

Chapter 1

Background

Conduct of the inquiry

1.1 The Senate referred the inquiry on 16 March 2005. The terms of reference are:
The operation of the wine-making industry, with particular reference to the supply and purchase of grapes.

1.2 The committee proposed the inquiry after it became aware of the problems created by the current low price of winegrapes. The committee decided to focus on the following points:

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

1.3 The committee advertised the inquiry in *The Australian* and invited submissions from peak bodies. The committee received 30 submissions (see Appendix 1) and held four public hearings (see Appendix 2). Submissions included 435 form letters from growers in the Riverina and Murray Valley regions, of which 115 attached additional comments. A sample of these comments is at Appendix 4. The committee thanks submitters and witnesses for their contribution. Submissions and transcripts of the committee's hearings are available on the parliament's internet site at www.aph.gov.au.

Structure of the report

1.4 Chapter 1 gives an overview of the present problem.

1.5 Chapter 2 discusses issues to do with the supply and demand for grapes, and possibilities for reducing the effect of peaks and troughs in the market cycle.

1.6 Chapter 3 considers issues to do with the apparent poor business relations between growers and some winemakers.

1.7 Chapter 4 discusses possibilities for improving relations between growers and winemakers, including a code of conduct for the winegrape trade and a national winegrape growers' body.

Overview

1.8 Australia's wine industry has expanded enormously in the last ten years, driven by strong growth in exports. Since 1994-5 production has almost trebled, while exports have increased five-fold. Average grape prices increased from a low of \$493 per tonne in 1993 to peak at \$1049 per tonne in 1999.¹

1.9 In 1996 the Winemakers' Federation of Australia (WFA) released *Strategy 2025*, a statement of the goals of the industry over the next 30 years. *Strategy 2025* expressed the hope that from 1996 to 2025 grape production would increase from 850,000 tonnes to 1,650,000 tonnes, and exports would increase from 125 million litres per year to 600 million litres per year. This would require average annual planting of 1,500 hectares.²

1.10 The industry expanded much more quickly than expected. Plantings increased rapidly to peak at 16,224 hectares in 1998. In 2000, *The Marketing Decade*, an industry publication, warned that 'as a result of this rapid expansion, from the 2001 vintage onwards Australia is expected to enter a period where the grape supply shortfall of the last decade has been reversed.'³ Commentator Kym Anderson said:

[*Strategy 2025*] was developed with nothing more in mind than providing a 30-year vision for the future so as to stimulate a steady flow of investment. At the time those targets were considered by many observers as rather optimistic, since they involved a three-fold increase in the real value of wine production, 55 per cent of it for the export market... So convincing was that document (helped by the provision of tax incentives to high-income investors in the form of accelerated depreciation of vineyard construction costs), and so intense has been the subsequent investment that the industry has virtually reached that half-way point towards its 30-year target - that is, in just five vintages!⁴

1.11 The 30 year targets have been reached in 10 years. As the new plantings of the late 1990s have come on stream in the early 2000s, grape prices have fallen, wine production has increased faster than sales and the stock to sales ratio has increased. Wine prices have fallen in response, as foreshadowed in *The Marketing Decade*:

1 Winemakers' Federation of Australia, additional information 22 September 2005. Derived from Australian Wine and Brandy Corporation National Utilisation Project. Figures in 2004 dollars.

2 Winemakers' Federation of Australia, *Strategy 2025*, s6, 7

3 Winemakers' Federation of Australia and Australian Wine and Brandy Corporation, *The Marketing Decade - setting the Australian wine marketing agenda 2000-2010*, 2000, p. 24

4 K. Anderson, 'The Anatomy of Australia's Wine Boom: Lessons for Other Industries', *Agribusiness Review*, Vol. 8, 2000

There is a strong likelihood of oversupply if the industry were to try and sell, at current prices and quality, all of the additional wine expected to be available in the next five years. However lower wine prices provide access to a larger share of the international market and therefore a higher probability of selling all the wine. In this sense, price adjustments usually clear the market and resolve the oversupply.⁵

1.12 Average grape prices have fallen to \$755 per tonne according to the Winemakers' Federation; or, according to ABARE, to \$600 per tonne (white) and \$419 (red) in the warm climate regions. This is similar to the low point of 1993. Prices are expected to continue to fall for several years.⁶

1.13 The focus of the inquiry is the problems this has created for the viability of grape growers. As well, the report discusses the complaints growers make about their business relations with winemakers. These are underlying issues to do with the balance of bargaining power, which have become more urgent because of the current low prices.

Other issues for the future of the wine industry

1.14 The committee notes some other issues which may affect the long term economics of grape growing and/or winemaking:

- the long term decline in Australia's terms of trade in agriculture, and competition from other 'New World' countries; implying the need for continuing productivity growth;
- rising fuel costs, which may affect both the costs of production and consumer confidence;
- environmental management of irrigated agriculture and possible effect of water reform (most grapes are irrigated);
- effect of alcohol and wine tax policy on production and consumption of wine;
- effect of capital gains and negative gearing tax concession on property values and the opportunities for investors versus smallholders;
- effect of proposed workplace relations law changes, including requiring small businesses to incorporate;
- changes to the ownership and nature of the retail sector; and
- consolidation and concentration of ownership of winemakers.

5 Winemakers' Federation of Australia and Australian Wine and Brandy Corporation, *The Marketing Decade - setting the Australian wine marketing agenda 2000-2010*, 2000, p. 26

6 Winemakers' Federation of Australia, additional information 22 September 2005 based on Australian Wine and Brandy Corporation figures. ABARE, *Australian Commodities*, March 2005, p. 54. ABARE, additional information, 9 September 2005, which updates the figures in *Australian Commodities*.

1.15 The committee notes that these matters have had, and will continue to have, a significant impact on the future of the industry, although they are not specifically discussed in this report.

A note on defining ‘over-supply’

1.16 The Winemakers’ Federation of Australia (WFA) rejected the notion that there is a winegrape ‘glut’. Rather, the WFA believes that there is ‘a cyclical imbalance at present, particularly of some red grape varieties. There is also a structural imbalance of some varieties in some regions.’⁷

1.17 Some submissions implied that ‘over-supply’ is a concept invented by wineries to justify low prices, and is rebutted by the fact that in the end most grapes do sell. For example:

Comments by wineries that the production is in oversupply and beyond the actual capacity of their facilities have proved false when in this region (apart from the 2002 vintage) all wine grapes have been purchased.⁸

If we are in oversupply, why wasn’t product left on the vine? I think a lot of wineries purchased that product because it was dead cheap on the premise that they could sell it down the track and they could store it.⁹

1.18 The Australian Wine and Brandy Corporation (AWBC) estimated that in 2005 about 2% of grapes were not sold. This may be compared with an estimated 3-4% in 2002.¹⁰

1.19 This reflects the nature of the market. In an efficient market where many buyers meet many sellers, the market will clear at the market clearing price. If sellers hold out for more, it is because they choose, if necessary, to keep unsold stock in the hope of getting a better price another day. With a perishable item like winegrapes that is impossible; hence the market will tend to clear at a price that is low enough. This contrasts with the position of winemakers, who have more flexibility to hold stock to cope with a temporary surplus of supply.

1.20 The AWBC suggested that unsold grapes are a sign of oversupply.¹¹ In evidence most references to ‘oversupply’ seemed to mean, more broadly: supply is such that the market-clearing price is below what the speaker regards as fair, or below what is needed for growers to break even. Conversely, in talk about restoring

7 Submission 4, Winemakers’ Federation of Australia, p. 2

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

9 Mr M. De Palma (Murray Valley Winegrowers), *Committee Hansard*, 28 June 2005, p. 19

10 Submission 17, Australian Wine and Brandy Corporation, p. 4. The Winemakers’ Federation of Australia estimated 3% in a June 2002, note: *Observations on the Winegrape Supply Situation*.

11 Submission 17, Australian Wine and Brandy Corporation, p. 4

‘balance’ in the market, ‘balance’ implicitly means: a balance of supply and demand which creates a price which allows a viable income to all concerned.

1.21 Whether on a narrower definition (unsold grapes indicates oversupply), or on a broader definition (struggling growers indicates oversupply), the committee accepts that there is currently a problem of oversupply.

