Submission from the Department of Industry and Science

to the

Inquiry into Australia's Grape and Wine Industry

by the

Senate Rural and Regional Affairs and Transport References Committee

May 2015

Table of Contents

Executive summary

The Department of Industry and Science works to foster the sustainable growth of Australian industries, particularly manufacturing industries, which includes winemaking. The Australian winemaking industry is a major contributor to the economy of rural and regional Australia, employing over 16,000 people. There are over 2,400 wine businesses who produce around 1,200 million litres of wine from about 1.70 million tonnes of grapes and, in doing so, add around $1,600 million to the Australian economy annually. Australian wines are produced in many regional areas of Australia, particularly in the south east of the continent.

The industry currently faces a number of issues, including:

- excess production keeping prices low, adversely affecting producer margins;
- increased competition in export markets due to a high Australian dollar and emerging producers;
- increasing imports;
- concerns about the operation of the Wine Equalisation Tax (WET) and the rebate scheme; and
- domestic market dominance by two retailers.

In recent years, the coinciding of excess production with the extended period of a relatively high Australian dollar, economic recessions in key target markets the United States and the United Kingdom, plus the emergence of countries such as Chile, Argentina and South Africa as low-cost producers has made this a challenging time for Australian wine exporters.

More positively however, Australia has recently signed key free trade agreements (FTAs) with China, Japan, and South Korea. Each of these FTAs will have benefits for the Australian wine industry. Also, the value of the Australian dollar has fallen significantly over recent months effectively lowering the prices of Australian products overseas and so providing an added boost for exports.

The Australian Government offers industry support through a range of programmes, including those managed by the Department of Industry and Science, such as:

- The $188.5 million Industry Growth Centres Initiative - initially focussing on five key growth sectors, including food and agribusiness, which incorporates the winemaking industry.
- The Entrepreneurs' Infrastructure Programme – designed to drive small and medium business growth and competitiveness through support for business improvement, research connections and commercialisation of novel products.

- The R&D Tax Incentive – to encourage industry investment in research and development.

The industry appears to be making serious efforts to build on the opportunities offered by the lower Australian dollar, the various FTAs, Australia's reputation as a producer of high quality wines and the scope to further increase volumes of premium products into a number of export markets. Further success will also be achieved by the industry better positioning itself in key markets by improving its understanding of consumer preferences. Recently released statistics from the Australian Grape and Wine Authority appear to confirm some notable success in these efforts.

As much of the industry support available through the Department of Industry and Science programmes has become available only recently, it remains largely untapped. These programmes offer a number of mechanisms to the industry to support its efforts to tackle some of the issues it faces and help ensure that the recent export results referred to above will eventually become a milestone marking a positive change in the fortunes of the Australian winemaking industry.

The Department of Industry and Science

The Department of Industry and Science works to foster the sustainable growth of Australian industries, particularly manufacturing industries. Wine manufacturing is included in Class 1214 of Division C (Manufacturing) of the Australian and New Zealand Standard Industrial Classification (ANZSIC) codes, 2006[1].

The Department is committed to developing policies and delivering programs, in partnership with stakeholders, to provide lasting economic benefits designed to ensure Australia's competitive future.

The Department has policy interests in various aspects of food processing including:

- policy advisory responsibilities in relation to preferential treatment under free trade agreements (FTAs), other tariff concessions where origin may be an issue, and international rules of origin for non-preferential purposes; and
- policy advisory responsibilities in relation to food industry policy.

This submission has been developed by the Department's Food, Chemicals and Fibres Branch.

[1] ABS, Australian and New Zealand Standard Industrial Classification (ANZSCI), 2006 (Revision 1.0), Cat. No. 1292.0

Industry outline

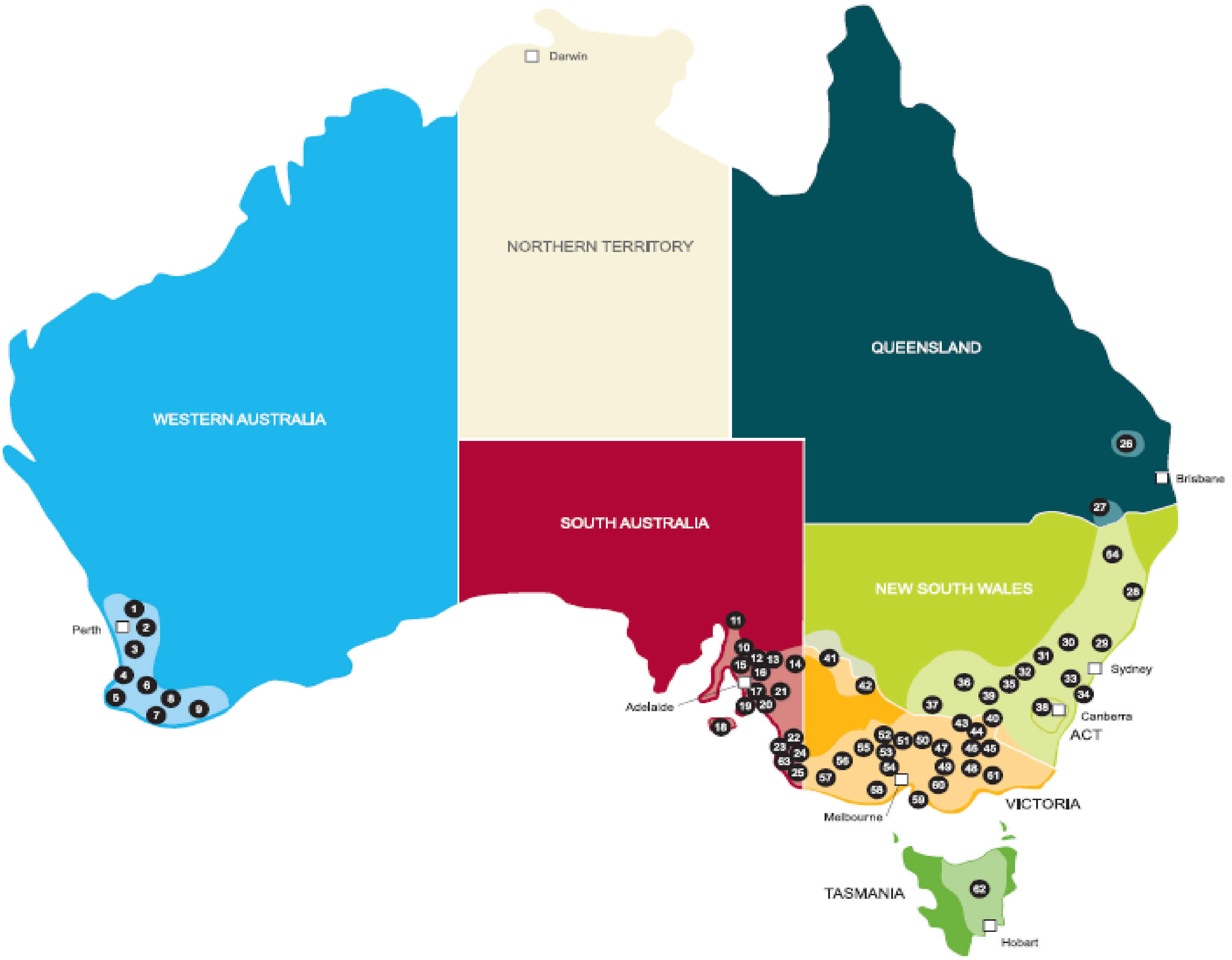
The Australian winemaking industry is a major contributor to the economy of rural and regional Australia, employing over 16,000 people.[2] According to Winebiz, there are over 2,400 wine businesses that make up the industry.[3] Manufacturing "wine and other alcoholic beverages" produced industry value added of $1,586 million in 2012-13 (slightly down from $1,626 million in 2011-12, but up on $1,285 million in 2010-11).[4]

Australia's main wine producing regions include:

- South Australia – Barossa Valley, Riverland, Clare Valley, Coonawarra, Eden Valley and Adelaide Hills regions;
- Victoria – Murray River, Yarra Valley, Mornington Peninsula, Heathcote, Western District, Rutherglen and Beechworth regions;
- New South Wales – Hunter Valley, Orange, Mudgee, Forbes, Griffith, Hilltops, South Coast, and Riverina regions, plus the Canberra district;
- Western Australia – Margaret River, Frankland, Mount Barker, Bindoon, Swan Valley regions;
- Queensland – Granite Belt, South Burnett regions; and
- Tasmania – Tamar Valley, East Coast, North coast (Pipers River) regions.

[2] IBISWorld Industry Report C1214 Wine production in Australia, April 2015
[3] http://www.winebiz.com.au/statistics/
[4] ABS, Australian Industry, 2012-13, Cat. No. 8155.0

Wine producing regions[5]



Western Australia

1 Swan District
2 Perth Hills
3 Peel
4 Geographe
5 Margaret River
6 Blackwood Valley
7 Pemberton
8 Manjimup
9 Great Southern

South Australia

10 Clare Valley
11 Southern Flinders Ranges
12 Barossa Valley
13 Eden Valley
14 Riverland
15 Adelaide Plains
16 Adelaide Hills
17 McLaren Vale
18 Kangaroo Island
19 Southern Fleurieu
20 Currency Creek
21 Langhorne Creek
22 Padthaway
23 Mount Benson
24 Wrattonbully
25 Coonawarra
63 Robe

Queensland

26 South Burnett
27 Granite Belt

New South Wales

28 Hastings River
29 Hunter
30 Mudgee
31 Orange
32 Cowra
33 Southern Highlands
34 Shoalhaven Coast
35 Hilltops
36 Riverina
37 Perricoota
38 Canberra District
39 Gundagai
40 Tumbarumba
64 New England Australia

Victoria

41 Murray Darling
42 Swan Hill
43 Rutherglen
44 Beechworth
45 Alpine Valleys
46 King Valley
47 Glenrowan
48 Upper Goulburn
49 Strathbogie Ranges
50 Goulburn Valley
51 Heathcote
52 Bendigo
53 Macedon Ranges
54 Sunbury
55 Pyrenees
56 Grampians
57 Henty
58 Geelong
59 Mornington Peninsula
60 Yarra Valley
61 Gippsland

Tasmania

62 Tasmania

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5 www.wineaustralia.com

In its *Wine Production in Australia* industry report (2015)[6], IBISWorld reported:

- The 2014 Australian grape crush to be 1.70 million tonnes, which was a 7 per cent decrease on the previous year's crush and on par with the 7-year average.
- The 2014 beverage wine production was 1,202 million litres (ML), a decrease of around 2 per cent on the previous year.
- Revenue was down from a high of $7.65 billion in 2006-07 to a forecast $5.6 billion in 2014-15. However, as the industry shows signs of recovery, revenue is forecast to increase over the next five years to reach $6.1 billion in 2019-20.

The major wine producing companies in Australia are[7]:

- Treasury Wine Estates Ltd (14.8% market share)
  - Major brands: Yarra Ridge, Wolf Blass, Lindeman's Wines, Penfolds
- Pernod Ricard Pacific Holding Pty Ltd (9.3%)
  - Major brands: Jacob's Creek, Wyndham Estate, Richmond Grove
- Accolade Wines Holdings Australia Pty Ltd (8.4%)
  - Major brands: Hardys, Echo Falls, Tintara, Houghton
- Casella Wines Pty Limited (6.8%)
  - Major brands: Yellow Tail, Yendah, Mallee Point

The Winemakers' Federation of Australia (WFA) is the peak national body for the Australian winemaking industry. The WFA's 380 members make up some 90 per cent of the industry by value[8]. Most winemaking regions also typically have their own formal or informal industry association.

The Australian Grape and Wine Authority (AGWA) commenced on 1 July 2014 as a new, single statutory authority for the grape and wine industry, replacing the former Wine Australia Corporation and the Grape and Wine Research and Development Corporation. AGWA assumed the functions of the two former bodies. AGWA is funded by grape growers and winemakers through levies and user-pays charges and the Australian Government, which provides matching funding for research and development (R&D) investments.

R&D activities are also carried out by the Australian Wine Research Institute, the National Wine and Grape Industry Centre, CSIRO, universities and state agencies.

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[6] IBISWorld Industry Report C1214 Wine production in Australia, April 2015
[7] Ibid
[8] http://www.wfa.org.au/information/noticeboard/winemakers-federation-signs-code-for-fairness-and-transparency-with-woolworths-liquor-group/

Issues facing the industry

In recent years a number of organisations have reported a range of issues affecting Australia's wine manufacturing industry leading to falling industry profitability. These issues include:

- excess production keeping prices low, adversely affecting producer margins;
- increased competition in export markets due to a high Australian dollar and emerging producers;
- increasing imports;
- concerns about the operation of the Wine Equalisation Tax (WET) and the rebate scheme; and
- domestic market dominance by two retailers.

Excess production is keeping prices low, adversely affecting producer margins

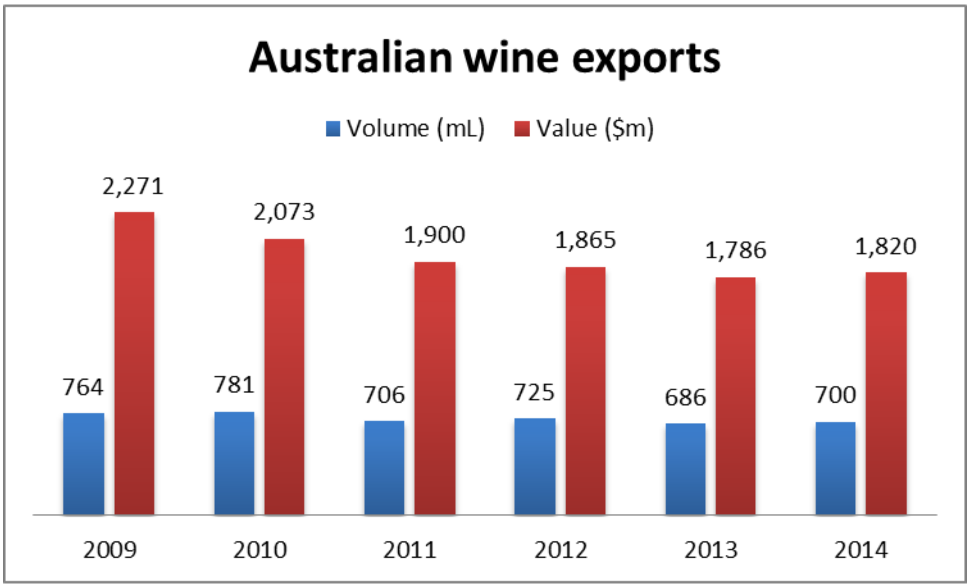
In November 2009, a joint statement issued by the WFA, Wine Grape Growers Australia, the former Australian Wine and Brandy Corporation and the then Grape and Wine Research and Development Corporation declared that Australia was then producing 20-40 million cases a year more than it was selling. Calculations using December 2014 figures from Winebiz[9] indicate a current surplus of around 5-10 million cases. This excess production is putting downward pressure on prices along the supply chain. While this is good for consumers, it is one of the factors adversely affecting the sector's profitability.

Increased competition in export markets due to a high Australian dollar and new low-cost producers

The coinciding of this production glut with the extended period of a relatively high Australian dollar, economic recessions in key target markets the USA and the UK, plus the emergence of countries such as Chile, Argentina and South Africa as low-cost producers competing in the same export markets has made this a challenging time for Australian wine exporters (see Chart 1 below).

[9] http://www.winebiz.com.au/statistics/ viewed 27 April 2015: 1202 million litres (ML) of beverage wine production in 2014 less 457.1 ML of domestic sales of Australia wine less 700 ML of exports leaves 44.9 ML unsold. 44.9 ML divided by 9 litres per case (12x750ml bottles) = 5 million cases or 4.5 litres per case (6 x 750ml bottles = 10 million cases.

Chart 1: Australia's wine exports 2009 - 2014[10]

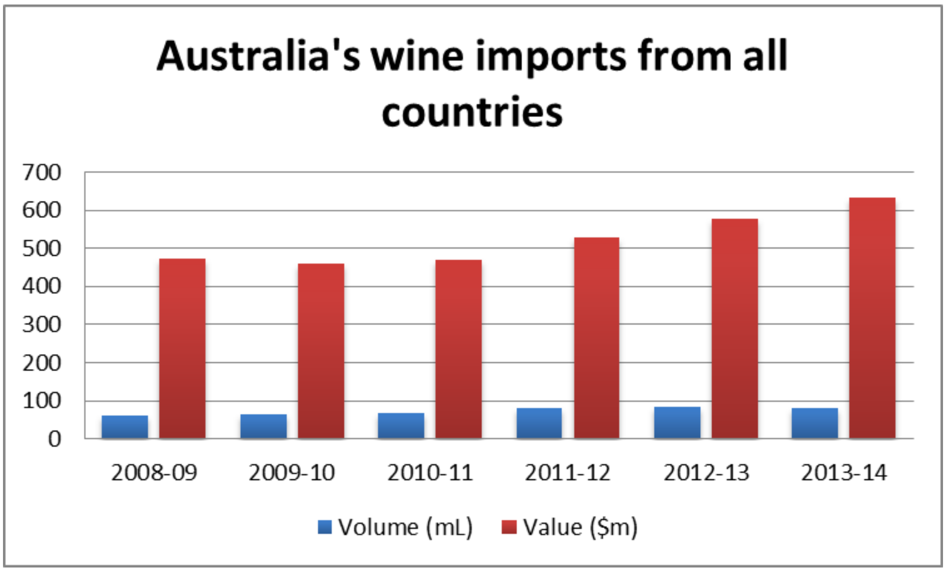


Increasing imports

Over a similar period there has been significant growth in the value of imported wines. Across the six years from 2008-09 to 2013-14, the value of imported wines from all countries has grown by $160.9 million (from $473.4 million to $634.3 million) or by 34 per cent.[11] Chart 2 below refers. A key factor here was the high Australian dollar effectively lowering the cost of imported products.

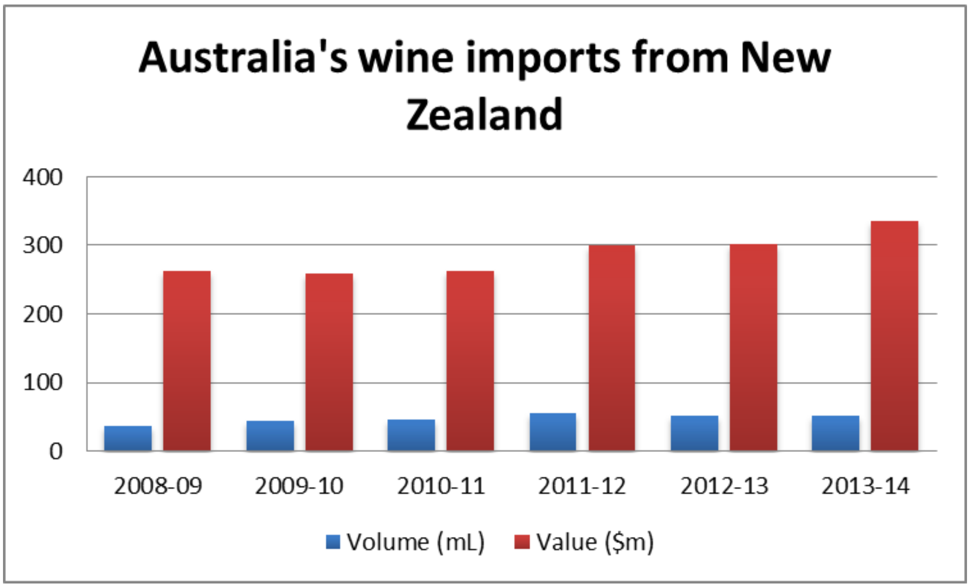
[10] http://www.winebiz.com.au/statistics/exportstable15.asp viewed 27 April 2015.
[11] ABS 8504.0 Shipments of Wine and Brandy in Australia by Australian Winemakers and Importers.

Chart 2: Australia's wine imports from all countries[12]



Almost half of this growth has come through imports from New Zealand. Over the six years from 2008-09 to 2013-14, the value of imported wines from New Zealand has grown by $73.1 million (from $261.8 million to $334.9 million) or by 28 per cent.[13] Chart 3 below refers. To place in context, Australian wines constitute 85 per cent of the Australian domestic wine market. Of the 15 per cent of wine imported, New Zealand wines constitutes 53 per cent by value and 64 per cent by volume.

Chart 3: Australia's wine imports from New Zealand[14]



[12] Ibid
[13] Ibid
[14] Ibid

Concerns about the operation of the Wine Equalisation Tax (WET) and the rebate scheme

The WET is a tax on wine sold in Australia. It is based on the value of the wine and generally applies to the last wholesale sale (usually between the wholesaler and the retailer) although it may apply in other circumstances. For wholesale/distributor sales, a WET of 29 per cent is applied to the sale price of the wine.[15]

A WET rebate scheme for Australian wine producers was introduced on 1 October 2004. The rebate entitles eligible producers to a rebate of 29 per cent of the assessable dealing, which is typically the price for which the producer sells the wine, excluding wine tax and GST. The maximum rebate that can be claimed for each financial year is $500,000 per eligible producer. Some Australian producers reportedly consider the rebates they receive under the WET as being critical to the viability of their business.

In addition to being offered to Australian wine producers, from 1 July 2005 a producer rebate has also been available to New Zealand producers, where their wine is subject to dealing in Australia on which the wine tax is paid[16] (by the Australian importer).

The WET rebate is seen by some as an impediment to necessary structural adjustment within the wine industry in the face of the current wine glut. This notion was explored in the 2009 review of Australia's taxation system by a panel lead by the (then) Secretary to the Treasury, Dr Ken Henry, which contended that:

> *…the wine producer rebate fosters small-scale production and supports some small, otherwise uneconomic wineries. The industry currently reports a widespread grape oversupply and that around half of all wine producers are currently unprofitable…Moreover, the rebate may be acting to prevent an appropriate market response to these circumstances by discouraging mergers within the industry. By supporting uneconomic wineries, the current arrangements are likely to increase the costs of inputs to other wineries that would otherwise be more successful.*[17]

In May 2015, in response to industry concerns about the WET and the rebate scheme, the Government stated that it will ask Treasury to prepare a discussion

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[15] Australia Taxation Office, https://www.ato.gov.au/business/wine-equalisation-tax/
[16] http://www.anao.gov.au/Publications/Audit-Reports/2010-2011/Administration-of-the-Wine-Equalisation-Tax/Audit-brochure
[17] Australia's future tax system, Report to the Treasurer, December 2009, pg. 438. http://taxreview.treasury.gov.au/content/downloads/final_report_part_2/AFTS_Final_Report_Part_2_Vol_2_Consolidated.pdf

paper on the operation of the WET rebate as part of the wider Tax White Paper process.[18]

Domestic market dominance by two retailers

Further compounding the challenges faced by Australian winemakers is the increased difficulty they have found in accessing the domestic market due to the dominance of the two major retailers – Woolworths and Wesfarmers. Woolworths owns the BWS and Dan Murphy's retail chains plus the Cellarmasters online outlet and the Langton's fine wine auction business. Wesfarmers owns the Liquorland, First Choice and Vintage Cellars retail chains. Claims of the size of market share vary, but according to IBISWorld, between them Woolworths and Wesfarmers have a combined share of the Australian alcohol retailing market estimated to be just under 60 per cent[19].

As in many industries where the retail market is controlled by a concentrated few businesses, producers are vulnerable to the decisions of those retailers. This is exacerbated by the fact that Woolworths and Wesfarmers now have established private brands. A 2013 wine industry report from Centaurus Partners states that "the private, exclusive and controlled labels of both major retailers are estimated to account for at least 16 per cent of domestic sales" and that "a number of winemakers interviewed noted "the retailers" are both their biggest customer and competitor and this is a major issue affecting…profitability"[20].

Costco, Metcash (Cellarbrations, IGA Liquor and Bottle-O stores), and the Aldi chain also have a significant presence in Australia's domestic retail liquor market. The emergence of Costco and Aldi provide an alternative channel to market for wine producers.

Online wine sellers – connecting directly to the consumer

In addition to traditional channels to market such as cellar door sales, direct sales, and restaurants/bars, advances in technology have increased the popularity of online wine sellers, who can source their products from a wide range of producers and sell directly to the consumer, often at a price equal to or lower than large retailers. Below are some examples of online sellers who have established a presence in the Australian wine market.

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[18] http://jaf.ministers.treasury.gov.au/media-release/022-2015/
[19] IBISWorld Industry Report C1214, Wine Production in Australia, April 2015.
[20] Expert Report on the Profitability & Dynamics of the Australian Wine Industry. Centaurus Partners, August 2013. Accessed 27 April 2015 at http://www.wfa.org.au/assets/noticeboard/Expert-Review-Report.pdf

Naked Wines Australia (*nakedwines.com.au)* is using crowd funding to raise the capital needed to fund the production, bottling and online marketing of wine. Investors, known as “Angels”, commit to paying $40 per month. In return, Angels are given access to better deals across the website, are invited to meet the winemakers, taste wines and give feedback before large-scale production begins and are able to withdraw their cash at any time. In late April 2015, there were 35,950 Angels participating in the scheme and, as an indicator of the scheme’s popularity, there were over 1850 people on a waiting list wanting to become Angels.

Another online initiative is *spokenwine.com*. This website enables consumers to purchase high quality Australian wines at cellar door prices (including free shipping if buying by the case) shipped directly from the winemaker. An important and unusual feature of this website is that it provides a facility to register your opinion of the wines offered and to gauge the opinions of other users. This feature provides a useful point of difference compared to visiting a traditional retail store.

A rapidly growing online wine retailer is Vinomofo (*vinimofo.com)*. This business uses social media to actively connect with consumers keen to find high quality wines at competitive prices. Due to its exceptionally high rate of growth, the business won the Deloitte Technology Fast 50 award for 2013.

Future growth lies with exporting

Given declining consumption of alcohol in Australia due to health, social and lifestyle factors, as well as the competitive pressures within the domestic market, the future prosperity of the Australian wine industry will come as a result of a shift in focus towards key export markets. For example, research estimates China's wine consumption will increase by 620-940 ML between 2011 and 2018.[21] The industry must take the lead in positioning itself internationally. The Government also has a role in facilitating access to new export markets, primarily through improving market access for Australian wine.

Opportunities exist in both mature and developing markets

The United States, the United Kingdom, and China continue to be the largest export markets for Australian wine. In 2012-13, Australian wine was the number one wine imported into the UK and New Zealand, second in the US, and fourth in Canada and China[22].

Chart 4: Australia's top wine export markets by value for 2012-13[23]

Whilst China is quickly developing its own wine industry in response to growing domestic demand, between 2011 and 2018, China's imports of wines are expected

[21] Asia's Evolving Role in Global Wine Markets, Kym Anderson and Glyn Wittwer, April 2015, Working Paper No. 0114, Wine Economics Research Centre, University of Adelaide.
[22] Wine Australia Annual Report 2012-13
[23] ABARES 2014 Wine Fact Sheet

to increase by between 330 and 740 ML.[24] (This compares to Australia's total wine production of 1,202 ML in 2014.[25]). Additionally, while Chinese production of wine is increasing (projected to increase by 210-290 ML by 2018), Chinese consumption of wine is expected to grow by 620-940 ML over the same period.[26]

The likely factors driving this growth in demand include China's growing middle class looking for premium "Western" products plus, as stated by Anderson and Wittwer of the University of Adelaide:

> *"…while the recent and projected rates of increase in per capita wine consumption in China are no faster than what occurred in several north western European countries in earlier decades, it is the sheer size of China's adult population of 1.1 billion – and the fact that grape wine still accounts for less than 4 per cent of Chinese alcohol consumption – that makes this import growth opportunity unprecedented."* [27]

Further, Anderson and Wittwer emphasise that this growth opportunity applies to producers of quality wines prepared to put in substantial effort:

> *"Not all segments of the industry are projected to benefit, with non-premium producers in both the Old World and the New World facing falling prices… But those exporting firms willing to invest sufficiently in building relationships with their Chinese importer/distributor – or in grape growing or winemaking as joint venturers within China – may well enjoy long-term benefits from such investments, just as others have been doing and will continue to do for so many other products besides wine."* [28]

While Chinese domestic production could be expected to grow with respect to the bulk wine segment, evidence of Australia's potential with premium bottled wine sales to China comes in figures published on 28 April 2015 by AGWA. In its *Wine Export Approval Report March 2015*, which covers the 12 months to the end of March 2015, figures from AGWA include the following: "Exports to China continued to recover, up 20 per cent to 44 ML and valued at $242 million. Bulk exports increased 77 per cent to 5 ML while bottled exports experienced record growth, up 15 per cent to 39 ML.

[24] Asia's Evolving Role in Global Wine Markets, Kym Anderson and Glyn Wittwer, April 2015, Working Paper No. 0114, Wine Economics Research Centre, University of Adelaide.
[25] IBISWORLD Industry Report C1214 Wine production in Australia, April 2015.
[26] Asia's Evolving Role in Global Wine Markets, Kym Anderson and Glyn Wittwer, April 2015, Working Paper No. 0114, Wine Economics Research Centre, University of Adelaide.
[27] Ibid
[28] Ibid

Bottled exports above $7.50 per litre increased by 12 per cent to 7 ML meaning China remains the number one destination for premium Australian wines."[29]

Improving consumer insights will better position Australian producers in export markets

To better position itself in key markets, the Australian wine industry needs to build on the work of AGWA to identify the types, styles and taste preferences of consumers. The industry is encouraged to work with Austrade and the soon-to-be-established Food and Agribusiness Industry Growth Centre to improve consumer insights around pairing Australian wines with local cuisine in the various target export markets.

For example, Top 8 Wines demonstrates the success Australian firms can achieve if they understand the taste preferences of consumers and work with the likes of Austrade to understand these market subtleties.

[29] http://static1.squarespace.com/static/53326cd5e4b0809d1a83b9bc/t/5541b894e4b006d7e513dba0/1430370452792/150428+MR+Australian+wine+exports+continue+to+rise+in+volume+and+value+-+WEAR+March+2015.pdf viewed 12 May 2015

A Case Study on Top 8 Wines and support from Austrade[30]

Top 8 Wines is the brainchild of Adelaide-based Francis Wong. Mr Wong started his company when he was unable to find small production Australian wines on sale in Asia. He was confident there was an untapped market.

"Top 8 Wines presents collections of the best Australian boutique wines," Mr Wong said. "By this I mean wines that are suited to the palates of particular Asian markets."

He said that tastes in Asia are far from being homogeneous. "Asia is huge and the different countries and different regions have distinct identities and needs. What sells in one place doesn't necessarily sell in another. So what we offer varies from market to market."

Mr Wong explained that the boutique wineries Top 8 Wines covers are rarely mass-marketed or distributed in Asia because of their small production capacities. "So we are finding a market for them which they probably wouldn't find on their own and we are providing wonderful wines which most customers would not otherwise be able to try."

He said that all the wines he carries are rigorously scrutinized by a panel of experts who not only have wine experience and expertise, but also understand Asian consumer tastes.

Mr Wong said he started selling into Malaysia first, because he considers this the most difficult market for his products in Asia. "Malaysia may not be so large in size, but it is extremely diverse. I knew that if we were successful in selling premium wines in Malaysia, then we could sell them anywhere in the region."

Mr Wong turned to Austrade in Kuala Lumpur for assistance and advice when he began to explore the Malaysian market. He said the help he was given was 'fantastic'. "I try to work with Austrade in every market, because they always have their finger on the pulse. It makes such a difference."

In China, export success will be determined by establishing the right relationships

Successful exporting is not just the province for larger players, as shown by the efforts of family owned Canberra wine producer Shaw Vineyards, which has opened its own cellar door and "wine shop" in conjunction with Suntay Wines in Haikou on

[30] http://www.austrade.gov.au/About-Austrade/News/Success-Stories/Suited-to-the-palates-of-the-Asian-market

Hainan Island (off the southern coast of mainland China). The cellar door and wine shop, both unique openings in China, exclusively feature only wines produced by Shaw Vineyard Estate. The company currently exports around 5,500 cases of wine to China each year, has plans to open two more cellar doors in China, one in Shi Jia Zhuang in Hebei province and one in Changzhi in Shanxi province, plus a new warehouse in Guangzhou in Guangdong province to supply direct to smaller wine shops and selected hotels.[31]

Another encouraging success story is that of a larger operation, Gemtree Wines, located in McLaren Vale. In October 2013, Chinese businessman Song Yuangang had become a minority shareholder in Gemtree Wines with a five year $30 million investment. This provided Gemtree Wines with access to Chinese markets through an existing extensive distribution network. The joint venture rapidly resulted in a tripling of production at the winery south of Adelaide, and more than a doubling of company turnover. By October 2013, exports had increased to 60 per cent of the company's sales, up from 5 per cent in 2011. The Gemtree Wines story demonstrates how the benefits of a joint venture with the right partner can outweigh the difficulties and costs of establishing the legal and accounting frameworks required for international joint ventures and partnerships[32].

Mature markets should not be ignored

While potential growth in mature markets such as the UK, Europe and the US may not be as exciting as that in China, these markets remain highly important to Australia's wine exports and related sales efforts should be maintained and built upon. In April 2015 AGWA reported: "The UK remains Australia's biggest export market by volume increasing by 2 per cent to 251 ML and valued at $371 million [in the year to 30 March 2015]. The UK is increasingly used as a trading hub for Australian bulk wine which is bottled in the UK and shipped to European markets including Ireland and Scandinavia, a key contributing factor in volume growth. Premium price segments however also experienced positive gains with the above $10.00 segment increasing by 46 per cent to 1.2 ML, halting a six-year decline in this segment. This growth saw the average value of bottled exports to the UK increase by 5 per cent to $4.13 per litre, the highest since 2008. Europe accounts for more than half of Australian wine exports and the latest figures show an increase of 3 per cent to 369 ML valued at $580 million. This increase was driven mostly by

[31] http://www.shawvineyards.com.au/f.ashx/shaw-vineyard-estate-launches-wine-shop-and-cellar-door-in-china-2.pdf
[32] The Australian, 13 October 2013, http://www.theaustralian.com.au/business/winery-blooms-with-chinese-equity/story-e6frg8zx-1226748533104

increases in the UK and Germany with exports to Germany up 11 per cent to 37 ML and valued at $48 million."[33]

With respect to Australia's wine exports to the US over the same period, AGWA reported: "Total Australian wine exports remained steady at 164 ML with a drop in value of 1 per cent to $421 million."[34]

US wine consumption is expected to rise 11 per cent between 2014 and 2018, reflecting a growing taste for wine amongst consumers. Given Americans on average drink less wine than their French counterparts, there is still potential for further growth in the US market.[35]

Encouragingly, there is a trend developing amongst Australian winemakers to focus their efforts increasingly on the promotion of high quality, premium wines in the US. This is evident with both large and small operations. One such example comes from Casella Wines. Casella Wines produces the very popular *Yellow Tail* wine which makes up approximately one in every two bottles of Australian wine exported to the US. In September 2014, *Business Review Weekly* (BRW) reported that Casella Wines was "preparing to launch a range of premium wines under the Casella label, rather than *Yellow Tail*, to tap rising demand in the US for more expensive wines. The new wines could retail at up to US$100 per bottle. *Yellow Tail* by comparison sells for about US$7 per bottle."

Australia is not alone in targeting growth markets

IBISWorld reported in April 2015: "Wine producing countries such as New Zealand, Argentina, Chile and, more recently, South Africa, have taken advantage of their lower costs and rising popularity to supplant Australian wines in major wine-consuming markets. Competition has also increased from producers in France, Italy and Spain, as these countries benefit from their iconic status as winemakers."[36]

While Australia stands to benefit from its FTA with China, Chile and New Zealand have been benefitting from their own FTAs with China which were signed in 2006 and 2008 respectively. As a result, China's tariffs for New Zealand reached zero in 2012 and by 2016 will phase down to zero for Chile.

[33] AGWA media release 28 April 2015
[34] Ibid
[35] http://www.bloomberg.com/news/articles/2015-01-26/u-s-demand-seen-driving-world-wine-market-growth-deglise-says and http://www.reuters.com/article/2014/05/13/us-wine-usa-france-idUSKBN0DT0YO20140513
[36] IBISWorld Industry Report C1214 Wine production in Australia, April 2015

China's imports of Chilean wine reportedly rose 37 per cent by volume in 2013 and by nearly 50 per cent in the first nine months of 2014.[37]

New Zealand's wine exports to China are reported to have also grown rapidly. In 2007, New Zealand shipped around 0.27 ML to China and by 2013 that figure had increased to about 1.93 ML – a more than seven-fold increase.[38]

South African wineries have reportedly increased their sales to China by 63 per cent over the previous year to now be supplying around 3 per cent of China's wine imports.[39] The same article described Chinese interest in South African wines as follows:

> *"Thousands of Chinese tourists are now visiting South Africa's wine lands every year, and Chinese translations have been added to the signboards at several wine estates here. One producer brings hundreds of Chinese wine salespeople on annual promotional vacations to South Africa, where they even spend a day harvesting and sorting grapes as an educational immersion in the industry."*

To compete, Australia must promote itself

There is some evidence to suggest that the Australian wine industry spends less on marketing and promotion than its competitors. In response, the industry has called on the Government to redirect some of the revenue raised by the WET into export marketing activities. Before seeking additional funding from Government, the industry could consider changes to the existing system of wine industry levies (paid by the industry, including the Wine Export Charge) to increase the amount of marketing funding available, in line with similar levies in other industries (e.g. meat and dairy).

The Wine Export Charge funds AGWA to undertake international promotional work aimed at creating a sustainable increase in the demand for Australian wine. The Wine Export Charge is payable by licensed exporters of wine produced in and exported from Australia and is payable quarterly or annually, depending on various circumstances. It is administered by the Department of Agriculture.

There are also Government export assistance programs which can help Australian wineries to establish themselves in foreign markets, namely Export Market Development Grants (EMDG), administered by Austrade, as well as assistance

[37] www.decanterchina.com/en/?article=990
[38] Ibid
[39] http://www.theglobeandmail.com/report-on-business/international-business/south-african-wineries-target-chinese-markets-new-taste-for-wine/article23598119/

offered by the Export Finance and Insurance Corporation (EFIC), which is a part of the Department of Foreign Affairs and Trade (DFAT).

The EMDG scheme provides incentives to small and medium Australian enterprises to develop export markets through reimbursement of up to 50 per cent of expenses incurred on eligible export promotion over $15 000. In a recent (March 2015) submission to a review of the EMDG scheme, the WFA noted that *the Australian wine industry has long been a major user of the EMDG scheme, averaging around 250 recipients each year.* [40]

EFIC can provide financial support to SME exporters, or SMEs involved in an export related supply chain, in the form of loans, guarantees and bonds to support specific export contracts. A number of Australian wineries have taken advantage of the support available through EFIC, including Cassegrain Wines. Cassegrain is a winemaking company based in Port Macquarie, NSW, which is growing its exports to Japan and China in response to high demand. EFIC provided Cassegrain with a $500,000 Export Contract Loan to enable the company to deliver on its growing export contracts in Japan and China by investing in its manufacturing capacity. An Export Contract Loan is a direct loan available to SME exporters to provide working capital finance for a specific export-related contract.[41]

The Government is improving market access for Australian wine

Australia is a party to a number of international trade agreements. Some of these agreements are specific to international trading of wine while others are the more widely known free trade agreements applying to most goods and services.

Wine-specific trade agreements

Australia is currently a party to two wine-specific trade agreements which significantly simplify many regulatory requirements of a number of export markets:

The Australia-European Community Agreement on Trade in Wine

This agreement, which commenced on 1 September 2010, guarantees and improves access for Australian wine producers to the European market. There are significant advantages to Australian producers and exporters in this agreement because new Australian wine making techniques are now accepted. There are much simpler requirements covering everything from labelling requirements and blending rules, to alcohol levels and the display of Australian awards. Australian wine producers will have to make fewer changes and concessions to sell their wine in the European Union.

[40] http://www.wfa.org.au/assets/submissions/Submission-to-the-Review-of-the-EMDG-Scheme-March-2015.pdf
[41] http://www.efic.gov.au/news-events/case-studies/manufacturing/cassegrain-wines/

The Agreement on Mutual Acceptance of Oenological Practices, also known as the MAA

Parties to the MAA are Argentina, Australia, Canada, Chile, New Zealand and the US. Under the MAA, countries will accept wine imported from other member countries, regardless of whether the production methods used in the other country are legal in the importing country. This is qualified only by the provision that acceptance of the other country's production methods is subject to health and safety considerations, recognising that oenological practices vary between countries for a variety of climatic and other reasons. All oenological practices for wines exported from Australia under the MAA must meet the Australia-New Zealand Joint Food Standards Code.

Recently signed Free Trade Agreements benefit Australian winemakers

Australia has recently signed key free trade agreements (FTAs) with China, Japan, and South Korea. Each of these FTAs will have benefits for the Australian wine industry.

The China-Australia Free Trade Agreement

Under the China-Australia Free Trade Agreement (CHAFTA), Chinese tariffs on imports of Australian wine will be reduced to zero within four years of the agreement entering into force. Currently the tariff on Australian wine exports to China is 14 per cent for bottled and 20 per cent for bulk wine meaning the economic benefits to the wine sector as a result of this agreement will be significant. The tariff removal will allow Australia to be more competitive in this market, particularly with Chile and New Zealand who have reduced or zero tariffs already in place as a result of their own FTAs with China. China's wine import market is growing dramatically, more than doubling in size since 2009-10 to be worth over $1.6 billion in 2013-14. Australia's wine exports to China totalled $201 million in 2013-14[42].

The Japan-Australia Economic Partnership Agreement

Australia's wine exports to Japan were worth an estimated $41 million in 2013-14. However Australian wine currently faces a disadvantage against Chilean wine as Chile secured tariff elimination over 12 years under its Economic Partnership Agreement (EPA) with Japan, which entered into force in September 2007. Australian wine exports to Japan previously faced a tariff of 15 per cent, or for some products, fixed tariffs of up to 182 yen per litre. This situation is changing as a result

[42] Department of Foreign Affairs and Trade, China-Australia Free Trade Agreement Fact Sheet 2015

of the Japan-Australia Economic Partnership Agreement (JAEPA; signed on 8 July 2014) with outcomes following entry into force on 15 January 2015[43] including:

- tariffs on Australian bottled and sparkling wine being eliminated over seven years;
- tariffs on bulk wine being eliminated immediately for wine in containers over 150 litres, and eliminated over ten years for containers between two and 150 litres; and
- tariffs on fortified wine, cider, perry and mead being eliminated over five years[44].

The Korea-Australia Free Trade Agreement

The Korea-Australia Free Trade Agreement (KAFTA), signed in April 2014, provides opportunities for Australian wine exporters to enhance their competitiveness in the South Korean market. Australia's wine trade with South Korea is significant, with over $7 million worth of wine exported to South Korea in 2013-14; however exports to South Korea in 2012 were 30 per cent lower than in 2007. Prior to the KAFTA coming into force Australian wine exports to South Korea faced a 15 per cent tariff. But as of entry into force on 12 December 2014[45], Australian wine can now enter South Korea duty free.[46]

The development of these three FTAs provides a welcome opportunity to help Australia's winemakers build their export sales in these markets. It is imperative that the industry seizes this opportunity without delay, as competitor countries chasing these same export markets may secure their own FTAs with the respective countries (if they have not already done so). Promptly using the time available now to establish and grow Australian brands in these markets can help secure Australian export sales there further into the future.

Organic certifiers reach global market access agreement – Australian winemakers benefit

Until recently, exports to China labelled organic but not certified so by Chinese regulators in China could not be sold there as organic. However, in 2014 the National Association for Sustainable Agriculture Australia (NASAA) secured approval from Chinese regulators for its certification arm, NASAA Certified Organic, to inspect organic operations in Australia and thus allow certified organic exports to China.

[43] Prime Minister of Australia, The Hon Tony Abbott MP, Joint Statement on the entry into force of the agreement between Japan and Australia for an economic partnership, www.pm.gov.au/media/2015-01-15/joint-statement-entry-force-agreement-between-japan-and-australia-economic
[44] Department of Foreign Affairs and Trade, Japan-Australia Economic Partnership Agreement Key Outcomes, 2015
[45] http://dfat.gov.au/trade/agreements/kafta/Pages/korea-australia-fta.aspx
[46] Department of Foreign Affairs and Trade, Korea-Australia Free Trade Agreement Key Outcomes, 2015

NASAA estimates that this deal could add between $60 million to $100 million per year to the Australian organic sector[47].

One Australian winery taking advantage of this new agreement is Temple Bruer winery. In 2004, Temple Bruer began exporting its wine (certified organic to Australian standards) to China, but then stopped after the Chinese law changed and Chinese certification became a requirement. However, after recently gaining Chinese certification through NASAA, Temple Bruer can once again export its organic certified wine to China. Temple Bruer has stated the Chinese market is vital to the company and having China as an export partner again could be worth more than $760,000 and boost the winery's export market by as much as 25 per cent.[48]

[47] http://www.nasaa.com.au/data/media/NASAA_CHC%20announcement_March2014_FINAL.pdf
[48] http://www.abc.net.au/news/2014-12-15/organic-wine-china-temple-bruer/5959836

Australian Government support through the Department of Industry and Science

The Australian Government offers industry support through a range of programmes managed by the Department of Industry and Science. Details on those programmes are set out below.

Industry Growth Centres

The $188.5 million Industry Growth Centres Initiative is the centrepiece of the Australian Government's Industry Innovation and Competitiveness Agenda and will initially focus on five key growth sectors, including food and agribusiness, which incorporates the winemaking industry. The initiative is a sector based approach to drive growth, productivity and competitiveness by investing in key growth sectors. Targeted investment in these sectors will get the best economic returns and outcomes in a tight fiscal environment. Similar models are already successfully operating in other developed countries such as the US, UK and Canada.

Industry Growth Centres will be established to deliver the Initiative in five high growth sectors. These are:

- Advanced Manufacturing;
- Food and Agribusiness;
- Medical Technologies and Pharmaceuticals;
- Mining Equipment, Technology and Services; and
- Oil, Gas and Energy Resources

Industry Growth Centres will be established as not-for-profit companies, led by eminent industry experienced Chairs. Chairs will use their expertise to work with business, researchers and governments on practical ways to grow these sectors, boost productivity and create jobs.

Once established, a strategic industry-led Board will be responsible for operation of the Growth Centre and the development and implementation of practical activities to lift the productivity and competitiveness of each sector.

Growth Centres will set a long-term strategy for their sector through Sector Competitiveness Plans. These plans and future activities of the Growth Centres will focus on:

- Identifying regulations that are unnecessary or over-burdensome and impede the sectors ability to grow, and suggest possible reforms;

- Improving engagement between research and industry, and within industry, to achieve stronger coordination and collaboration of research and stronger commercialisation outcomes;
- Improving capability to engage with international markets and access global supply chains; and
- Improving management and workforce skills.

The industry-led Growth Centres will work across each sector, linking businesses and research organisations, to deliver activities and collaborations that boost industry competitiveness and productivity. The Growth Centres Initiative is flexible in its delivery to help ensure that the Food and Agribusiness sector implements solutions to the impediments to success.

The Food and Agribusiness Growth Centre may:

- Assist food manufacturers to work with packaging companies and researchers to consider packaging solutions to extend the shelf life of products, especially into regional export markets where the lack of refrigeration is a problem;
- Work with industry and governments to develop point of sale promotional material for Australian food;
- Help coordinate national inbound missions of senior buyers, representing Tier 1 supermarkets and distributors from key Asian markets;
- Strengthen industry and researcher innovation in pre- and post-farm gate activities which include the transformation of raw materials or ingredients into food or beverages, or supply integral services, technologies or inputs for food or beverage production;
- Accelerate information dissemination and facilitate teaming and collaboration;
- Develop cost effective programmes targeted at SMEs; and
- Develop sectoral strategies and pooled resources to raise industry capability.

Further information on the Industry Growth Centres Initiative can be found at http://www.business.gov.au/advice-and-support/IndustryGrowthCentres/Pages/default.aspx or by phoning 13 28 46.

Further information on the Food and Agribusiness Growth Centre is available at http://fial.com.au/.

The Entrepreneurs' Infrastructure Programme

The Entrepreneurs' Infrastructure Programme is the Australian Government's flagship initiative for improving business competitiveness and productivity at the firm level. The programme will drive small and medium business growth and competitiveness through support for business improvement, research connections and commercialisation of novel products, processes and services in the five targeted growth sectors (as listed above under Industry Growth Centres) and the enabling technologies and services that support these sectors.

The Entrepreneurs' Infrastructure Programme uses experienced facilitators and advisers, drawn from industry, to ensure businesses get the advice and support they need to improve their competiveness and productivity. The primary focus is on providing access to the best advice and networks to solve business problems, rather than focusing on financial assistance. Practical support for businesses includes: advice from people with relevant private sector experience; co-funded grants to commercialise new products, processes and services; funding to take advantage of growth opportunities, and connection and collaboration opportunities.

Further information can be found at: http://www.business.gov.au/advice-and-support/EIP/Pages/default.aspx or by phoning 13 28 46.

The R&D Tax Incentive

The R&D Tax Incentive is the Australian Government's principal measure to encourage industry investment in research and development (R&D). It is a broad based, market driven programme that is accessible to all industry sectors with the key goal of encouraging Australian businesses to conduct R&D that would otherwise not be conducted in the absence of government support, by helping to offset some of the costs to business of undertaking R&D activities.

The R&D Tax Incentive offers a refundable tax offset of 45 per cent for businesses with turnover of less than $20 million per year and a non-refundable tax offset of 40 per cent for larger businesses. The refundable tax offset means that eligible small and medium-sized enterprises can receive a cash refund if they are in tax loss.

In the 2012-13 income year there were 29 winemaking companies that registered $29 million of R&D expenditure under the R&D Tax Incentive.

Further information is available at: http://www.business.gov.au/grants-and-assistance/innovation-rd/RD-TaxIncentive/Pages/default.aspx or by phoning 13 28 46.

A Case Study on the R&D Tax Incentive and Bremerton Wines

Craig Willson, the founder of South Australia's Bremerton Wines, is a firm believer in staying open to new ideas. It is a philosophy that is reflected in all aspects of the family business – from developing new ways of combating fungal disease to experimenting with different types of oak barrels.

"We are great believers in giving things a go," he explains. "It is part and parcel of how we approach life. If you do not innovate and improve you will get left behind. It is important to be at the forefront by investing in new equipment and research and development."

In 1985 Mr Willson and his wife Mignonne purchased a lucerne farm at Langhorne Creek, 70km southeast of Adelaide. A flood in 1992 – which wiped out their crop – was a catalyst for making their dream of establishing a vineyard a reality. Now they grow 290 acres of grapes and run a thriving winery, cellar door and restaurant.

The business employs 14 full-time and five part-time or casual staff and is now managed by Mr Willson's daughters – Rebecca and Lucy, who were the first sister team to run a winery in Australia. The business produces around 40,000 cases of wine a year, and exports a third of all production to Switzerland, Germany, Brazil, China, the United Kingdom and other markets.

Research and development takes place in the vineyards and in winemaking, and is supported by the Australian Government's R&D Tax Incentive. For example, the company systematically tests oak barrels sourced from various countries to assess the impact on the malbec grape variety, which is a specialty of the region.

"Each year we spend about $200,000 on oak barrels – about a third of which are used in experimental trials undertaken by Rebecca, our winemaker," Mr Willson said.

"We examine the impact of different oak sources from as far as France, the United States, Russia and Hungary. This process requires a lot of testing and monitoring of results. It is both expensive and time consuming but it is important if we are to produce high quality wine. After fastidious testing we have discovered that, for us, the malbec grape is most suited to Hungarian oak."

Other areas of R&D include developing methods to combat the damaging fungal disease eutypa. Bremerton Wines will also invest approximately $500,000 over four years to explore the merits of replacing existing outdated and worn equipment with an innovative underground irrigation and soil moisture monitoring system.

Concluding remarks

The Department is aware of a considerable amount of anecdotal evidence, particularly over the last year or so, of a concerted effort by Australian winemakers, both large and small, to focus export marketing activities more tightly on promoting premium wines in major overseas markets. This aims to capitalise on the opportunities offered by the various trade agreements as explained above and the recent turnaround in the value of the Australian dollar to its current level of around 78 US cents[49]. Other recent anecdotal evidence also indicates both consumers and wine industry stakeholders in a wide range of overseas markets hold a positive disposition towards Australian wines.

In what could be the first factual evidence of some success in the above efforts, AGWA has recently (28 April 2015) released its *Wine Export Approval Report March 2015*, which details some encouraging statistics covering the 12 months to the end of March 2015, including the following[50]:

- There has been a rise of 3.6 per cent in volume and 3.9 per cent in value of wine exports.
- Australian wine was exported to 123 destinations by 1,385 exporters with the majority (890 exporters) recording volume growth.
- The average value of all wine exports (bottled and bulk) remained steady at $2.60 per litre.
- Growth at higher price points drove the increase in the average value of bottled wine exports up 4.7 per cent to $4.87 per litre, the highest it's been in a decade.
- While the over $7.50 price segment accounts for just 5 per cent of total export volume, the value share is considerably higher at 27 per cent.
- More than half of exports in the over $7.50 per litre segment were shipped to Asian markets (up 13 per cent) with the average value of exports to Asia $18.77 per litre.
- The UK remains Australia's biggest export market by volume increasing by 2 per cent to 251 ML and valued at $371 million.
- Europe accounts for more than half of Australian wine exports and the latest figures show an increase of 3 per cent to 369 ML valued at $580 million.
- Australian wine exports to the US remained steady at 164 ML with a drop in value of 1 per cent to $421 million.

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[49] http://www.rba.gov.au/statistics/frequency/exchange-rates.html viewed 26 May 2015

[50] http://static1.squarespace.com/static/53326cd5e4b0809d1a83b9bc/t/5541b894e4b006d7e513dba0/1430370452792/150428+MR+Australian+wine+exports+continue+to+rise+in+volume+and+value+-+WEAR+March+2015.pdf viewed 12 May 2015

- Exports to China continued to recover, up 20 per cent to 44 ML and valued at $242 million. Bulk exports increased 77 per cent to 5 ML while bottled exports experienced record growth, up 15 per cent to 39 ML. Bottled exports above $7.50 per litre increased by 12 per cent to 7 ML meaning China remains the number one destination for premium Australian wines.
- Exports to Japan grew by 20 per cent to a record 11 ML in what could be evidence that exporters are benefitting from the JAEPA.

The industry appears to be making serious efforts to build on the opportunities offered by the lower Australian dollar, the various trade agreements, Australia's reputation as a producer of high quality wines and the scope to further increase volumes of premium products into a number of export markets, particularly China. As much of the industry support available through the Department of Industry and Science programmes has become available only recently, it remains largely untapped. These programmes offer a number of mechanisms to the industry to support its efforts to tackle some of the issues it faces and help ensure that the recent export results listed above will eventually become a milestone marking a positive change in the fortunes of the Australian winemaking industry.