

# Chapter 1

## Background

1.1 On 25 March 2015, the Senate referred the following matter to the Senate Rural and Regional Affairs and Transport References Committee (the committee) for inquiry and report by 11 November 2015:

- a) the extent and nature of any market failure in the Australian grape and wine industry supply chain;
- b) the extent to which federal and state legislative and regulatory regimes inhibit and support the production, processing, supply chain logistics and marketing of Australian wine;
- c) the profitability of wine grape growers, and the steps industry participants have taken to enhance profitability;
- d) the impact and application of the wine equalisation tax rebate on grape and wine industry supply chains;
- e) the extent to which grape and wine industry representation at regional, state and national level effectively represents growers and winemakers with respect to equity in the collection and distribution of levies;
- f) the work being undertaken by the Australian Grape and Wine Authority pertaining to levy collection information;
- g) the power and influence of retailers of Australian wine in domestic and export markets;
- h) the adequacy and effectiveness of market intelligence and pricing signals in assisting industry and business planning;
- i) the extent to which the Australian grape and wine industry benefits regional communities both directly and indirectly through employment, tourism and other means; and
- j) any related matters.

### **Conduct of the inquiry**

1.2 The inquiry was advertised on the Australian Parliament House website, the Australian Senate's Twitter account and the committee's website. The committee also directly invited submissions from government departments, organisations and individuals within Australia's grape and wine industry. On 13 August 2015, the Senate granted an extension of time for reporting by 12 February 2016.

1.3 The committee received 41 submissions which are listed in Appendix 1 and are available on the committee's website. The committee held public hearings in Adelaide on 24 September, Launceston on 25 September and Swan Valley on 27 October 2015. Appendix 2 provides details of the persons and organisations who gave evidence at the hearings.

### **Acknowledgement**

1.4 The committee thanks the organisations and individuals who provided evidence to the inquiry. The committee particularly acknowledges those who travelled some distance to attend the hearings.

### **Outline of the report**

1.5 This chapter discusses the extent to which the wine industry benefits regional communities, the profitability of grape growers and the extent and nature of any market failure in the Australian grape and wine industry supply chain.

1.6 Chapter 2 considers the impact and application of the wine equalisation tax rebate on grape and wine industry supply chains.

1.7 Chapter 3 considers the power and influence of retailers of Australian wine in domestic markets.

1.8 Chapter 4 considers the work of the Australian Grape and Wine Authority (AGWA) and the role of export markets, pricing signals and market intelligence to assist industry.

1.9 Chapter 5 considers grape and wine industry representation at regional, state and national level, including the code of conduct that operates between winemakers and winegrape growers.

### **Value of the industry**

1.10 Australia's grape and wine industry strongly contributes to the Australian economy. Winemakers' Federation of Australia (WFA) estimated that the industry contributed \$1.77 billion in 2013–14, stating 'most of which is reinvested in regional Australia.'<sup>1</sup> IBISWorld provided a similar estimate of \$1.6 billion for 2014–15, at an estimated 0.08 per cent of Australia's gross domestic product.<sup>2</sup>

1.11 The first Australian vineyards were established in the early 1800s, but today these vineyards represent only 0.9 per cent of the industry. Most Australian vineyards are new, with 40.5 per cent of businesses having been established between 1990 and

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1 WFA, *Submission 41*, p. 7.

2 Ms Brooke Tonkin, *IBISWorld* industry report C1214: *Wine production in Australia*, July 2015, pp 34–35.

1999 and 31.3 per cent between 2000 and 2014.<sup>3</sup> In 2015, the Australian Food and Grocery Council's State of the Industry Report reported that 1 852 individual businesses listed wine manufacturing as their primary purpose.<sup>4</sup>

1.12 Wine Grape Growers Australia (WGGA) reported that there were 6 200 growers of grapes (for all uses) in Australia in 2012.<sup>5</sup> That year, grapes contributed approximately \$1 billion to the economy, an equivalent contribution to sugar cane. Of that total, winegrapes contributed \$880 million, making them the tenth most valuable crop in Australia. When converted to wine, the economic value of winegrapes is significantly higher.<sup>6</sup>

1.13 Australia's winemakers and growers include small, medium and large enterprises. WGGA submitted that compared to grower businesses, winemaking or wine company businesses are generally larger and more diversified; they are more likely to undertake both growing and production and be part of a group of companies.<sup>7</sup>

1.14 The largest 18 winemaking businesses all crush in excess of 20 000 tonnes of grapes per year.<sup>8</sup> However, data provided by the University of Adelaide suggests that winemakers are crushing increasingly fewer grapes. In 1998, 29.4 per cent of Australia's winemakers crushed less than 20 tonnes. By 2014, this had increased to 39.1 per cent.<sup>9</sup>

1.15 The wine industry provides indirect economic benefits including through tourism and employment. AGWA advised that in 2013 the industry generated a further \$50 billion in economic value add.<sup>10</sup> WFA estimated this includes \$8.2 billion in tourism expenditure.<sup>11</sup> By way of example, Wine Tasmania told the committee that:

...it is important to recognise, in looking at the value of the Tasmanian wine industry, that it is not just the farm gate value of grapes and not just

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3 Professor Kym Anderson AC and Nanda R. Aryal, *Growth and cycles in Australia's wine industry: A statistical compendium, 1843 to 2013*, Wine Economics Research Centre, University of Adelaide, February 2015, p. 226.

4 Australian Food and Grocery Council, State of the Industry 2015, p. 16.

5 Mr Lawrence Stanford, Executive Director, WGGA, *Committee Hansard*, 24 September 2015, p. 38.

6 WGGA, *Submission 30*, p. 3.

7 WGGA, *Submission 30*, p. 10.

8 Department of Agriculture, *Submission 29*, p. 6.

9 Professor Kym Anderson AC and Nanda R. Aryal, *Growth and cycles in Australia's wine industry: A statistical compendium, 1843 to 2013*, Wine Economics Research Centre, University of Adelaide, February 2015, p. 221.

10 AGWA, *Submission 8*, p. 24.

11 WFA, *Submission 41*, p. 8.

the marketing of wine but all of these other things that the wine industry brings to the economy of Tasmania.<sup>12</sup>

1.16 Wine production directly employs around 16 186 people in Australia.<sup>13</sup> AGWA advised that in 2012 the industry provided a further 7 500 jobs in grape growing.<sup>14</sup> Wine is the 'fifth largest agricultural exporting sector' in Australia and Australian wines are available in over 100 countries.<sup>15</sup>

1.17 With the exception of the Northern Territory, wine production occurs in all Australian jurisdictions. The majority of winemakers are located in Victoria (773), followed by South Australia (720), New South Wales/Australian Capital Territory (484), Western Australia (379), Tasmania (117) and Queensland (100). The Northern Territory has not produced wine since 2007, according to 2013 research by Professor Kym Anderson AC.<sup>16</sup>

1.18 South Australia, New South Wales and Victoria are the leading states for wine production. ABS data establishes that 46 per cent of grapes were produced in South Australia, followed by 31 per cent in New South Wales/Australian Capital Territory and 20 per cent in Victoria.<sup>17</sup> *IBISWorld* predicts that South Australia will in 2015–16 continue to produce the highest volume of wine (32.3 per cent) but Victoria (26.7 per cent) may overtake New South Wales (18.5 per cent).<sup>18</sup> South Australia's Riverland 'is the largest single wine producing region in Australia', and 'the wine industry is the largest single wealth generator' in the region.<sup>19</sup>

1.19 The committee heard from WFA that there are over 65 distinct wine producing regions across Australia.<sup>20</sup> The three warm inland regions—the Riverland in South Australia, the Riverina in New South Wales and the Murray Valley in Victoria—account for 60 per cent of wine grape production. Most other wine regions

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12 Ms Graeme Lynch, Chair, Wine Industry Tasmania Ltd, *Committee Hansard*, 25 September 2015, p. 23.

13 WFA, *Submission 41*, p. 63.

14 AGWA Authority, *Submission 8*, p. 24; see also WFA, *Submission 41*, p. 7.

15 WFA, *Submission 41*, p. 8.

16 Professor Kym Anderson AC and Nanda R. Aryal, *Growth and cycles in Australia's wine industry: A statistical compendium, 1843 to 2013*, Wine Economics Research Centre, University of Adelaide, February 2015, p. 295.

17 Australian Bureau of Statistics, 1329.0.55.002: *Vineyards Estimates 2014–15*, 'Table 1: Vineyards production, area and number of businesses – Australia, States and Territories–2014-15'.

18 Ms Brooke Tonkin, *IBISWorld* industry report C1214: *Wine production in Australia*, July 2015, p. 3.

19 Mr Chris Byrne, Executive Officer, Riverland Wine, *Committee Hansard*, 24 September 2015, pp 41–42.

20 WFA, *Submission 41*, p. 8.

are considered cool climate, including the Barossa Valley in South Australia, the Hunter Valley in New South Wales and Margaret River in Western Australia.<sup>21</sup>

1.20 Production costs, grape characteristics, yield and price all vary significantly between warm and cool climate regions. The committee heard that warm inland regions have 'higher water, fertiliser and herbicide costs', but lower labour and contract costs due to the use of mechanical harvesting systems. Warm regions typically produce 'significantly more grapes per hectare' which allows for 'spreading production costs' and typically receive lower prices. For example, the Department of Agriculture submitted that the average price for chardonnay grapes from Tasmania was \$2 560 per tonne in 2013–14 compared with \$245 per tonne from the Riverland.<sup>22</sup>

1.21 Australia's four largest wine producers—Accolade, Pernod Ricard Australia, Treasury Wine Estate and Casella Wines Pty Ltd—will collectively account for 39.3 per cent of industry revenue in 2015–16. The University of Adelaide estimated that in 2013 these wine producers generated over 40 per cent of the value of domestic sales.<sup>23</sup> While substantial, this is a reduction from the 1996 level of 50 per cent.<sup>24</sup> IBISWorld has concluded that for wine producers, market concentration is low.<sup>25</sup>

### **A 'structural mismatch of supply and demand'**

1.22 The Australian wine industry had tripled in size between 1991 and 2007<sup>26</sup> in what was described to the committee as 'the longest sustained boom in an industry.'<sup>27</sup> A 2005 inquiry by this committee observed that the 30 year targets set by the WFA in 1996 were achieved in only a decade.<sup>28</sup> The total area of grapevines planted increased from 62 454 hectares in 1995 to a peak of 166 197 hectares in 2008.<sup>29</sup>

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21 Department of Agriculture, *Submission 29*, p. 5.

22 Department of Agriculture, *Submission 29*, p. 5.

23 Professor Kym Anderson AC and Nanda R. Aryal, *Growth and cycles in Australia's wine industry: A statistical compendium, 1843 to 2013*, Wine Economics Research Centre, University of Adelaide, February 2015, p. 22.

24 Professor Kym Anderson AC and Nanda R. Aryal, *Growth and cycles in Australia's wine industry: A statistical compendium, 1843 to 2013*, Wine Economics Research Centre, University of Adelaide, February 2015, p. 221.

25 Ms Brooke Tonkin, *IBISWorld industry report C1214: Wine production in Australia*, July 2015, p. 20.

26 WFA, *Submission 41*, p. 8.

27 Accolade Wines, *Submission 26*, p. 2.

28 Senate Rural and Regional Affairs and Transport References Committee, *The operation of the wine-making industry*, October 2005, p. 2.

29 Professor Kym Anderson AC and Nanda R. Aryal, *Growth and cycles in Australia's wine industry: A statistical compendium, 1843 to 2013*, Wine Economics Research Centre, University of Adelaide, February 2015, p. 152.

1.23 The committee heard that the 2005–06 financial year was a watershed for industry profitability. A 'record harvest' of 1.93 million tonnes was achieved in 2004–05 and sales increased on both the domestic and export markets.<sup>30</sup> From 2005 onwards, the volume of grapes crushed steadily declined, to approximately 1.7 million in 2014.<sup>31</sup> A 'supply and demand imbalance' in the wine industry was acknowledged in 2005–06.<sup>32</sup>

1.24 Submitters and witnesses were divided over whether the industry had experienced 'market failure'. On the one hand, WGGGA submitted that industry's delayed recovery is the result of market inefficiency:

The wine sector has failed to adjust to supply and demand imbalance since it was widely acknowledged to exist in the industry by 2005-06... Prima facie, this is evidence of market failure.<sup>33</sup>

1.25 It was argued to the contrary that 'market failure' as a label is inaccurate.<sup>34</sup> Accolade Wines submitted that the price shift was an effective market response, as:

...low grape prices in some wine regions in Australia are not the result of market failure, but are in fact the result of an efficient market, in economic terms, reflecting changes in demand and competing sources of supply.<sup>35</sup>

### **Impact**

1.26 The repercussions of a 'structural mismatch of supply and demand' have been amplified in more recent years.<sup>36</sup> By 2009, Australia was producing 20–40 million cases a year more wine than it was selling, according to a joint statement issued by industry representative bodies.<sup>37</sup> Since 2009, demand for Australian wine has fallen even further due to a variety of international factors, including:

- the high Australian dollar
- economic turbulence in overseas markets
- an oversupply of grapes within the European Union

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30 Australian Bureau of Statistics, *1329.0: Australian wine and grape industry, 2004–05*, p. 3.

31 Department of Agriculture, *Submission 29*, p. 3.

32 WGGGA, *Submission 30*, p. 3.

33 WGGGA, *Submission 30*, p. 3. See also AGWA, *Submission 8*, p. 19.

34 For example, WFA, *Submission 41*, p. 13; Mr Marc Allgrove, *Submission 2*, p. 1.

35 Accolade Wines, *Submission 26*, p. 2.

36 WFA, *Submission 41*, p. 8. See also Mr Warren Randall, Proprietor and Managing Director, Seppeltsfield Wine, *Committee Hansard*, 24 September 2015, pp 12–13.

37 WFA, WGGGA, Australian Wine and Brandy Corporation, Australian Wine Research and Development Corporation, *Wine Restructuring Action Agenda*, Supporting report, p. 2, <http://wgga.com.au/wp-content/uploads/WRAA-supporting-101109.pdf>, (accessed 18 November 2015).

- competition with new low-cost producers (including Chile, Argentina and South Africa)<sup>38</sup>, and
- a decline in consumer interest in Australian wine in key international markets including the United Kingdom and the United States.<sup>39</sup>

1.27 The committee heard consistent evidence about recent challenges for growers and winemakers, leading to industry downsizing.<sup>40</sup> Increasing supply has been accompanied by falling profits for winemakers.<sup>41</sup> By 2014, an estimated 84 per cent of producers were not covering their variable costs, up from 77 per cent in 2012.<sup>42</sup> In contrast, over the past six years United States and New Zealand producers received positive returns.<sup>43</sup> WFA estimated that up to 70 per cent of total current Australian wine grape production may be uneconomic,<sup>44</sup> expressing the following commitment to restored profitability:

This era of sustained poor profitability has placed enormous pressure on grape growers and winemakers alike and unsurprisingly has created tensions in the industry – tensions we are committed to resolving through measures that support the restoration of profitability for all.<sup>45</sup>

1.28 The committee heard that grape growers are particularly affected by market risk, and particularly the price risk inherent in an oversupplied market.<sup>46</sup> The committee heard that without 'price determination systems based on quality attributes':

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38 Professor Kym Anderson AC and Nanda R. Aryal, *Growth and cycles in Australia's wine industry: A statistical compendium, 1843 to 2013*, Wine Economics Research Centre, University of Adelaide, February 2015, p. 24; Ms Brooke Tonkin, *IBISWorld* industry report C1214: *Wine production in Australia*, July 2015, p. 6.

39 WFA, *Submission 41*, p. 9.

40 Ms Victoria Angove, Director, Angove Family Winemakers, *Committee Hansard*, 24 September 2015, p. 19; Mr Warren Randall, Proprietor and Managing Director, Seppeltsfield Wine, *Committee Hansard*, 24 September 2015, p. 12; AGWA, *Submission 8*, pp 8, 25; Riverland Wine, *Submission 15*, p. 4–6; Department of Industry and Science, *Submission 19*, p. 8; South Australian Wine Industry Association, *Submission 32*, pp 3, 8; Treasury Wine Estates, *Submission 35*, pp 1–3, WFA, *Submission 41*, pp 7–9.

41 Professor Kym Anderson AC, Wine Economics Research Centre Wine Policy Brief No 11, 'How to return Australia's wine industry to growth? Lessons from previous cycles', University of Adelaide, April 2015, p. 15.

42 WFA, *Submission 41*, p. 14.

43 Professor Kym Anderson AC and Nanda R. Aryal, *Growth and cycles in Australia's wine industry: A statistical compendium, 1843 to 2013*, Wine Economics Research Centre, University of Adelaide, February 2015, p. 34.

44 Additional information from WFA, *Actions for Industry Profitability 2014–16*, received 19 May 2015, p. 23.

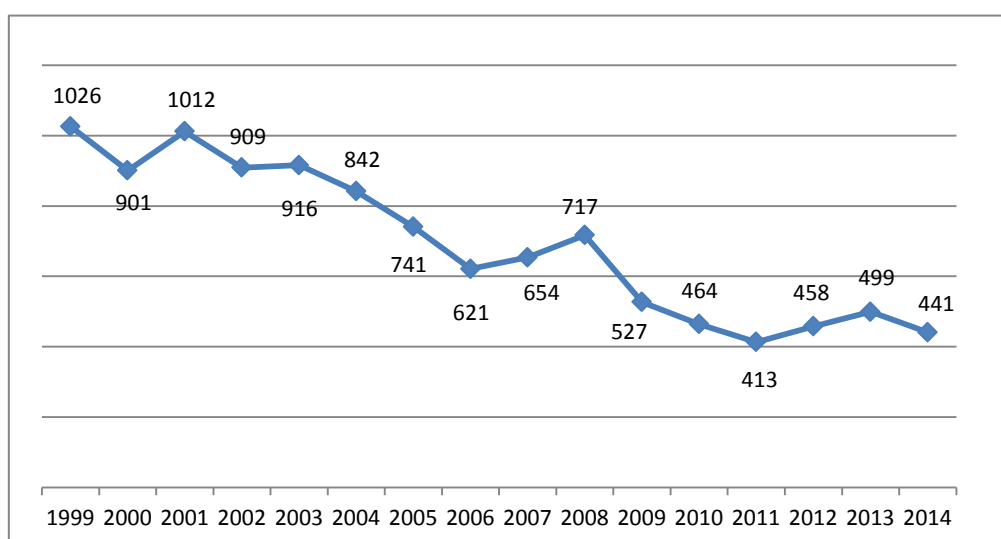
45 WFA, *Submission 41*, p. 9.

46 WGGA, *Submission 30*, p. 10.

A grower's grapes... may be downgraded, not because of quality problems, but because purchasing wine companies may have filled their quotas for grapes at matching price points.<sup>47</sup>

1.29 Indeed, despite a reported quality increase,<sup>48</sup> grape growers have seen prices steadily decline to a historic low of an average \$413 per tonne in 2011, down from \$1 026 per tonne in 1999.<sup>49</sup> WGGA likened the 2014 grape price to that of 'thirty years ago, at a time when the industry fortunes were so low that a vine pull was enacted'. They calculated that the average grower in Australia 'has not met cost of production in the last to five to six years'.<sup>50</sup>

1.30 Figure 7: Average \$AUD grape wine price per v/t: 1999–2014<sup>51</sup>



1.31 Grower representative organisations in the Murray Valley and Clare regions both told the committee that low prices have had a marked impact in their regions:

Over the past two years, the exodus of growers in the Murray-Darling and Swan Hill regions has been at a rate we have not experienced before. Net vine removals in 2014–15 exceeded 1,400 hectares. Over the same period, 100 growers left our industry, and we are expecting more as a consequence of wine grape prices this year being among the lowest in 10 years.<sup>52</sup>

47 WGGA, *Submission 30*, p. 9.

48 Mr Lawrence Stanford, Executive Director, WGGA, *Committee Hansard*, 24 September 2015, p. 34.

49 AGWA, *Submission 8*, p. 26.

50 WGGA, *Submission 30*, pp 15–16.

51 Professor Kym Anderson AC and Nanda R. Aryal, *Growth and cycles in Australia's wine industry: A statistical compendium, 1843 to 2013*, Wine Economics Research Centre, University of Adelaide, February 2015, p. 152.

52 Mr Michael Stone, Executive Officer, Murray Valley Winegrowers, *Committee Hansard*, 24 September 2015, p. 28.



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...everybody is doing it tough. Even those who are doing relatively well are certainly not returning cost of capital. If you are cash positive, you are doing well.<sup>53</sup>

1.32 Not all regions have been equally affected. Warm inland regions in particular have seen the most significant price decline, where it was reported in 2014 that prices were below the cost of production.<sup>54</sup> The oversupply experienced in many regions is the inverse for Tasmania, which Wine Tasmania described as 'a sellers' market'. They stated 'we would actually like to have more grapes.'<sup>55</sup> The committee heard that in Tasmania, 'the industry can grow threefold over the next five years,' pursuing internal growth and investment from interstate and overseas.<sup>56</sup>

1.33 Wines of Western Australia told the committee that despite a 30 per cent downturn in the most recent vintage, 'grape prices in Western Australia over the past five years have been trending upwards.'<sup>57</sup> The committee heard there is more flexibility in that market to diversify businesses and respond to industry trends:

We have already seen that there is capital still available in Western Australia to change structure of vineyards. So we are seeing clonal improvement and we have seen variety changes, to realign vineyards into better marketable positions.<sup>58</sup>

1.34 The committee also heard of 'big ticket items happening to increase tourism' in the Margaret River region of Western Australia, including funding for an airport.<sup>59</sup>

### ***Industry recovery***

1.35 The committee heard evidence of qualified optimism for the industry.<sup>60</sup> Conditions for most winemakers and growers will improve in the next five years as

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53 Professor Geoffrey Lewis, Committee Member, Clare Region Winegrape Growers Association, *Committee Hansard*, 24 September 2015, p. 66.

54 Department of Agriculture, *Submission 29*, p. 5.

55 Ms Sheralee Davies, Chief Executive Officer, Wine Industry Tasmania Ltd, *Committee Hansard*, 25 September 2015, p. 25.

56 Mr Graeme Lynch, Chair, Wine Industry Tasmania Ltd, *Committee Hansard*, 25 September 2015, p. 23.

57 Mr Colin Bell, Chief Executive Officer, Wines of Western Australia, *Committee Hansard*, 27 October 2015, p. 4.

58 *Ibid.*

59 Mr Redmond Sweeny, President, Wines of Western Australia, *Committee Hansard*, 27 October 2015, p. 10.

60 See, for example, Mr Andreas Lee Clark, Executive Officer, AGWA, *Committee Hansard*, 24 September 2015, p. 6; Ms Victoria Angove, Director, Angove Family Winemakers, *Committee Hansard*, 24 September 2015, p. 19; Mr Chris Byrne, Executive Officer, Riverland Wine, *Committee Hansard*, 24 September 2015, p. 42; Mr John Griffiths, President, Swan Valley & Regional Winemakers Association, *Committee Hansard*, 27 October 2015, p. 47.

the industry rebalances, according to the Department of Industry and Science.<sup>61</sup> They cited *IBISWorld* forecasts that over the next five years revenue will increase to \$6.1 billion in 2019–2020.<sup>62</sup> The Wine Australia Price Dispersion Survey shows that, the national average purchase price in 2015 was up 5 per cent from the 2014 average, and is now \$463 per tonne.<sup>63</sup> Nevertheless, WFA submitted recovery would take time:

This oversupply is likely to continue even under the most optimistic projections of demand growth for the domestic and international markets and will continue to see downward pressure over the long term on grape prices.<sup>64</sup>

1.36 The University of Adelaide saw 'potential for return to at least normal levels of profitability', provided industry participants are willing to undertake 'major adjustments', collaborate and invest for the long term.<sup>65</sup> WGGA warned against 'sole reliance on demand growth', arguing that:

... such an emphasis has the potential to create another up-cycle that will solicit lead to yet another cycle of overproduction such as that currently being experienced.<sup>66</sup>

1.37 Their submission calls for better commercial practices and improved 'grower-winery relations,' as well as a quality-based price determination structure.<sup>67</sup> The Australian Small Business Commissioner submitted that objective measures developed by the Australian Wine Research Institute are used internationally, and that:

... adoption by the Australian wine industry for the purpose of incentivising better quality and fit-for-purpose fruit appears to be one way which could avoid and resolve the number of wine grape price disputes.<sup>68</sup>

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61 Department of Industry and Science, *Submission 19*, p. 7.

62 Ms Brooke Tonkin, *IBISWorld* industry report C1214: *Wine production in Australia*, July 2015, p. 8.

63 WFA, *Submission 41*, Appendix B, p. 1.

64 WFA, *Submission 41*, p. 59.

65 Professor Kym Anderson AC and Nanda R. Aryal, *Growth and cycles in Australia's wine industry: A statistical compendium, 1843 to 2013*, Wine Economics Research Centre, University of Adelaide, February 2015, p. LI.

66 WGGA, *Submission 30*, p. 4.

67 WGGA, *Submission 30*, pp 4–7.

68 Australian Small Business Commissioner, *Submission 23*, p. 8.