Chapter 2

Issues to do with the supply and demand for grapes

Background: structure of the wine industry

Grape-growing

2.1 There are about 164,000 hectares of vines in Australia. South Australia has almost half the total. Victoria and New South Wales have almost a quarter each. The other states have small amounts.[1]

2.2 Australia-wide, 90% of grapes are used for winemaking, 6½% for drying, and 3½% for the table. These proportions differ between states: for example 99% of South Australian grapes, but only 72% of Victorian grapes, are used for winemaking.

2.3 Winegrapes are grown in 7,957 vineyards. The average area per vineyard is about 25ha in New South Wales and South Australia, 16ha in Victoria, and 13ha in the other states. 89% of vineyards, representing 87% of the area of vines, use irrigation.

2.4 The 'warm climate' regions (NSW Riverina, NSW/Victorian Murray Valley, and South Australia's Riverland) grow about 70% of Australia's winegrapes, and generally have higher yields, lower operating costs and receive lower prices than the 'cool climate' regions. Cool climate grapes tend to be targeted to wines at higher price points. The dominance of the warm climate regions is expected to increase.[2]

2.5 The 2004 crush was 1.817 million tonnes. This was 40% higher than the drought affected 2003 crop and 23% higher than the previous record in 2002. This was a result of above average yields and a moderate expansion in bearing area.

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1 All figures in this section not otherwise referenced are from Australian Bureau of Statistics, *Australian Wine and Grape Industry*, 2004, cat. 1329.0

2 CSIRO, additional information 8 June 2005. ABARE, *Australian Wine Grape Production Projections to 2006-07*, 2005, p.19

Table 1: Production of Grapes (tonnes)				
Year	**Winemaking**	**Drying**	**Table & Other**	**Total**
1994	661,282	212,870	45,456	919,608
1995	577,364	147,006	44,456	768,827
1996	782,381	248,342	55,786	1,086,509
1997	743,382	136,435	63,296	943,113
1998	870,627	176,570	64,972	1,112,170
1999	1,076,207	119,438	69,891	1,265,536
2000	1,111,137	133,454	66,791	1,311,382
2001	1,391,074	90,241	64,686	1,546,002
2002	1,514,501	152,863	86,524	1,753,888
2003	1,329,595	92,264	75,080	1,496,939
2004	1,816,556	129,489	68,920	2,014,965
Source: ABS cat 1329.0, various years				

2.6 Production of winegrapes has increased by 180% since 1994, driven by export growth of 350% in the same period.[3] This has been made possible by strong growth in plantings, particularly in the late 1990s, peaking in 1998-99:

Table 2: Annual Plantings of Winegrapes (ha)					
Year	**Total (ha)**	**Year**	**Total (ha)**	**Year**	**Total (ha)**
1987	1957	1993	3371	1999	11646
1988	1790	1994	6450	2000	6772
1989	3036	1995	7613	2001	7367
1990	2193	1996	8520	2002	6566
1991	1807	1997	12035	2003	6338
1992	2191	1998	16224	2004	5337
Source: WFA, Additional Information, 22 September 2005					

2.7 The estimated 2005 crush is 1.924 million tonnes. This is 6% more than 2004. Projections are for a 2% drop to 1.879 million tonnes in 2006, then a 3% increase to 1.933 million tonnes in 2007.[4]

2.8 In 2004, 24% of grapes were sourced from wineries' own vineyards, and 76% from independent growers.[5] There are significant regional variations to this

3 Winetitles, *The Australian and New Zealand Wine Industry Directory*, 2005, p. 8. ABARE, *Australian Wine Grape Production Projections to 2006-07*, 2005, p. 13

4 Winemakers' Federation of Australia, *2005 WFA Vintage Report*, June 2005, p. 1. ABARE, *Australian Wine Grape Production Projections to 2006-07*, 2005, p. 14

proportion: for example, in 2001 in the Coonawarra region, only 15% of white and 24% of red grapes were sourced from independents.[6]

Wine making

2.9 The wine industry is extremely diverse, varying from small family companies to very large corporations. In 2004 there were 1,798 wineproducers (defined as companies selling wine commercially).[7] 364 winemaking businesses crushed 50 tonnes or more, at 410 locations.

2.10 There has been a long history of mergers and acquisitions by the major companies. The largest four companies (Hardy, Southcorp, McGuigan Simeon and Orlando Wyndham) account for about 50% of production. The largest twenty companies account for 80% of production.[8] Winemakers crushing more than 400 tonnes, though only about half the total winemakers, account for 98% of production.

2.11 Wine production increased by 71% from 1999-2000 to 2003-04. The dip in 2002-03 reflects the bad season in that year. The growth has been driven by modest growth in domestic demand and very strong growth in exports:

Table 3: Wine Production and Sales of Australian-Produced Wine ('000 L)

Year	Gross Wine Production	Domestic Sales	Exports	Total Disposals	Exports as % of Production	Exports as % of Disposals
1993-94	587,377	319,532	125,464	444,996	21.4%	28.2%
1994-95	502,796	313,357	113,663	427,020	22.6%	26.6%
1995-96	673,445	309,463	129,671	439,134	19.3%	29.5%
1996-97	617,379	333,591	154,393	487,984	25.0%	31.6%
1997-98	741,547	338,814	192,404	531,218	25.9%	36.2%
1998-99	851,143	348,349	216,149	564,498	25.4%	38.3%
1999-00	859,166	369,271	284,935	654,206	33.2%	43.6%
2000-01	1,076,538	384,847	338,289	723,136	31.4%	46.8%
2001-02	1,220,372	386,232	418,393	804,625	34.3%	52.0%
2002-03	1,085,985	402,479	518,642	921,121	47.7%	56.3%
2003-04	1,471,228	417,378	584,397	1,001,775	39.7%	58.3%

Source: ABS cat 1329.0, various years. Production by winemakers crushing more than 400 tonnes annually or with sales of more than 250,000 litres.

5 ABARE, *Australian Wine Grape Production Projections to 2006-07*, 2005, p. 37

6 Iain Fraser, 'The Role of Contracts in Wine Grape Supply Coordination: An Overview', *Agribusiness Review* Vol. 11, Paper 5 (2003)

7 Winetitles, *The Australian and New Zealand Wine Industry Directory*, 2005, p. 20

8 Winetitles, *The Australian and New Zealand Wine Industry Directory*, 2005, p. 24

2.12 The difference between production and sales reflects additions to inventories (stock). Inventories increased greatly in 2004:

Table 4: Beverage Wine held by Winemakers 30 June ('000 L)			
1994	656,706	2000	1,191,791
1995	642,459	2001	1,376,884
1996	782,281	2002	1,570,536
1997	815,558	2003	1,581,843
1998	900,299	2004	1,854,506
1999	1,089,583		
Source: ABS cat 1329, various years. Includes only winemakers who crush more than 400 tonnes annually and have domestic wine sales of 250,000 litres or more.			

2.13 The stock to sales ratio, which is the main indicator of the supply/demand balance, is expected to resume its downward trend in 2005 (after being boosted by the above average 2004 harvest). However it will still be at the same level as two years ago, which according to the Australian Wine and Brandy Corporation is still 18% higher than the 'desirable' level.[9]

Table 5: Stock to Sales Ratio					
1987-88	1.34	1993-94	1.46	1999-00	1.82
1988-89	1.56	1994-95	1.50	2000-01	1.98
1989-90	1.66	1995-96	1.78	2001-02	2.16
1990-91	1.66	1996-97	1.67	2002-03	1.96
1991-92	1.54	1997-98	1.69	2003-04	2.07
1992-93	1.41	1998-99	1.93	2004-05	1.94
Source: Winemakers' Federation of Australia, Additional Information, 22 September 2005					

Employment in the wine industry

2.14 In 2001 about 15,000 people had their main job in grapegrowing, and 15,000 in winemaking. This is a threefold increase over 1991 figures. In some wine growing areas, such as Swan Hill, Barossa Valley, Berri and Barmera, wine industry employment is over 25% of total employment.[10]

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9 Australian Wine and Brandy Corporation, *Upgraded Industry Forecasts Point to Continued Tightness*, 17 January 2005, p. 2

10 ABS cat 1329.0: 14,480 in winemaking and 15,629 in grape growing. Bureau of Rural Sciences, *A social atlas of Australia's wine regions, 2001/02*, 2004, p. 62

Grape and wine prices

2.15 Average winegrape prices in real terms, after increasing greatly in the late 1990s, have returned to the level of the mid 1990s, and lower in the warm climate areas:

Table 6: Trend in Winegrape Prices				
WFA based on AWBC National Utilisation Project (2004 $)		**ABARE Weighted Average Warm Climate Indicator Prices (2005 $)**		
			White	**Red**
1992	505	1992-93	485	527
1993	493	1993-94	505	719
1994	635	1994-95	738	984
1995	767	1995-96	802	1070
1996	773	1996-97	857	1252
1997	976	1997-98	791	1378
1998	1043	1998-99	687	1259
1999	1049	1999-00	592	882
2000	915	2000-01	597	784
2001	905	2001-02	632	740
2002	866	2002-03	671	575
2003	814	2003-04	669	501
2004	755	2004-05 estimate	600	419
Source: Winemakers' Federation of Australia, Additional Information, 22 September 2005. ABARE, *Australian Commodities,* March Quarter 2005, p. 54, updated by Additional Information, 9 September 2005.				

2.16 As well, because of the current oversupply, uncontracted growers have been offered very low prices on the spot market. For example, for the 2005 vintage, spot prices of $140 per tonne for premium grapes in the Riverland were reported, and $100 to $200 in the Murray Valley.[11]

2.17 Prices tend to be more volatile in warm climate regions than in cool climate regions, since at times of oversupply the lower quality grapes (that are traditionally sourced from warm climate regions) tend to be abandoned as better grapes are available at relatively lower prices. On the other hand, the major category of grapes in oversupply is red grapes sourced from the higher cost cool climate areas. [12]

11 Submission 7, Murray Valley Winegrowers, p. 2. Primary Industries and Resources South Australia, *A report on the impact of current grape-pricing trends on the Riverland region*, April 2005, p. 36

12 Submission 17, Australian Wine and Brandy Corporation, pp. 4 and 8

2.18 The average price of wine has also declined, as export growth is concentrated at lower price points. Export prices have also been affected by the appreciation of the Australian dollar in recent years.

Table 7: Price Per Litre, Exported Wine, (2005 $)					
	Million Litres	**Price per Litre**		**Million Litres**	**Price per Litre**
1992-93	103	3.80	1999-00	287	5.54
1993-94	131	3.65	2000-01	339	5.29
1994-95	114	4.30	2001-02	416	5.12
1995-96	130	4.47	2002-03	508	4.92
1996-97	155	4.70	2003-04	581	4.49
1997-98	194	5.12	2004-05	661	4.16
1998-99	216	5.53			
Source: ABARE, Additional Information, 9 September 2005					

Australia in the world market

2.19 Australian wine sales are about $4.5 billion per year, of which $2.5 billion is exports (2003-04). This may be compared, for example, with about $4 billion for wheat exports and about $2.3 billion for wool exports.[13]

2.20 Australia is the world's 7th largest producer of wine, but because the largest producers (France, Italy and Spain) are very large, this is still only 3.8% of total world production. Australian exports are about 1.4% of world production.[14]

2.21 Exports, as a proportion of total production, have been increasing. In 2003-04 exports were about 40% of production (ABS, Table 3 above) or 43% (ABARE).[15] Among wine-exporting nations Australia has the highest ratio of exports to total production.

2.22 The UK, the USA, Canada, Germany and New Zealand take 84% of Australia's exports. This proportion has increased over the past decade from 77% of Australia's exports.

2.23 The high reliance on exports and the small presence of Australian exports in proportion to the total world market leaves the Australian industry exposed to influences such as exchange rate movements and competition from the growing wine industry in other 'New World' countries.

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13 AWBC, *Australian wine sales 2004 at a glance.* ABARE, *Australian Commodities,* March quarter 2005, pp. 19 and 54

14 In 2001: Australian exports 375 million litres; world production 26,473 million litres.

15 ABARE, *Australian Commodities,* Vol. 12, No. 1, March Quarter 2005, p. 48

Projections

2.24 According to ABARE, 'In the short term, a combination of lower export values and above average yields in the previous vintage are expected to result in further reductions in prices for both red and white wine grapes in 2004-05… However, tighter supplies and improved demand from wineries will result in a price recovery in the medium term.'[16] ABARE predicts that in the five years to 2009-10:

- the bearing area of grapes will increase by about 15 per cent to 176,000ha;
- winegrape production will increase by about 12 per cent to 2.1 million tonnes;
- the proportion of production from cool climate regions will fall;
- domestic sales will grow modestly to almost 500 million litres;
- exports will increase to about 1.2 billion litres - about double the 2003-04 figure;
- the unit value of exports will continue to fall;
- white grape prices will continue to fall; and
- red grape prices will continue to fall in the short term, then recover slightly after 2006-07.[17]

Table 8: Outlook for Winegrape Production and Prices

	Bearing Area (ha)	Production ('000 tonnes)	Average Price (2004-05 $A per tonne)		Exports (ML)	Exports Value (2004-05 $A million)	Exports Value $/tonne
			White	Red			
2002-03	140,000	1,411	687	589	508	2,502	4.92
2003-04	146,000	1,895	685	513	581	2,606	4.49
2004-05	153,000	1,872	629	439	679	2,791	4.16
2005-06	159,000	1,879	590	407	778	3,013	3.87
2006-07	163,000	1,933	552	401	880	3,251	3.69
2007-08	167,000	1,982	528	446	980	3,560	3.63
2008-09	171,000	2,037	505	473	1,082	3,879	3.59
2009-10	176,000	2,095	488	503	1,181	4,260	3.61

Source: ABARE, *Australian Commodities,* March Quarter 2005, p. 54. Forecast weighted average warm climate indicator prices. Differences from corresponding ABARE figures in Table 6 are because Table 6 is based on updated estimates.

16 ABARE, *Australian Commodities,* Vol. 12, No. 1, March Quarter 2005, pp. 53-4

17 ABARE, *Australian Commodities,* Vol. 12, No. 1, March Quarter 2005, pp. 55-6

Issues raised in submissions

Grape prices below cost of production

2.25 The key issue raised in submissions is that for many growers grape prices are below the cost of production:

> The Australian grape growing industry is now at a crisis point with many growers unviable at current grape price levels. This insecurity and lack of confidence is impacting severely on regional economies where in the last decade, viticulture has provided a significant revival.[18]

2.26 For example, Murray Valley Winegrowers gave figures showing the decline in prices in the NSW/Victorian Murray Valley since 1999:

Table 9: Weighted Average Price of Winegrapes, Murray Valley ($/tonne)

	Cabernet Sauvignon	Merlot	Shiraz
1999	1135	1092	1146
2000	803	773	812
2001	726	723	736
2002	686	614	802
2003	538	596	657
2004	487	535	620
2005 (est)	350	450	500

Source: Submission 7, Murray Valley Winegrowers

2.27 The South Australian Department of Primary Industries and Resources (PIRSA) recently estimated the costs of production of Riverland farms at between $330 per tonne on a 600ha farm and $763 per tonne on a 10ha farm.[19] The Riverland Winegrape Growers Association noted that most Riverland growers rely on off-farm income.[20]

2.28 Growers reliant on the spot market, as opposed to growers under contract, are particularly hardpressed. The proportion of growers reliant on the spot market varies greatly around the country. For example, in the Riverland, 90% of growers are under contract; in the Murray Valley only two thirds. In the Murray Valley the spot price for

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18 Submission 30, Wine Grape Growers Australia Inc., p. 5

19 Primary Industries and Resources South Australia, *A report on the impact of current grape-pricing trends on the Riverland region*, April 2005, pp. 28 and 41

20 Primary Industries and Resources South Australia, *A report on the impact of current grape-pricing trends on the Riverland region*, April 2005, p. 65

premium reds in the last few years has been $100-$200 per tonne.[21] There was evidence that some winemakers are not renewing contracts, presumably because at this time of oversupply they feel more confident of sourcing grapes on the spot market.[22] KPMG comments that 'this trend represents a significant shift in risk from winery to grower.'[23]

Winemakers are also under pressure

2.29 There was evidence that winemakers are also under pressure. Profit has trended down since 2002 and almost half surveyed wineries reported a loss in 2004. Deloitte (which carries out the survey concerned), commented in 2004 that in response to continuing poor financial results 'some wineries may choose to merge to achieve cost and/or distribution efficiencies, while others may be forced to exit the market.' The listed winemakers have performed best.[24]

2.30 The Winemakers' Federation of Australia noted other matters that have put downward pressure on wine prices:

- appreciation of the Australian dollar;
- strong growth of the industry in other 'New World' countries; and
- retail consolidation increasing the bargaining power of wine buyers. Coles and Woolworths hold about 45-50% of the retail wine market, and this proportion is expected to increase. The consolidation trend is also apparent in major export markets such as the United Kingdom.[25]

2.31 Mr Moularadellis (Riverland Winemakers Association), commented:

> A winemaker can only provide pricing stability if it is offered to them by their customers, and that just does not exist… You only have to look at the public companies, and the rates of return that they are making on their assets, to be able to see that the industry is under significant pressure.[26]

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21 Submission 7, Murray Valley Winegrowers, p. 2. Mr C. Byrne (Riverland Winegrape Growers Association), *Committee Hansard,* Berri, 27 June 2005, p. 6

22 For example, McGuigan Simeon has advised 270 Riverland and Sunraysia growers that their contracts will not be renewed past 2007. Primary Industries and Resources South Australia, *A report on the impact of current grape-pricing trends on the Riverland region*, April 2005, p. 64

23 KPMG, *Australian Grape and Wine Outlook 2004,* December 2004, p. 12

24 Deloitte, *Annual Financial Benchmarking Survey for Australian Wine Industry - Vintage 2004,* 2004, p. 3

25 Submission 4, Winemakers' Federation of Australia, p. 7

26 Mr B. Moularadellis (Riverland Winemakers Association), *Committee Hansard,* Berri, 27 June 2005, pp. 22,24

2.32 Winemakers' stock to sales ratio is unusually high, creating pressure to clear stock in hand and leading to lower prices. There is concern that official statistics may underestimate stock.[27] Mr Moularadellis said:

> One major company that is no longer owned by Australian interests honoured its contracts and paid the growers what was due under those contracts. As a result of that, it wrote down in excess of $60 million and is no longer owned by Australian shareholders; it is part of a multinational. There are numerous other examples of large companies, medium-sized companies and small companies that have paid significantly high prices for grapes based on the market at the time and then have had to write stocks down.[28]

2.33 Growers, on the other hand, argue that they are bearing an unfair share of the industry's troubles:

> WGGA accepts that such negative market factors will obviously impact on grape prices. However, we contend that because of their powerless position, growers have been forced to accept an inequitable share of those impacts…. Grapegrowers have had their prices slashed by 50% while winemakers endure comparably tiny fluctuations in average prices for wine.[29]

Concerns about growth at lower price points

2.34 Many submissions were concerned about the growth of production, particularly for export, at lower price points. They were concerned that this might damage the quality and reputation of Australian wine. For example, the Riverland Winegrape Growers Association said:

> Growers are confounded by the progressive shift away from quality emphases and increasing reliance on bulk wine to increase through-put to achieve low cost of production objectives. Growers perceive the focus is increasingly less on growing quality winegrapes and more on reducing unit costs of production. This quality spiral is being driven by the declining price spiral.[30]

2.35 Mr De Palma (Murray Valley Winegrowers) said:

> As an industry we are perpetuating the low end market because we are oversupplying ourselves for no reason. An oversupply market does no-one any good.[31]

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27 Submission 24, Department of Agriculture, Fisheries and Forestry, p. 5

28 Mr B. Moularadellis (Riverland Winemakers Association), *Committee Hansard,* Berri, 27 June 2005, p. 26

29 Submission 30, Wine Grape Growers Australia Inc., p. 4

30 Riverland Winegrape Growers Association, in Primary Industries and Resources South Australia, *A report on the impact of current grape-pricing trends on the Riverland region*, April 2005, p. 64

31 Mr M. De Palma (Murray Valley Winegrowers Inc.), *Committee Hansard,* 28 June 2005, p. 18

2.36 Primary Industries and Resources South Australia (PIRSA) has noted that 'the concern amongst growers is that they believe that there has been undue emphasis on price discounting and, in particular, on export of bulk (essentially commodity) wine and that this is undermining the reputation of Australian warm climate wines.'[32]

2.37 The Winemakers' Federation made the following comments on this proposition:

> … 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.[33]

2.38 PIRSA has argued similarly that 'because demand for popular premium wines is relatively stable (around an upward trend) and grape production fluctuates, there is an important role for the international bulk market in absorbing seasonal and cyclical surpluses.'[34] KPMG suggests that growth in bulk exports also reflects 'increasing cross-border ownership of the Australian industry and associated moves to pack offshore'.[35]

Comment

2.39 Clearly the main cause of the current low grape prices is the boom in plantings of the late 1990s. Plantings have slowed greatly since then, and removal of vines has increased, which is a rational response to market signals.[36] Both domestic demand and exports are expected to continue growing. The committee accepts the expert projections that the market will return to balance in the medium term.

2.40 However, this is small comfort to the growers who have gone bankrupt in the interim, or to the regional economies which depend on them. As noted in paragraph 2.14, in some regions over 25% of all employment is in the wine industry. For example, the Mudgee Wine Grape Growers Association said:

> It is probable that almost all grape growing business within the Mudgee region was unprofitable in 2004 and 2005…. The conclusion we draw is

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32 Primary Industries and Resources South Australia, *A report on the impact of current grape-pricing trends on the Riverland region*, April 2005, p. 12

33 Mr S. Strachan (Winemakers' Federation of Australia), *Committee Hansard,* Adelaide, 27 June 2005, pp. 15-16

34 Primary Industries and Resources South Australia, *A report on the impact of current grape-pricing trends on the Riverland region*, April 2005, p. 37

35 KPMG, *Australian Grape and Wine Outlook 2004,* December 2004, p. 9

36 Australian Wine and Brandy Corporation, *Upgraded Industry Forecasts Point to Continued Tightness*, 17 January 2005, p. 2

> that many small growers will be bankrupted over the next 3 years. This has a dramatic impact on the local economy.[37]

2.41 Grapegrowing suffers the boom-bust cycle more than many agricultural industries because of the long lead time before vines come into production. This makes it more difficult to predict the market.

> It is not an industry like the wheat industry, where, if the wheat is no good this year, that is fine—you can make a decision to grow barley, triticale or whatever you like. Once the grapes are in, it takes a while for them to come out again, so people tend to stick with them and our lows tend to last a bit longer than our highs.[38]

2.42 This makes it all the more important to do as much as possible to make the industry more stable and to reduce the peaks and troughs of the market cycle. Suggestions for this are considered further below.

Effect of the former tax incentive for vineyards

2.43 Some submissions argued that the former tax incentive for planting vines must bear serious responsibility for the excessive plantings of the late 1990s.

2.44 A tax incentive for establishing grapevines was introduced in 1993 as part of a package of measures agreed between the wine industry and the government to facilitate the passage of the 1993 budget through the Senate. The incentive consisted of allowing capital expenditure on establishing grapevines to be written off over four years. A Committee of Inquiry into the Winegrape and Wine Industry noted in 1995 that this 'considerably reduced the effective tax rate on new investment in vineyards' and 'provides most assistance where a tax entity has a taxable income against which the costs can be written-off':

> Given that it can take up to five years before a new vineyard produces a flow of income, the four year tax write-off for vineyards provides greater benefit for taxpayers with established vineyards who are increasing their plantings and for large diversified companies entering the industry, than it does for new businesses.[39]

2.45 At that time some grapegrowers opposed extending the concession beyond owner-operators on the grounds that this could 'encourage the entry of short term investor or corporate operators and risking an oversupply of grapes':

> Growers fear that the relaxation… will seriously harm their futures in the industry due to the incentive for short term investors [to be] part of a huge expansion and [who] subsequently, when the taxation measures cease to

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37 Submission 26, Mudgee Wine Grape Growers Association, pp. 1-2

38 Mr J. Caddy (CCW Cooperative Ltd), *Committee Hansard,* 28 June 2005, p. 35

39 Committee of Inquiry into the Winegrape and Wine Industry, *Winegrape and Wine Industry in Australia*, June 1995, p. 329

> give them benefit in their operation, will leave the industry and leave the potential oversupply situation for full time long term growers to have to deal with.[40]

2.46 By 1998, grapegrowers were warning that the tax incentive would cause an excess of new plantings. At that time, commentators Osmond and Anderson considered that the current boom was 'largely market driven with only a small element of influence from government intervention.' By 2000 there were reportedly 'calls within the industry to extend the tax relief to encourage wineries to invest in infrastructure to handle that additional tonnage'.[41] In 2001 winemakers reportedly argued that market forces were mainly responsible for the expansion of the industry.[42]

2.47 In 2002, grapegrowers reportedly said:

> We've been negotiating with government for three and a half years to remove the tax incentive for new plantings… If you look at the plantings, it's the large corporates that have gone in with hundreds of acres, they're the ones that have caused the oversupply, the traditional farmer, the traditional horticulturalist that plants 10 or 20 acres, he hasn't caused the oversupply, it's the system that has taken advantage of the accelerated depreciation that has caused the oversupply.[43]

2.48 In 2002, the office of the then Minister for Agriculture, Fisheries and Forestry reportedly calculated that the accelerated depreciation provision had saved only $4 million across a $300 million investment, and said that the government did not intend to abolish any tax breaks in the rural sector.[44]

2.49 In submissions to government in 2003, the Winemakers' Federation of Australia suggested ending the tax incentive:

> These provisions have assisted the orderly growth of the vineyard sector. Nevertheless, the more immediate industry priority is to safeguard the viability of wineries and their regional economic contributions. Removal of

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40 South Australian Farmers Federation, quoted in Committee of Inquiry into the Winegrape and Wine Industry, *Winegrape and Wine Industry in Australia*, June 1995, p. 329

41 Mr R. Marlowe (Winegrape Growers Council of Australia), quoted in 'A not-so-rosy time for reds', *The Australian and New Zealand Grapegrowers and* Winemaker, May 2002. R. Osmond & K. Anderson, *Trends and Cycles in the Australian Wine Industry, 1850 to 2000*, 1998, p. 15. Mr A. Piccoli MP, NSW Legislative Assembly Hansard, 28 November 2000, p. 109991

42 ABC Queensland Country Hour Summary, 4 July 2001, Summary: 'The growers say the scheme has encouraged overproduction… The winemakers say that is rubbish, market forces have been responsible for the billion dollar investment in the industry.' At www.abc.net.au/rural/qld/storiess323247.htm (September, 2005)

43 Leo Pech (Australian Wine Grape Growers' Association) & John Dal Broi, reported in ABC *Landline*, 9 June 2002, at www.abc.net.au/landline/stories/s571509.htm (September, 2005)

44 ABC *Landline*, 9 June 2002, at www.abc.net.au/landline/stories/s571509.htm (Sept 2005)

> accelerated depreciation provisions enables the government to refocus this important provision towards a higher industry and government priority.[45]

2.50 The Government abolished the concession in the 2004 budget, saying this was in response to 'concerns that accelerated depreciation arrangements – which drove considerable expansion of the industry over the past decade – could lead to oversupply.'[46]

2.51 The South Australian Farmers' Federation in its submission to the committee claimed that the former tax incentive, continued for too long, bears serious responsibility for encouraging the excessive plantings of the late 1990s:

> Growth has exceeded all expectations and the justification for this provision has disappeared. As a consequence, it was removed in the May 2004 budget, effective from 1 October 2004. There is a strong case to say that from an industry view point, this change occurred much later than it should have, and that this delay has contributed substantially to the current record production and inventory levels.[47]

2.52 The Winemakers' Federation of Australia accepted that 'a proportion of these new plantings were 'speculative', partly stimulated by accelerated depreciation incentives and not necessarily backed by a winery contract.' However the Federation also argued that 'the level of impact that [the tax concession] 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'.[48]

Comment

2.53 It is clear that the tax incentive, whether or not it was the main cause, contributed to the explosion of plantings in the late 1990s. With hindsight, given the present problems, it is clear that it was continued longer than necessary. It appears that growers realised this before the winemakers did, yet the message was not being received by government. This illustrates the need for an effective national growers' body able to convey such messages.

2.54 The committee suggests that there is a need for government to consider the economic effects of such measures not only when establishing them, but also by way

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45 Winemakers' Federation of Australia, pre-budget submissions, February 2003 and October 2003.

46 Hon. Warren Truss, *Wine industry initiatives welcomed*, Media Release, 12 May 2004

47 Submission 3, South Australian Farmers' Federation, p. 4

48 Submission 4, Winemakers' Federation of Australia, p. 4. Mr S. Strachan (Winemakers' Federation of Australia), *Committee Hansard,* Adelaide, 27 June 2005, p. 3

of regular monitoring to ensure that they are still needed and achieving their purpose. This needs to include regular consultation with a broad range of stakeholders.

Should there be price or supply controls?

2.55 The committee now considers possible initiatives to make the industry more stable and sustainable, and to reduce the peaks and troughs of the market cycle. Firstly, the question arises, whether government should try to control price or supply in some way.

2.56 A few submissions suggested this. Most strongly opposed it. The Winemakers' Federation of Australia argued strongly that 'there is no rationale for government intervention in the operations of the wine market':

> Intervening in such market mechanisms will usually have undesired consequences. Intervention in other agricultural markets in the past, such as regulations in the domestic dairy and wool industries (eg minimum pricing) resulted in significant market inefficiencies and costly readjustment processes, once the regulations were removed. It is paramount that the wine industry avoids these types of situations.[49]

2.57 The Department of Agriculture, Fisheries and Forestry (DAFF) argued that 'the industry appears to have responded rationally to forecast and current market signals… little evidence exists to support regulatory intervention in supply side management...'[50] The Australian Wine and Brandy Corporation also supported market-based solutions in preference to regulation.[51] No submissions to the committee's inquiry from industry organisations, whether winemakers or grapegrowers, disagreed.

2.58 On the other hand, many submitters did comment on the need for better market information and advice to guide investors, to prevent a recurrence of the excessive planting of the late 1990s. This is considered further below.

Price controls

2.59 A few submitters suggested that the price of grapes should be controlled in some way.[52] Implicitly this would be based on some concept of a 'fair' price with reference to the cost of production. There are precedents for this. For example, The Riverina Wine Grapes Marketing Board used to have power to set a minimum market price, but this was removed in 2000 after a review in accordance with National

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49 Submission 4, Winemakers' Federation of Australia, p. 9

50 Submission 24, Department of Agriculture, Fisheries and Forestry, p. 7

51 Submission 17, Australian Wine and Brandy Corporation, p. 3

52 For example, in Submission 23, form letters submitted by growers.

Competition Policy guidelines (the Board still has powers to set default terms and conditions of payment and to compulsorily obtain price information from wineries).[53]

2.60 A related suggestion is that contracted growers, who may be receiving survival prices, and uncontracted growers, who are receiving offers far below their costs on the spot market, should somehow share the pain more evenly:

> No-one should get $150-200 per tonne. Some contracts are probably too high. Everyone, and not just reds and chardonnay, should bring $500-700 per tonne and we could survive.[54]

Comment

2.61 The committee does not agree with price control. A legislated floor price, if it was higher than the market price, would simply mean that more product would not sell. The only way to prevent that would be to control supply as well. None of the organisations that provided evidence suggested that. What would happen if the target supply was less than growers wished to offer? How would a regulator decide who would get a permit to harvest their grapes?

2.62 It is said that price control of grapes introduced in South Australia in 1966 'did nothing to relieve the inequities and imbalances in the market'.[55] More recently, the failure of the former Reserve Price Scheme for wool, which collapsed with huge debts in 1991, shows the risks of trying to manipulate a market in this way.[56]

Supply controls

2.63 Supply could also be controlled by subsidising a vine pull or by regulating plantings.

2.64 No submissions, whether from grape growers or winemakers, favoured a vine pull. Mr Stone of the Murray Valley Winegrowers said:

> If you have a large scale subsidised vinepull, in three or four years time there is going to be a shortage.[57]

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53 Submission 29, Riverina Wine Grapes Marketing Board, p. 1

54 Submission 23, form letters submitted by growers.

55 J. Halliday, *A History of the Australian Wine Industry 1949-1994*, p. 12

56 From 1970 to 1991 the Australian Wool Commission (later Australian Wool Corporation) guaranteed to buy all wool offered to it at a set floor price. When this price exceeded the market price, a stockpile of wool developed which could not be onsold. The stockpile peaked at 4.7 million bales with associated debt of $2.8 billion. The scheme was abandoned in 1991 and the last of the stockpile was sold only in 2001.

57 Mr M. Stone (Murray Valley Winegrowers Inc.), *Committee Hansard,* 28 June 2005, p. 15

2.65 The Riverina Wine Grapes Marketing Board argued that there should be compulsory national registration of vineyards, but did not think that plantings should be restricted 'as this would be anti-competitive'.[58]

2.66 The Commonwealth spent over $6 million on a vine pull scheme in 1985-88.[59] In 1993 it introduced a tax incentive to encourage planting of vines (see paragraph 2.44).

2.67 A few submissions seemed to suggest controls on planting, without detailed proposals.[60] The committee suggests that this would raise the same problems as price control concerning the likely inefficiencies of government trying to second-guess the market.

Comment

2.68 The committee agrees that, given the underlying policy of allowing free enterprise in agriculture, the government should not intervene in the market by controlling price or supply.

2.69 However, the committee recognises that supply may be affected by future regulation for environmental purposes, such as controls on land use or water supply.

2.70 Other possibilities for making the wine industry more stable are considered below.

Other initiatives to stabilise the industry

Better market information and business advice

2.71 Many submissions raised the need for better market information and advice to guide investors. Implicitly, the main purpose of this would be to prevent a repeat of the excessive plantings of the late 1990s. The AWBC commented that 'a well informed wine sector, which is sophisticated enough to interpret and apply available information, is key to ensuring sustainability and profitability.'[61]

2.72 According to the Australian Wine and Brandy Corporation (AWBC) 'the Australian wine sector is widely acknowledged as having "excellent data which

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58 Submission 29, Riverina Wine Grapes Marketing Board, p. 5

59 $6,279,000 in total was spent on a Dried Vine Fruits Assistance Scheme and a Wine Industry Adjustment Scheme. Department of Agriculture, Fisheries and Forestry, Additional Information: Answers to Questions on Notice.

60 Submission 23, form letters submitted by growers. In February 2005 Wine Grape Growers Australia suggested 'no vineyard expansion without the security of a fair contract for the purchase of fruit for a predetermined term and price; no speculative vineyard developments.' *Major wine grower group insists on change*, news release 17 February 2005.

61 Submission 17, Australian Wine and Brandy Corporation, p. 9

allows us to monitor trends and risks in a timely manner"'. Prominent examples include the regular analysis and updates of the market outlook provided by the AWBC, as well as funding for ABS viticulture collections and ABARE's annual production and intake projections.[62] However, it does appear that there is not as much information as would be desirable about how many vines there are in Australia. There is accurate information for South Australia, but less so for other states. Mr Jim Caddy, of CCW Cooperative Ltd, said:

> Market situations say that we are going to have highs and lows, and that is fine, but if we can work together we can trim them out. We are still going to have our highs and lows but we are not going to have super lows and super highs. Part of that problem is information. We do not know how many grapes are grown in Australia, so when people make their projections nobody really knows. We might be 200,000 or 300,000 tonnes out.'[63]

2.73 Statistics on inventories are also uncertain.[64]

2.74 Submissions proposed that there should be a national register of vines.[65] McGuigan Simeon argued that 'this is essential not only to monitor complete vineyard plantings but also to understand the variety by variety availability, and therefore be able to determine whether the variety is in undersupply, oversupply or balance.'[66] It was suggested that maintaining the register could be a role of a national growers' body. Presumably there would need to be some legislative backing if growers were to be forced to register. DAFF suggested that, without compulsion, there might be significant cost in keeping the information up to date. The benefits and costs would have to be considered.[67]

2.75 It is also important to get information out to the stakeholders. The Australian Wine and Brandy Corporation described its recent innovation: online WINEFACTS Statistics. However 'the uptake of WINEFACTS Statistics among independent grapegrowers and their representative organisations has thus far been low… There is an important government role in facilitating independent growers' access to initiatives such as WINEFACTS statistics.'[68]

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62 Submission 17, Australian Wine and Brandy Corporation, p. 9. Submission 4, Winemakers' Federation of Australia, p. 9

63 Mr J. Caddy (CCW Cooperative Ltd), *Committee Hansard,* 28 June 2005, p. 34

64 Submission 17, Australian Wine and Brandy Corporation, p. 6

65 For example, Submission 29, Riverina Wine Grapes Marketing Board, p. 1. Mr C. Byrne (Riverland Winegrape Growers' Association), *Committee Hansard,* Berri, 27 June 2005, p. 2

66 Submission 10, McGuigan Simeon, p. 1

67 Mr D. Mortimer (DAFF), *Committee Hansard,* 10 August 2005, p. 7

68 Submission 17, Australian Wine and Brandy Corporation, p. 10

2.76 Growers also need business planning skills to help them structure their businesses so they can survive the downturns in the business cycle. The AWBC commented:

> If price volatility for warm inland fruit is greater than for fruit from the rest of Australia, warm inland growers need to be aware that this is the nature of their market and appropriate business plans are needed to accommodate forward price volatility. The factor that will facilitate such awareness is accurate, timely and accessible information and interpretation. Traditionally, most independent grapegrowers do not seek such information and interpretation as individuals. Rather, they rely on their representative organisations…[69]

2.77 The South Australian Farmers Federation noted that there is an increasing trend to grapes being the only crop on the farm, which increases the risk to growers.[70] The Riverina Wine Grapes Marketing Board said that 'the skills levels of wine grape producers in terms of business development and relationships needs enhancing'.[71]

Improving productivity and economies of scale

2.78 It appears that there is potential for improving productivity in winegrape growing. Primary Industries and Resources South Australia (PIRSA) recently estimated the costs of production of Riverland farms of varying sizes. There were substantial economies of scale, with costs dropping from $763 per tonne for a 10ha farm to $330 per tonne for a 600ha farm. This suggested that to get an 8% return at $650 per tonne requires at least 50ha; at $450 per tonne it requires at least 150ha. At present 61% of Riverland farms are less than 10ha, and only 4% are greater than 50ha. In the Murray Valley the average farm is about 20ha.[72]

2.79 This raises the obvious possibility of amalgamating farms. According to Dr Dambergs this has already been occurring:

> Other than people who have outside income, as in my case, those sorts of [10 to 20 acre] properties will not be viable in the future. There has been a large degree of consolidation just in the last 10 years, with people buying out neighbours. People who could see what was going to happen were expanding… There is not too much of that happening now because nobody really has the resources to do it. Every industry and every business has boom and bust cycles. In the next boom cycle I am sure that a lot more of

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69 Submission 17, Australian Wine and Brandy Corporation, p. 9

70 Submission 3, South Australian Farmers' Federation, p. 7

71 Submission 29, Riverina Wine Grapes Marketing Board, p. 11

72 Primary Industries and Resources South Australia, *A report on the impact of current grape-pricing trends on the Riverland region*, April 2005, pp. 7, 28 and 41. Mr M. Stone (Murray Valley Winegrowers), *Committee Hansard,* 28 June 2005, p. 12

> the smaller places will be absorbed and consolidated as the opportunities arise.[73]

2.80 Mr Moularadellis suggested that bigger vineyards will also improve the bargaining power of growers:

> I would suggest that the retailer has significantly more power than any producer and that producers have significantly more power than any grape grower. And so the natural consequence is for producers—wine makers—to get bigger to deal with that retail power, and the natural consequence must be that growers must get bigger.[74]

2.81 Other witnesses did not agree that amalgamating farms is a practical solution:

> This region has grown up on small vineyards. It is impractical to try to imagine that we could move to a region of big vineyards because suddenly we would have to diminish our population by two-thirds.[75]

2.82 PIRSA has suggested possibilities for improving the efficiency or bargaining power of Riverland growers:

- collaborative marketing structures can improve growers' bargaining power and reduce transaction costs for wineries;
- syndication or consolidation of production from many farms under one management unit. This could include assigning management of the vineyard to an external manager, or leasing or selling vineyards into a trust or company in which the participants have shares;
- 'new generation cooperatives'. These typically replace the requirement to take all produce from all members with a combination of quality specifications and a payment-for-quality system that parallels that of the client;
- syndication of machinery; and
- consolidation of properties to take advantage of economies of scale.[76]

2.83 PIRSA estimated that from 2004 to 2015, under a 'Base Case' scenario Riverland grape production would increase by 37 per cent and wine industry employment (grape-growing and winemaking) would increase by 10 per cent. Under a 'potentially achievable' scenario, which assumes somewhat higher export growth and

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73 Dr R. Dambergs (Australian Wine Research Institute), *Committee Hansard,* Berri, 27 June 2005, p. 35

74 Mr B. Moularadellis (Riverland Winemakers Association), *Committee Hansard,* Berri, 27 June 2005, p. 32. Similarly Submission 19, Great Southern Plantations, p. 2

75 Mr C. Byrne (Riverland Winegrape Growers Association), *Committee Hansard,* Berri, 27 June 2005, p. 13

76 Primary Industries and Resources South Australia, *A report on the impact of current grape-pricing trends on the Riverland region*, April 2005, p. 48

a 'structural productivity growth' of 22 per cent over the period, grape production would increase by 113 per cent and total wine industry employment by 61 per cent.[77]

Possible structural adjustment assistance

2.84 A few submissions suggested that there should be structural adjustment assistance for winegrape growers. For example:

> It is interesting to note that millions of dollars have been spent restructuring the dairy and sugar industries…. The Sugar Industry Reform Package is worth $400 million and is prepared to fund each sugar grower $100,000 tax free to exit the industry. Wouldn't it be appropriate that the wine industry receive exceptional circumstances funding while it adjusts through this turbulent period?[78]

2.85 Mr Byrne of the Riverland Winegrape Growers Association said that 'we have to come up with a formula that will enable those who want to exit the industry to do so with some dignity rather than be squeezed out and left on the scrap heap':

> There are growers who do not have preferred varieties and do not have the means to upgrade to those preferred varieties. They have a sense of futility about their future in the industry either because of that situation or because of their age or some other circumstance. They would like in normal circumstances to move on and enable the rationalisation process to occur. Someone else, perhaps a neighbour, would buy that property thereby improving their own economy of scale and giving that person an exit opportunity.[79]

Comment

2.86 The committee agrees that there is a need for better market information and business planning advice to guide growers. Improving basic statistics would logically be the role of the bodies that already handle that: the ABS, AWBC and ABARE. Improving the business planning skills of growers would be an obvious role for a national growers' body. The national growers' body is considered further in Chapter 4.

2.87 A national register of vines appears worthwhile to improve market information and guide business decisions, if it is generally supported by growers. The committee suggests that to be practical it would have to be based on compulsory reporting by growers. To base it on voluntary information-gathering, for example by

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77 Primary Industries and Resources South Australia, *A report on the impact of current grape-pricing trends on the Riverland region*, April 2005, p. 50ff.

78 Submission 16, Mr J. Gropler, p. 1

79 Mr C. Byrne (Riverland Winegrape Growers Association), *Committee Hansard,* Berri, 27 June 2005, p. 13

the national growers' body, would be troublesome and unlikely to yield full information.

2.88 Compulsory reporting would require regulation under state law. The committee recommends that DAFF should consult peak bodies and state authorities to progress this.

Recommendation 1

2.89 The committee recommends that the Department of Agriculture, Fisheries and Forestry should consult with state authorities and peak bodies with a view to establishing a national register of vines.

2.90 The committee notes the evidence that rationalisation and amalgamation of farms has been occurring. This may be expected to continue under market forces. The committee notes PIRSA's estimate that even allowing for this, total employment in the Riverland wine industry is expected to continue growing. Presumably the same forces are at work elsewhere. The growth of the industry may be expected to cushion the effects of structural change on regional communities.

2.91 The committee is not convinced that there is a case for structural adjustment support to growers. The industry does not suffer from declining world prices to the same extent as the sugar industry. Neither is it suffering a significant one-off drop in income because of the end of price support, as was the case in the dairy industry in 2000. Prices are expected to stabilise in a few years, and long term growth is expected.

2.92 The Commonwealth's 'Exceptional Circumstances' assistance would not be applicable. Exceptional Circumstances Assistance is intended to respond to a rare, severe event such as a drought. It is not available in a case of foreseeable change or where the problem arises from a need for structural adjustment – for example, in response to a long-term downturn in commodity prices.[80]

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80 *Information Handbook - Exceptional Circumstances Assistance*, July 2005, pp. 9-10