higher price levels at the level at which they are struck. The way in which they have used the labels they have bought up will be to provide that full range of price options for varieties and styles of wines—say dry red shiraz of what would be regarded internationally as a quaffing grade, all the way through to Grange Hermitage at the top end, which is fixed at a price for a very small proportion of the total grapes grown that the market would be prepared to pay for it. The small producers just cannot survive that kind of competition.

**ACTING CHAIR**—Isn't this really just an example of the market at work and the difference between the business of farming and the fantasy of farming?

**Mr Lewis**—Sure, there is no question about that, but there is a way of addressing it so that the small producers can survive if they so desire. That is for them, with the assistance of government but not much money—more in marketing terms—to make it possible for them in law to collaborate. That needs some amendment to competition policy—

**ACTING CHAIR**—What do you mean by 'collaborate'?

**Mr Lewis**—To regionally badge their wine and set their wines up before a panel of independent judges in masked form, replicated through the range of sample at random, and to assess the quality of the wine, and put a label on it that says what the appellation is so that there is then not only the regional badge but also the appellation that has been objectively determined by independent assessors, and then the name of the family or winery on the bottle. That means that, with the assistance of Austrade, that region and that appellation can be aimed at a market that will buy it at a price that is profitable to the producers of it.

**ACTING CHAIR**—Don't you then run into a problem with the hub, as it were—like a forest hub?

**Mr Lewis**—We have regional wine shows now.

**ACTING CHAIR**—You do not mean to regionalise the crush; you mean to regionalise the market.

**Mr Lewis**—This right; this is about marketing.

**ACTING CHAIR**—So this is a bit like Hereford Prime meat goes out there and has a little niche in the market?

**Mr Lewis**—It is a bit like the Castrol oil ad—'Oils ain't oils!' It enables the small producers to collaborate with each other to identify where their wines fit in the common standards that are adopted by all of them.

**ACTING CHAIR**—Would that work in an export context?

**Mr Lewis**—Yes, it does; the French already do it. The other thing that we can and ought to do that will beat the French is not play the game the way they do, whether it is in France or other countries in Europe, like Germany, Italy or Spain. We ought not to be hidebound about using bottles and corks. I remember two things from when I was involved in market research in 1970-72. The first was the kind of package. The package changed from glass to a bladder inside cardboard. That was then used by the larger producers to get rid of their poorer quality wine. It indicated to the Australian consumer that wine in cardboard would be inferior. It does not have to be this way at all. The second was the stopper on bottles and the size of bottles. We do not have to sell 750 ml bottles, which is about what a seasoned drinker can cope with without becoming too inebriated to function properly. A bigger bottle of two or more litres, which would suit family consumption or the restaurant trade, is a better way to go because the cost per unit of

volume so packaged is much lower. It is even more sensible not to use corks but to use screw closures. They are more effective and result in less wine being lost through deterioration. There is variation in corks, as everybody knows.

Finally, we ought to segregate those markets which are growing fastest and in which there are not hidebound attitudes to the fashion in which the beverage they drink is packaged and delivered to them. In other words, avoid glass containers in favour of other, more flexible, durable and effective packaging and do market research by segment internationally and by sector on a geographical basis. A country like China will not have the same prejudice towards the container that a country like Canada or the United States will have. Quebec, in eastern Canada, will have a different attitude to British Columbia, in western Canada. If proper market research is undertaken, at very little expense and with the encouragement of the federal government, the mechanism by which Australian producers can then penetrate the international market, particularly the smaller producers, who are otherwise going to go broke, will be far more effective than it is at present or can be at present under ACCC law.

**ACTING CHAIR**—An example of packaging in Australia is rum; the boys at Tilpa and Louth, down the Darling River, used to drink it out of kegs, but it would be pretty unfashionable now to drink rum out of a keg, wouldn't it? You would have to drink it out of a bottle.

**Mr Lewis**—Unless it was a heritage reunion event where everybody got dressed up in period costume and did not mind going home with a hangover.

**Senator BUCKLAND**—I am interested in your comment at the bottom of the first page of your submission, that there are too many small producers who do not benefit from economies of scale.

**Mr Lewis**—In their marketing thrust.

**Senator BUCKLAND**—You go on to say that this could trigger a price war. They are my words; I am summarising what you say. Having heard the evidence this morning—and I do not know how much of the testimony of the previous witness that you heard—the committee might be of the view that the opposite is the case. Through the wine industry's marketing, it appears to me that small boutique wineries are going to be the beneficiaries of much of what is happening. I wonder how you came to that conclusion.

**Mr Lewis**—Only if they find a buyer in an overseas destination who is savvy about quality and simply takes their entire production that is available for export. That is a very expensive exercise for them to be involved in. If they have not done it by now, they will not have the cash flow to enable them to go and do it in the future, because the price, which might have been around \$14 a bottle up till now—that is, a 750 ml bottle—is likely to fall very quickly now to somewhere around \$6 a bottle. The margin is not there. If that happens, the total loss to South Australia will be over \$60 million and the total loss nationally will be in the order of \$220 million. That is a fair bit to take out of less than 20 per cent of the total production.

**Senator BUCKLAND**—I led questions to another witness in relation to whether wines at the higher end of the market—which, price-wise, are generally the boutique wines—were going to suffer because the low-price end of the market is the area that is rising and is on the increase. I

was assured and, with the expertise we had to assure us of that, I was quite convinced that a price war will not break out and, if it does, it will be within the range that that producer is involved in and will not be to try to further obstruct the higher end of the market, boutique producers. I am interested to know how you came to that conclusion.

**Mr Lewis**—History is on the side of the analysis which I have provided. Policies that are corporate and commercial, or public and political, that are based on opinions and sentiments and not on good science are policies that will come back to bite you.

**ACTING CHAIR**—Thank you very much, everyone, for your time, patience and evidence this morning.

**Committee adjourned at 12.11 pm**