How prospective FTAs, following Brexit, may affect Australian wine SMEs

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Summary

This submission reveals the importance of small and medium enterprises (SMEs) in Australian winemaking and grapegrowing. It then summarizes the recent growth and re-direction toward East Asia of Australia's wine exports, before projecting global wine markets to 2025 and modelling possible effects by then of Brexit. Those results make clear that future export growth prospects are concentrated in East Asia, and that Brexit and possible follow-on FTAs will have relatively very little on Australian wine trade. Those wine SMEs that are not yet established suppliers in East Asia will face considerably larger up-front costs of entry into those markets than they may have had in entering Australia's traditional English-language markets.

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Submission to the inquiry of the Trade Sub-Committee of the Joint Standing Committee on Foreign Affairs, Defense and Trade (JSCFADT) into access by small and medium sized enterprises to the benefits of Australia's bilateral free trade agreements.

How prospective FTAs, following Brexit, may affect Australian wine SMEs

Australia's bilateral Free Trade Agreements (FTAs) invariably involve freeing up trade in wine. The vast majority of producers in the Australian wine industry are small and medium enterprises (SMEs), as are equipment suppliers to grapegrowers and winemakers and those further along the wine value chain involved in transporting, warehousing and exporting wine. This note examines how those SMEs might be affected by growth in global wine markets and recent and prospective FTAs.

Australia's recent bilateral FTAs include those with China, Japan and Korea; prospective ones following Brexit (without or with an FTA being signed between the UK and the remaining 27 members of the European Union) are with EU27 and with the UK. Meanwhile, a Comprehensive and Progressive Agreement for Trans-Pacific Partnership (TPP-11) that was signed by 11 countries on 8 March 2018 is currently in the process of being ratified by the 11 national parliaments. TPP-11 is an FTA between Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, Peru, New Zealand, Singapore and Vietnam.

The first section of this note reveals the importance of SMEs in Australian winemaking and grapegrowing. The second and third sections summarize the growth and direction of Australia's wine exports and imports. The fourth section summarizes results from projecting global wine markets to 2025 and modelling possible effects by then of Brexit (and follow-on bilateral FTAs with Europe) on Australian wine trade.

1. Structure of Australia's wine industry

The number of wine firms operating in Australia grew every year for 25 years to 2013, rising from 500 to just over 2500. So too did the number of grapegrowers. Most of the new wineries are very small: during 2010-16, around one-fifth crushed less than 10 tonnes and another one-third or more crushed between 10 and 50 tonnes (Table 1). The proportion below 100 tonnes has fallen only slightly over the past two decades, and the proportion above 1000 tonnes has been below 5% since 1996 – compared with more than 15% in 1978 (Figure 1).

In 2000, 80% of wineries had a 'cellar door' (meaning they sell direct to retail customers from the winery itself or have a separate retail outlet they own), and 40% were exporting (though mostly to just four English-language countries). By 2016, there were twice as many wineries, but only two-thirds had a cellar door, and the share exporting had already peaked and then fallen to 47%. While virtually all make table wines, a declining share is making fortified wines (less than 30% in 2016) and a rising share (42% by 2016) produces sparkling wines; 4% are making organic wines and only half are making wine on site (down from two-thirds prior to 2000). All but one-tenth now have a website. Around half export wine, but in 2016 only one in five or six exported to what had been Australia's two largest markets, the United Kingdom and the United States, with a larger proportion exporting to the fast-growing markets in Asia, especially China (Table 2).

True, the 1% of Australian wineries that crush more than 10,000 tonnes account for all but one-seventh of the national crush, with around half crushed by the three biggest wineries.

By contrast, those firms crushing less than 1000 tonnes account for less than 5% of the national crush and of the wine produced in Australia.[1]

There are more than twice as many independent grapegrowers as winemaker-grapegrowers in Australia, and their vine area and wine grape crush also are about twice that of winemaker-grapegrowers. This varies by state though, with South Australia having a disproportionate share of independent grapegrowers (see bold columns of Table 3). Many of those independent growers would have been members of processing co-operatives before those organizations were absorbed by private companies. The average vineyard size was 23 hectares nationally in 2012, but that of independent grapegrowers was only two-thirds the size of that of winemaker-grapegrowers (20.5 vs 30.4 hectares). The latter have lower yields per hectare though, at 8.6 tonnes compared with 12.3 tonnes for independent grapegrowers in 2012, according to the data reported in Table 3. It is not clear whether the average size of vineyards and their average yields will rise or fall over coming years, given the wide dispersion in vineyard area around the average size.

2. Growth of Australia's wine exports and imports

The dramatic growth in Australia's exports led to its export share of production rising to two-thirds, before falling a little over the past decade thanks in part to the real exchange rate appreciation associated with the country's mining investment boom.

That currency appreciation also increased competitiveness of imports in the domestic market, so their share of the volume of consumption rose to 16% (Figure 2). Much of those imports came from New Zealand: despite it being a key market for Australian red wine exports, Australia is also a key market for New Zealand's exports of white wine. Almost half Australia's volume of wine exports to New Zealand are bulk, as are more than one-third of Australia's imports from New Zealand; and the volumes in that two-way bilateral trade are almost the same (Table 4). Especially for lower-quality wines, importable bulk wine is a close substitute to domestic winegrapes from the winery's perspective. Since Australia is a small player in global wine markets (4% of global production, 7% of global exports), that means international markets now determine Australian prices of not only commercial wine but also winegrapes – even though winegrapes are not traded internationally.

Thus there is a strong correlation between movements in Australia's wine export price and the average price of domestic winegrapes. In the boom years of the 1990s, the winegrape price rose faster than the export price, since wineries were outbidding each other by offering long-term (up to ten-year) contracts to secure fruit to meet their expanding export orders. Both average prices peaked in 2001 though, and both halved over the next ten years before bottoming out and then beginning to rise again (Figure 3).

Part of the reason for the extent of the recent decade-long decline in winegrape prices is that Australia's vineyard bearing area continued to expand until 2007. That area began to fall significantly only from 2012 – a response delay that is common for all perennial crops, given their high upfront sunk investment costs. That uprooting of vines coincided with the average winegrape price beginning to rise; but the latter may have been due more to the dwindling of

[1] This very strong concentration of firms in Australia's wine production is similar to that in other New World wine-exporting countries. In 2009 Australia at 62% was second after Chile in the share of domestic sales accounted for by the country's four largest wineries. That share had fallen to 41% by 2015 though, as several large firms consciously moved away from producing large-volume but low-priced/low-profit lines. This compares with Chile with 91% of domestic sales accounted for by the four largest wineries, Argentina at 60%, and the United States at 56% in 2015. By contrast, in Western Europe the highest national four-firm concentration in 2015 was 20% (Spain), followed by Italy (18%) and France (16%). See Anderson (2018).

the excess supplies of stored wine that accumulated during the previous decade. In any case it happened despite the fact that the average export price remained flat for two more years (Figure 3).

The rise and then fall in the average price of Australia's exports was not matched by the rest of the world's wine exporters (Figure 4). It led to a rise from 1% to 10% in Australia's share of global wine export value, followed by a fall to 5% (Figure 5). The export take-off was helped by an historic low in the value of the Australian dollar in the mid-1980s that persisted for 15 years, before the real exchange rate (RER) rose 80% over the first dozen years of this century (Figure 6).

3. Direction of Australia's wine exports

Australia's wine exports in the 1980s and 1990s were mostly directed to just 4 English-language markets: the UK, US, Canada and New Zealand. Despite subsequent diversification to other European markets, Europe's share has since fallen from two-thirds to two-fifths by volume and from 60% to 25% by value, initially as sales to the US market grew in the new millennium. Then in the most-recent decade, the importance of both Europe and North America in Australia's wine exports has been eclipsed by the growth in sales to East Asia, most notably China and especially in value terms (Table 5).

Part of the decline in the average price of exports to Europe is the faster rise in the share of wine shipped in bulk to Europe versus elsewhere. In 2017, 80% of exports to the UK and Germany were in bulk, compared with 55% to Canada, 50% to New Zealand, 44% to the US and just 28% to China and Japan.

The redirection to Asia is not surprising, given the huge growth in wine consumption there – although it is concentrated in the more affluent countries of East Asia, most notably China (Figure 7). That concentration is projected to continue, helped by the Free Trade Agreements Australia recently signed with China, Korea and Japan, which have helped to divert wine imports from Chile and New Zealand – who preceded Australia in signing bilateral FTAs with those Northeast Asian countries (Anderson and Wittwer 2015, 2017).

Thus the fastest-growing markets for Australian wine in the next few years will be in East Asia. These markets are less familiar to SME producers who have previously sold only in English-speaking countries. Without assistance in getting started in those markets, smaller SMEs may decide they cannot afford the high up-front costs of building the necessary business links to succeed in Asia.

4. Possible effects of Brexit and follow-on FTAs on Australian wine trade

How much impact might Brexit (the UK's planned withdrawal from the European Union) and follow-on FTAs involving Europe have on Australia's wine export markets? The short answer is: probably not a lot except for those firms with a major foothold in those markets.

To see why, we have projected global wine markets to 2025 both without and with Brexit plus various possible follow-on FTAs (Anderson and Wittwer 2018a,b). The scenarios modelled include a 'hard' Brexit in which the UK leaves the EU Single Market, and a softer Brexit involving a replacement trade agreement between the UK and EU27 and then various bilateral FTAs with non-EU trading partners.

The trade-reducing and trade-diverting effects of altering bilateral import tariffs is part of the impact of the UK withdrawing from the EU's Single Market. But it is only a small part of that impact, because the process of exiting the EU, establishing new trading arrangements,

and adjusting to altered incentives is inherently uncertain and is expected to spread over many years. That is slowing the growth of UK incomes, and causing the pound to devalue. UK consumption of wine is therefore expected to be lower than it otherwise would have been, and more so if a 'hard' Brexit rather than a 'soft' Brexit is the ultimate outcome.

Various additional bilateral FTAs may be signed sequentially after Brexit. The EU has signalled it would like bilateral trade agreements with Australia and New Zealand (EC 2015). The UK too has signalled that it will be looking to sign FTAs with non-EU trading partners as soon as it has settled a new trade arrangement with EU27 – but that won't be legally possible before the end of the recently offered transition period to 31 December 2020. Again Australia and New Zealand have been mentioned as early possibilities (together they account for one-fifth of the value of UK wine imports), as have Chile and South Africa (whose combined share is one-sixth, with all other non-EU suppliers accounting for just one-eighth of UK wine imports). Each of these FTAs may have some trade-creating effects, but none is likely to have significant positive macroeconomic effects to offset the adverse macro effects of the prolonged uncertainty introduced by Brexit. They will, however, have some trade-diverting effects that may offset each other – just as has happened with recent bilateral FTAs between wine-exporting countries and three Northeast Asian countries (see Anderson and Wittwer 2015).

Detailed results of those various scenarios are available in Anderson and Wittwer 2018a,b). Suffice it to say that the aggregate impact on the growth of Australian wine exports over the next few years is very minor, because it is swamped but the magnitude of the projected growth in sales to Asia, especially China (see Figure 8). And if the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (TPP-11) that was signed by 11 countries on 8 March 2018 is ratified, it will provide further export growth opportunities in East Asia as well as a little in Canada, Mexico and Peru for Australian winegrowers.

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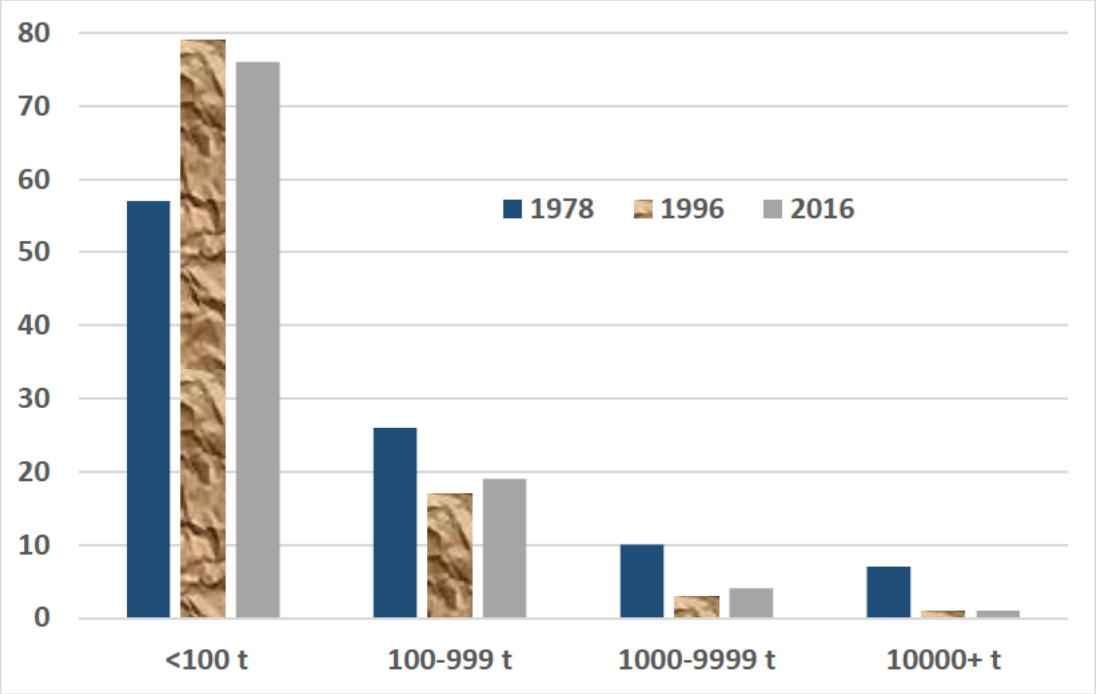
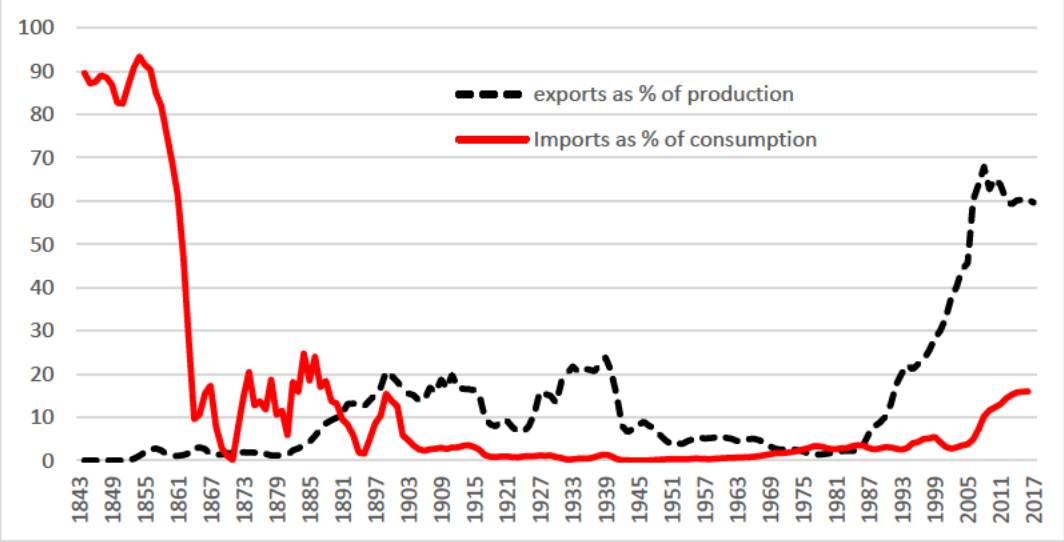
Figure 1: Share of Australian wineries by crush, 1978, 1996 and 2016 (%)



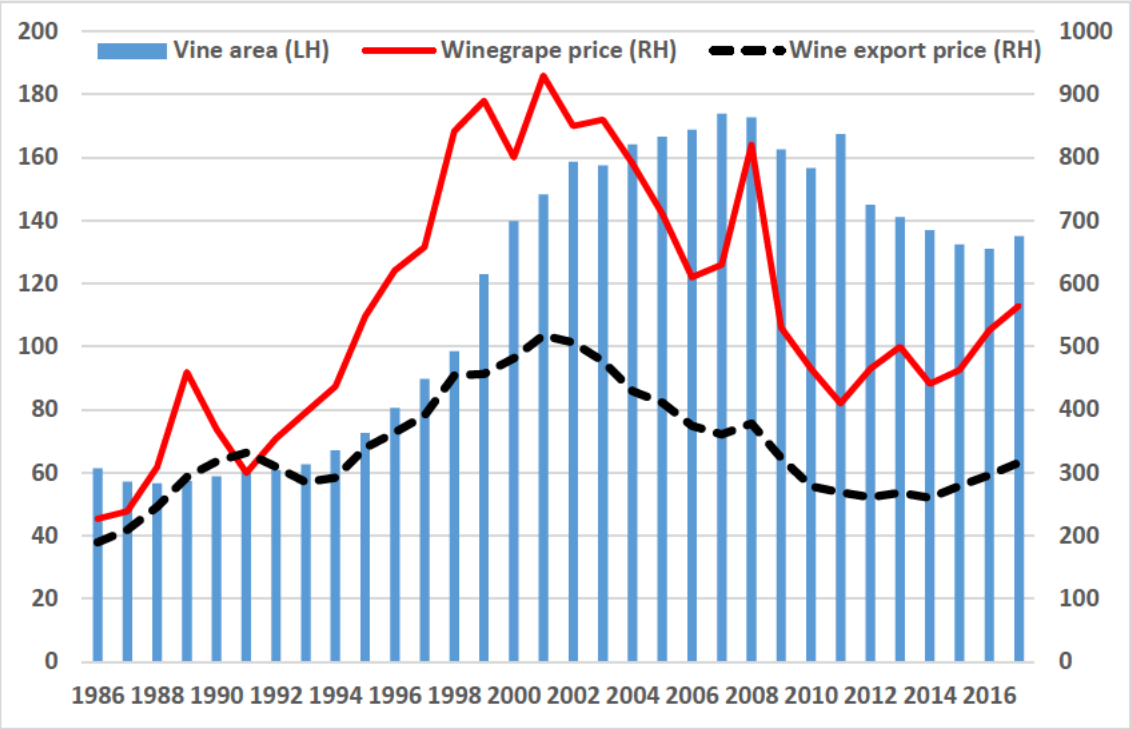
Source: Updated from Anderson (2015, Table 21).

Figure 2: Exports as a % of wine production and imports as a % of wine consumption volume, Australia, 1843 to 2017 (3-year moving average to year shown)



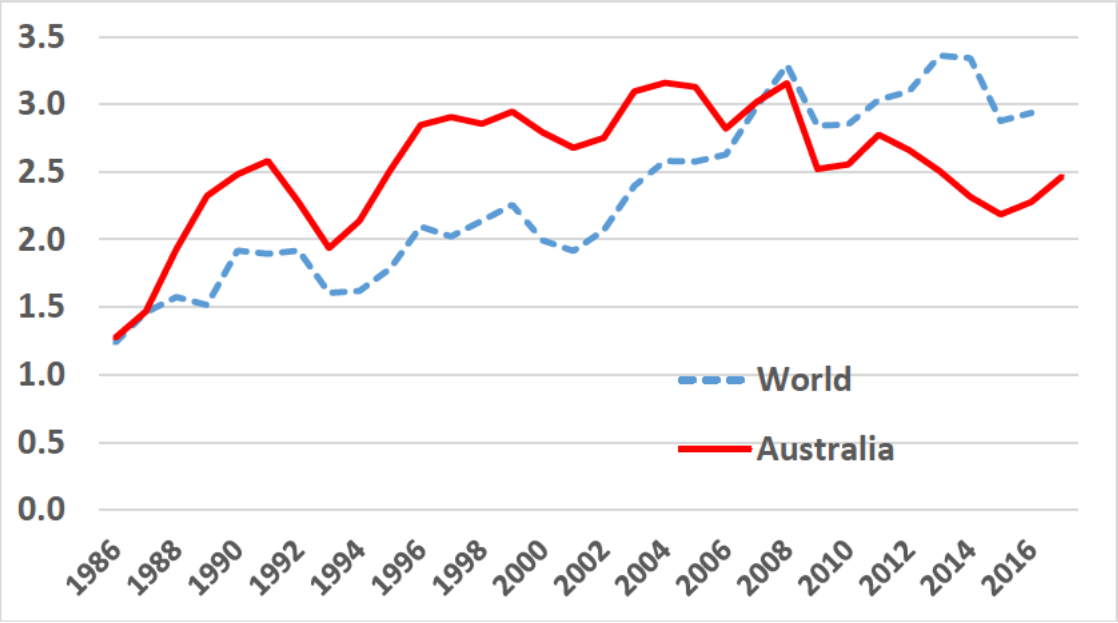
Source: Anderson and Pinilla (2017).

Figure 3: Vine bearing area, average winegrape price, and wine export price 1986 to 2017 ('000 ha, A$ per tonne, and A$ per hectolitre)



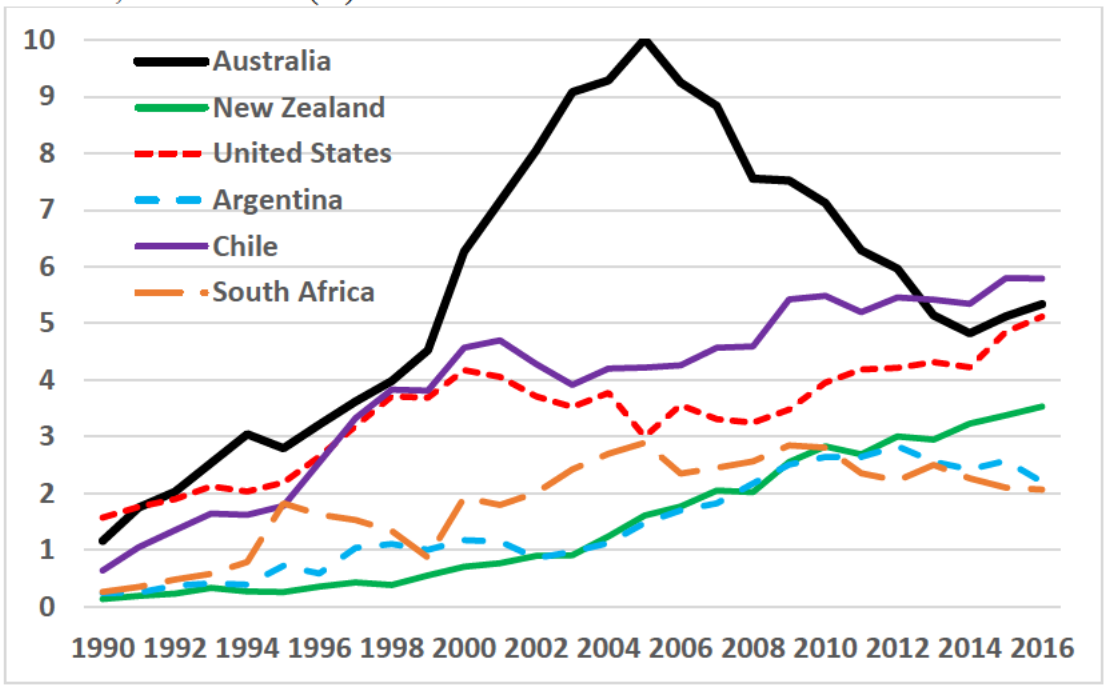
Source: Updated from Anderson (2015).

Figure 4: Average price of wine exports, Australia and the world, 1986 to 2017 (current US$/litre)



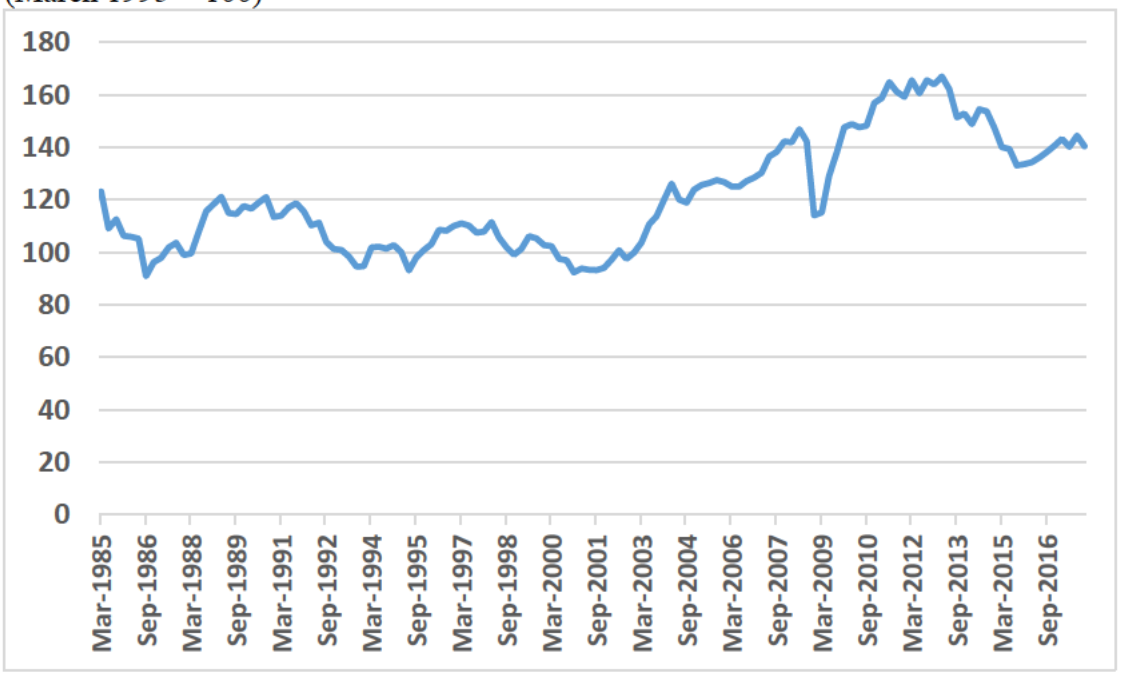
Source: Anderson, Nelgen and Pinilla (2017).

Figure 5: National shares of value of global wine exports, Australia and other New World countries, 1990 to 2016 (%)



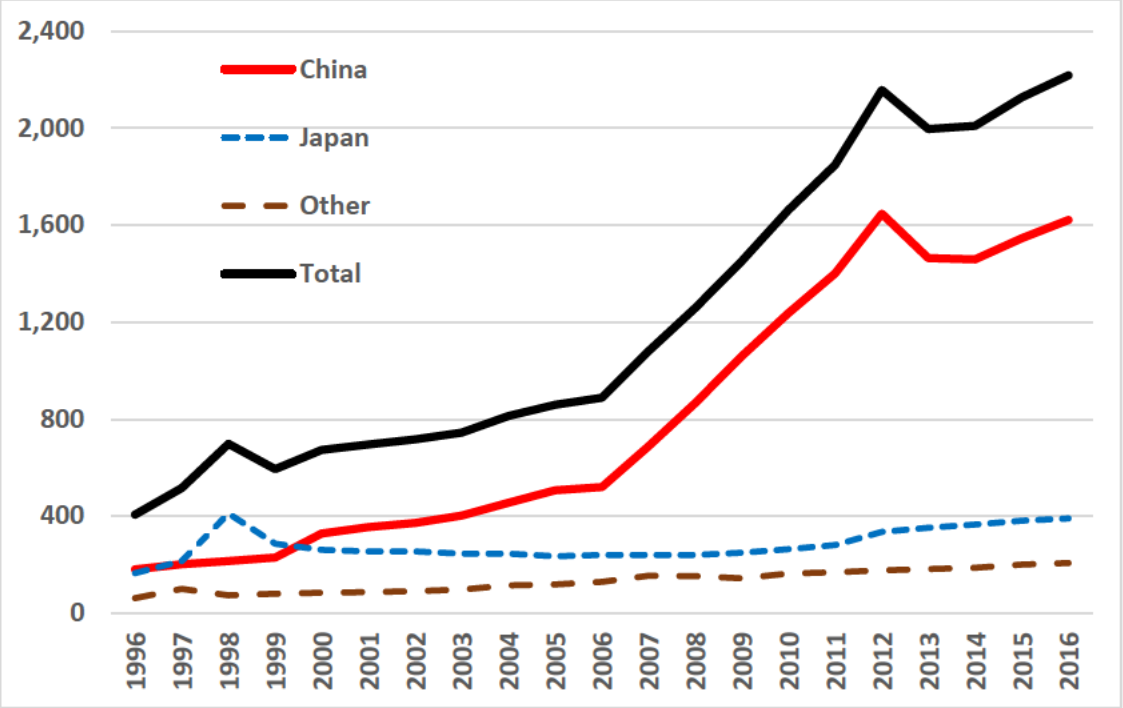
Source: Anderson, Nelgen and Pinilla (2017).

Figure 6: Australia's trade-weighted real exchange rate, March 1985 to December 2017 (March 1995 = 100)



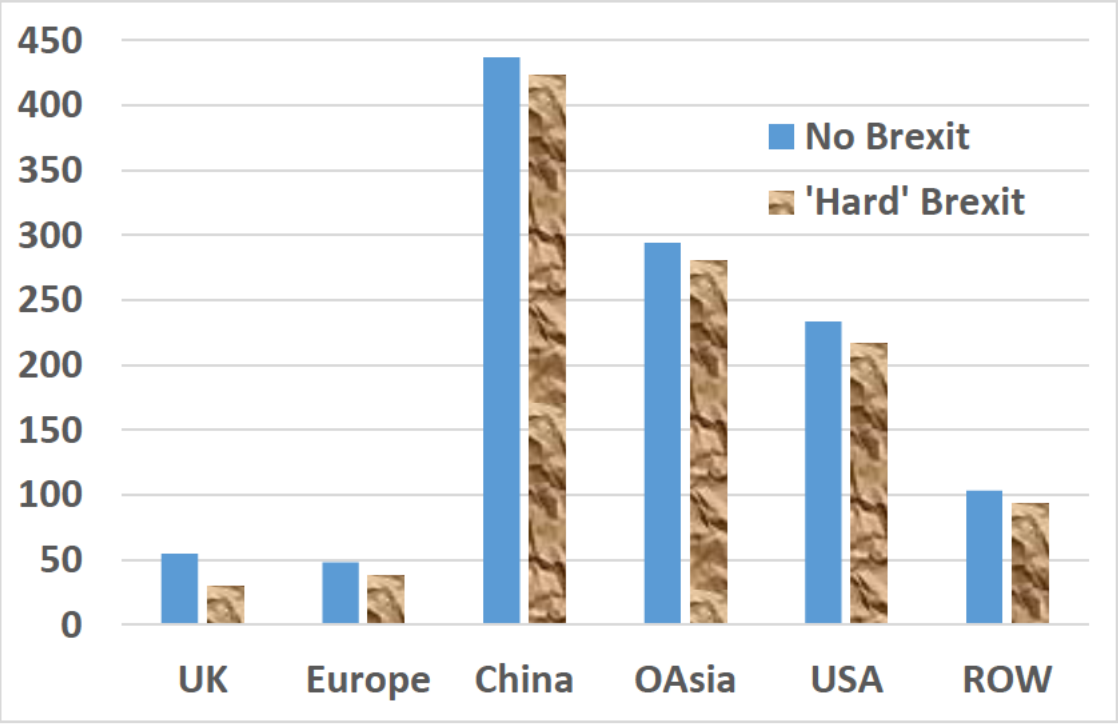
Source: Reserve Bank of Australia, www.rba.gov.au

Figure 7: Asian wine consumption volume, 1995 to 2016 (ML)



Source: Updated from Anderson and Pinilla (2017).

Figure 8: Increase in the value of Australian wine exports, 2014 to 2025, without and with a 'hard' Brexit (2014 US$ million)



Source: Anderson and Wittwer (2018a).

Table 1: Number of Australian wineries by tonnes crushed, 1998 to 2016

	1998	**2000**	**2002**	**2004**	**2006**	**2008**	**2010**	**2012**	**2014**	**2016**
< 10 tonnes					277	390	459	543	548	526
10 to 19 tonnes					324	376	412	449	391	365
< 20 tonnes	293	337	418	582						
20 to 49 tonnes	211	259	331	414	481	512	527	553	506	472
50 to 99 tonnes	145	180	212	254	303	337	346	316	328	306
100 to 249 tonnes	142	157	189	211	242	257	259	235	229	235
250 to 499 tonnes	50	78	88	106	126	150	158	147	146	144
500 to 999 tonnes	31	40	61	72	74	76	85	85	81	85
1,000 to 2,499 tonnes	44	45	54	45	69	61	58	52	61	58
2,500 to 4,999 tonnes	19	29	36	40	27	37	38	36	27	29
5,000 to 9,999 tonnes	16	20	23	24	28	23	22	16	12	10
10,000+ tonnes	34	41	41	43	41	28	28	31	27	123
Unspecified	13	11	12	7	16	73	85	109	125	141
Total	998	1197	1465	1798	2008	2320	2477	2572	2481	2494

Source: Anderson (2015, Table 21), updated from http://winetitles.com.au/statistics/

Table 2: Various attributes of Australian wineries, 2000, 2010 and 2016 (%)

	2000	**2010**	**2016**
Total number of producers	1,197	2,477	2,494
Share (%) of producers ...			
making table wine	99	99	98
making fortified wine	33	29	29
making sparkling wine	28	35	42
making organic wine	na	5	4
making wine on site	63	52	53
with a website	25	84	90
with a cellar door	78	68	66
who export wine	41	51	47
who export to UK	28	27	21
who export to USA	26	27	18
who export to Canada	11	24	19
who export to NZ	14	8	8
who export to Japan	12	12	13
who export to Hong Kong	8	19	21
who export to Singapore	7	25	22
who export to China	2	23	30

Source: Anderson (2018), drawing on
http://winetitles.com.au/statistics/wineries_numbers.asp

Table 3: Number, vine bearing area and crush of Australian independent and winemaker grape-growing establishments, by vineyard size range (ha) and State, 2012

(a) Number	Independent grapegrowers					Sub-total	Winemaker-grapegrowers					Sub-total	Total
	<10	10-25	25-50	50-100	>100		<10	10-25	25-50	50-100	>100		
South Australia	1 158	585	261	117	55	**2 176**	161	145	95	50	58	**509**	**2 685**
New South Wales	430	244	124	65	53	**916**	204	66	21	16	29	**335**	**1 252**
Victoria	568	190	63	39	25	**885**	348	89	50	29	17	**532**	**1 417**
Western Australia	214	70	21	11	6	**323**	168	79	16	18	17	**298**	**620**
Tasmania	51	2	2			**56**	61	10	1	3	3	**79**	**134**
Australia Total[a]	**2 458**	**1 096**	**472**	**232**	**140**	**4 398**	**994**	**394**	**187**	**116**	**125**	**1 815**	**6 213**

(b) Area (ha)	Independent grapegrowers					Sub-total	Winemaker-grapegrowers					Sub-total	Total
	<10	10-25	25-50	50-100	>100		<10	10-25	25-50	50-100	>100		
South Australia	5844	9018	9033	8192	11596	**43683**	761	2437	3395	3453	16242	**26287**	**69970**
New South Wales	1853	3870	4423	4315	13194	**27654**	872	977	671	1075	7114	**10709**	**38363**
Victoria	2333	2876	2167	2565	4272	**14213**	1465	1347	1688	2124	3876	**10500**	**24713**
Western Australia	799	1069	733	760	860	**4222**	766	1281	494	1206	2349	**6095**	**10316**
Tasmania	105	28	71			**205**	213	125	41	204	442	**1024**	**1229**
Australia Total[a]	**11045**	**16934**	**16427**	**15833**	**29921**	**90160**	**4254**	**6229**	**6399**	**8144**	**30196**	**55222**	**145382**

(c) Crush (tonnes)	Independent grapegrowers					Sub-total	Winemaker-grapegrowers					Sub-total	Total
	<10	10-25	25-50	50-100	>100		<10	10-25	25-50	50-100	>100		
South Australia	67291	119257	121043	83905	150648	**542143**	3525	14816	20897	22529	165008	**226776**	**768918**
New South Wales	15801	42393	57528	54819	177313	**347854**	2312	3356	2279	8156	96844	**112948**	**460802**
Victoria	26215	38323	32406	35426	55704	**188074**	5681	7861	11218	17344	47576	**89680**	**277754**
Western Australia	3557	6781	6138	4601	5450	**26528**	3490	7419	3409	9184	17992	**41493**	**68021**
Tasmania	455	147	155			**757**	971	638	136	1503	1375	**4622**	**5379**
Australia Total[a]	**113534**	**206947**	**217269**	**178752**	**389115**	**1105618**	**16311**	**34240**	**38172**	**58717**	**328992**	**476431**	**1582049**

[a] Total includes Queensland, the Australian Capital Territory and the Northern Territory, where winegrape growing is very minor.
Source: Anderson (2015, Table 64), drawing on WGGA (2013).

Table 4: Australian wine trade with New Zealand, 2014 to 2017

(a) Australian exports to New Zealand

Bulk wine:	Volume (ML)	Value (US$m)	Price(US$/L)
2014	14.7	12.6	0.86
2015	11.8	8.2	0.69
2016	15.2	9.9	0.65
2017	14.6	10.2	0.70
Bottled wine:			
2014	15.3	56.3	3.68
2015	15.5	50.8	3.27
2016	15.3	51.5	3.38
2017	14.8	53.6	3.62

(b) Australian imports from New Zealand

Bulk wine:	Volume (ML)	Value (US$m)	Price (US$/L)
2014	15.0	42.6	2.85
2015	18.3	45.3	2.48
2016	21.1	56.3	2.67
Bottled wine:			
2014	36.8	247.4	6.73
2015	38.0	209.0	5.50
2016	35.6	203.0	5.71

Source: Author’s compilation using data from UN COMTRADE.

Table 5: Shares of Australian wine exports to key regions, by volume and value, and average unit values, 1990 to 2017 (% and US$/L)

VOLUME	Europe	Nth America	Asia	New Zealand	Other
1990-95	62	16	7	14	1
1996-01	64	22	6	8	1
2002-07	55	34	5	4	1
2008-11	49	36	11	3	1
2012-15	44	35	16	4	1
2016	42	30	23	4	1
2017	42	29	24	4	1

VALUE	Europe	Nth America	Asia	New Zealand	Other
1990-95	60	23	8	9	1
1996-01	58	29	7	5	1
2002-07	48	41	7	4	1
2008-11	41	37	17	4	1
2012-15	32	34	29	4	1
2016	26	29	40	4	1
2017	24	25	46	4	1

UNIT VALUE (US$/litre)	Europe	Nth America	Asia	New Zealand	**WORLD**
1990-95	2.23	3.24	2.37	1.51	**2.28**
1996-01	2.03	2.92	2.55	1.54	**2.22**
2002-07	2.57	3.49	3.85	2.48	**2.94**
2008-11	2.19	2.72	4.12	2.97	**2.92**
2012-15	1.63	2.18	4.00	2.26	**2.75**
2016	1.04	1.62	2.91	1.55	**2.28**
2017	1.33	1.36	4.50	2.17	**2.43**

Source: Updated from Anderson, Nelgen and Pinilla (2017, Tables 211, 213 and 215).