

## INQUIRY INTO WINE GRAPE MARKET AND PRICES

**Organisation:** Industry and Investment NSW  
NSW Government

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## Industry & Investment NSW

### Submission to the Standing Committee on State Development Inquiry into the Wine Grape Market and Prices

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#### 1. Government Involvement in the Wine Grape Market

The wine grape industry has a long history of government involvement in NSW, particularly in the Riverina, which has primarily related to the objective of providing countervailing power to the large number of small wine grape growers.

In this context, the Wine Grapes Marketing Board (the Board) was established in 1933 to represent the interests of growers within the City of Griffith and the Shires of Leeton, Carrathool and Murrumbidgee. From 1933 to 1976 the Board operated informally in negotiated arrangements with MIA winemakers, with price agreements being on a "hand shake" basis.

During the mid 1970s, significant demand changes were reflected in price slumps for the main red varieties which comprised the more significant plantings in the MIA and other irrigated regions at that time. It was in this climate that in 1976 vesting power (taking ownership of the crop) was granted to the Board for those wine grape varieties then under its control. In 1978, this power was extended to all wine grapes produced in the MIA.

Vesting enabled the Board to set prices for different varieties and grades of wine grape. It also empowered the Board to enforce terms and conditions of payment, as outstanding payments were effectively a debt to the Board.

The Competition Principles Agreement between states, territories and the Commonwealth, endorsed in 1995, required the review of the Wine Grapes Marketing Board in 1996 and again in 2001, with the result that vesting was removed and the Board was reconstituted under its present statute, the *Agricultural Industry Services Act 1998*.

An important feature of these changes was a move toward a regulatory framework that supported the development of marketing arrangements suited to the needs of individuals, rather than applying a 'one size fits all' approach. The Board therefore retained powers in relation to the terms and conditions of payment for non-contracted grape deliveries which provides a form of 'safety net' for those growers not wanting to develop their own arrangements. For those growers considering entering into individual supply contracts, the Board was provided with certain functions designed to facilitate this transition. Subsequent minor reviews of these transitional marketing powers resulted in some of them being extended until 2012.

The history of the Board can also be viewed in the context of the changes to trade practices law as an alternative means of providing countervailing power to growers. When the Board was first established in 1933, trade practices legislation was minimal. The earliest Commonwealth trade practices legislation was the *Australian Industries Preservation Act 1906*.

Commonwealth trade practices legislation initiatives were commenced in 1960. The *Trade Practices Act 1965* became effective on 1 September 1967 and was repealed by the *Restrictive Trade Practices Act 1971*, which was itself repealed by the present *Trade Practices Act 1974*. This last act fundamentally changed the nature of trade practices protection by changing the onus of proof with regard to restrictive practices. Such practices are now unlawful unless authorised by the Australian Competition and Consumer Commission, whereas previously they were lawful unless successfully challenged by the Trade Practices Commission.

Price intervention by government often results in unsustainable supply increases and unsold commodities (such as the wool stockpile of the late 1990s). Consequently, contemporary methods for regulating prices focus on penalising unconscionable behaviour rather than differences in market or bargaining power and provide those with lesser negotiating power with the ability to collectively bargain. The *Trade Practices Act 1974* therefore contains various collective bargaining and code of conduct provisions to facilitate more efficient price outcomes.

It can be observed that regulatory reform of the Riverina wine grape market lagged the strengthening of trade practices legislation that otherwise applies to grower-processor relations.

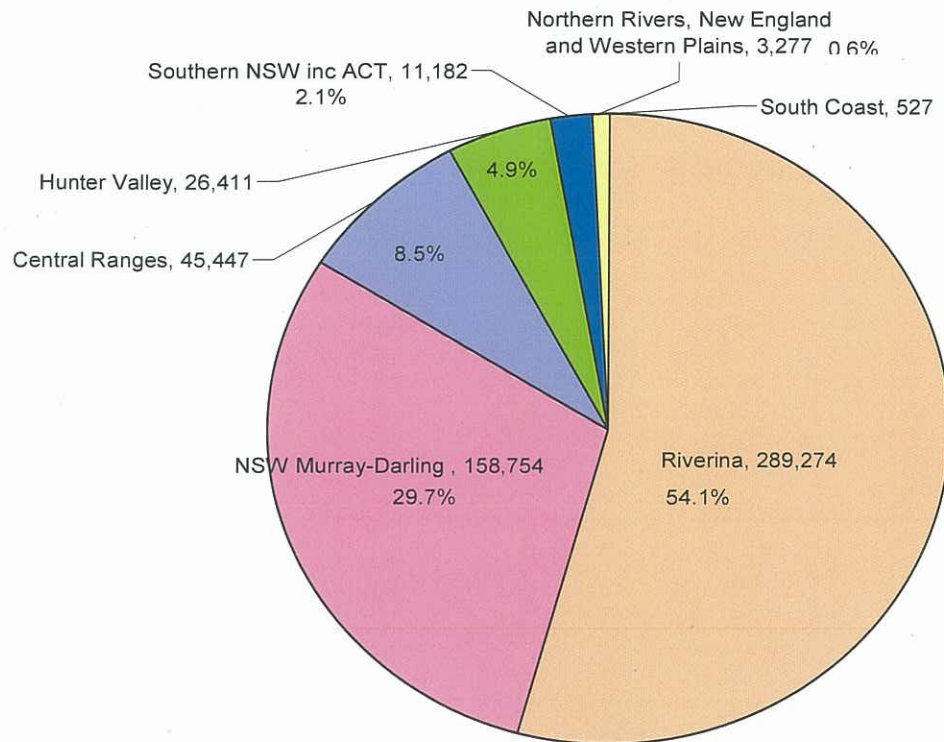
## **2. ToR (a): Price Formation**

Like all markets exposed to competition between multiple buyers and sellers, supply and demand for wine grapes greatly influences the average clearing price and price trends through time, although price spreads may be influenced by other factors, such as quality differentials.

The Riverina dominates the volume of wine grapes produced in NSW (Figure 1) and is the most commodity orientated wine grape region (grower interests in the product cease at the point of sale to wineries). This latter characteristic may be a legacy of the Board's historic commodity focus.



Figure 1: Production of major NSW wine grape growing regions (tonnes)



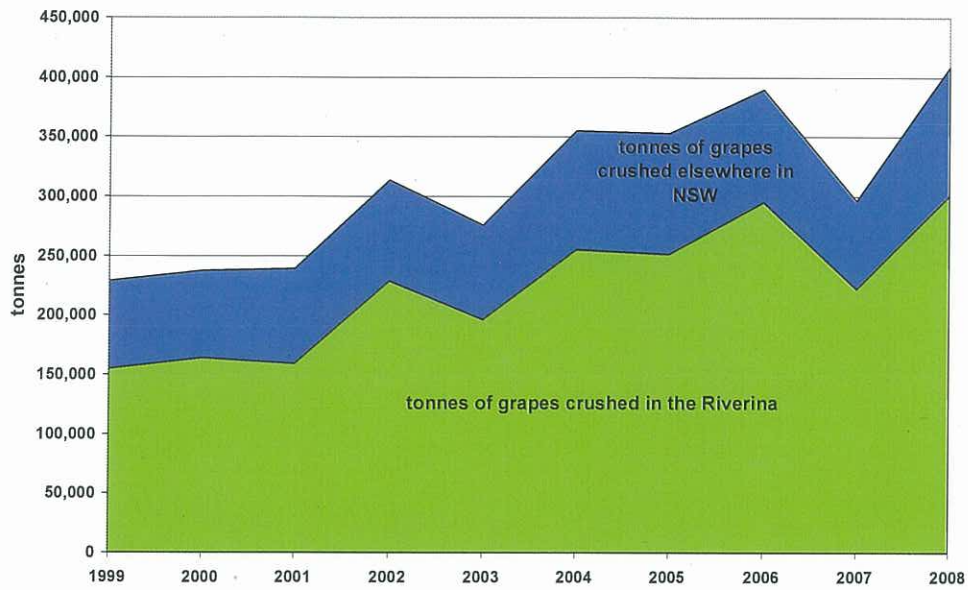
Sources:

NSW Wine Industry Association (2010) Wine Grape Pricing Utilisation Survey, New South Wales, Griffith.  
ABS (2010) 1329.0 Australian Wine and Grape Industry, Canberra, 2009.

### Supply

There are over 450 wine grape growers in the Riverina and all are constituents of the Wine Grapes Marketing Board (a Services Committee constituted under the *Agricultural Industry Services Act 1998*). The vast majority grow grapes for sale to wineries with very few having their own grapes processed for sale into their own wine, as is common in the Hunter and upland wine regions of NSW. Consequently, growers rely directly on the prices paid by wineries for their farm income, and these prices have been falling over the last ten years in the face of a doubling of supply over the same period (Figure 2).

**Figure 2: Grape crush in the Riverina and rest of NSW**

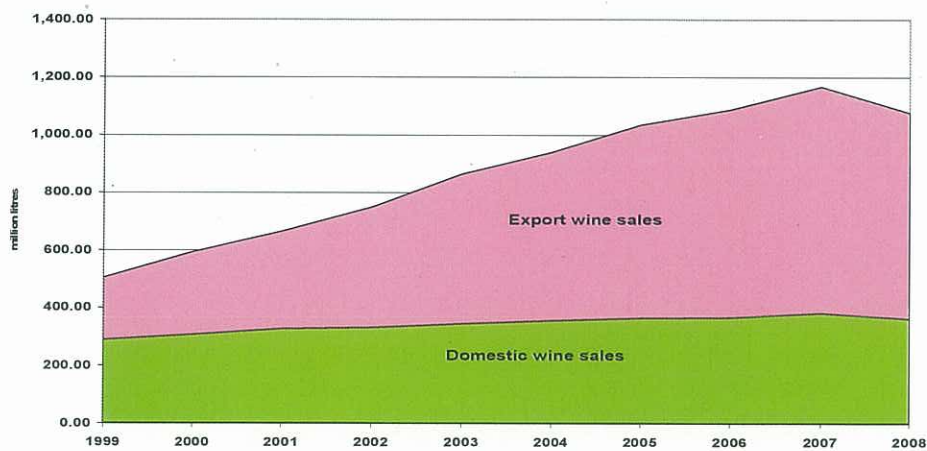


Sources:  
 NSW Wine Industry Association (1999-2009) Wine Grape Pricing Utilisation Survey, New South Wales, Griffith.  
 ABS (2010) 1329.0 Australian Wine and Grape Industry, Canberra.

### Demand

Domestic and export sales of wine increased steadily over the first half of the decade, but sales volumes have now levelled off on the domestic and export markets and winery stocks have increased (Figure 3).

**Figure 3: National wine sales**



Source:  
 ABS (2010) 1329.0 Australian Wine and Grape Industry, Canberra.

Both domestic and export sales volumes peaked in 2007 and have since stabilised. While export volumes have steadied, the value of export sales has decreased with the rising value of the \$AUD and with increasing competition in the main UK and US markets from wines of other New World producers.

### Prices

The recent trends of rising supply and steady demand have had the expected effect on prices offered by Riverina wineries. 65 percent of the red grapes crushed in the Riverina are Cabernet Sauvignon and Shiraz and 65 percent of the white grapes are Chardonnay and Semillon. The average nominal price paid for these varieties is now around half the price that was paid in 1999.

Table 1: Average nominal prices for main red and white varieties in the Riverina

	<b>Cabernet Sauvignon</b>	<b>Shiraz</b>	<b>Semillon</b>	<b>Chardonnay</b>
<b>1999</b>	\$989	\$877	\$377	\$686
<b>2000</b>	\$670	\$506	\$338	\$565
<b>2001</b>	\$558	\$593	\$371	\$649
<b>2002</b>	\$440	\$504	\$395	\$761
<b>2003</b>	\$449	\$466	\$388	\$865
<b>2004</b>	\$425	\$457	\$416	\$882
<b>2005</b>	\$402	\$439	\$411	\$653
<b>2006</b>	\$384	\$386	\$351	\$425
<b>2007</b>	\$449	\$424	\$338	\$416
<b>2008</b>	\$561	\$562	\$436	\$482
<b>2009</b>	\$366	\$396	\$297	\$344
<b>2010</b>	\$318	\$360	\$224	\$301

Prices offered at the start of the decade encouraged growers to extend vineyards and encouraged citrus growers to convert orchards to vines, particularly in the Riverina. The export success of many of the Riverina's winemakers seems likely to have encouraged supply by local growers, but as supply exceeded demand, winemakers necessarily became more discerning with regard to quality and priced accordingly.

With increased wine grape supply, intra-varietal price differentials based on quality attributes have widened with the lowest prices offered for each variety having decreased substantially over the last ten years (Table 2). This is understandable given not only the increased wine grape availability, but also that recent plantings are likely to be of varieties more consistent with current consumer tastes and preferences, giving rise to a dynamic and evolving supply-side to the Riverina wine grape market and one where growers need to be closely monitoring varietal trends and returns.



Table 2: Lowest prices offered for the main red and white varieties in the Riverina, 1999-2010 (\$ per tonne)

	<b>Cab Sav lowest</b>	<b>Shiraz lowest</b>	<b>Semillon lowest</b>	<b>Chardonnay lowest</b>
<b>1999</b>	\$740	\$600	\$160	\$650
<b>2004</b>	\$250	\$220	\$300	\$350
<b>2009</b>	\$195	\$187	\$151	\$155
<b>2010</b>	\$174	\$177	\$178	\$139

Given the nature of the Riverina wine grape market, and with \$200 per tonne considered to be the minimum return needed to cover harvest costs (mechanical picking), some growers have, and will, find it cost effective to leave grapes on the vine rather than incur harvest expenses. It is in this business environment that growers are attempting to negotiate prices with wineries.

### **3. ToR (b): Role of the Wine Grapes Marketing Board**

The agricultural industry services for which the Board is constituted are listed in clause 9 of the Agricultural Industry Services Regulation 2009. The first three are:

- (a) the development of a code of conduct for contract negotiations between wine grape growers and wineries,
- (b) the development of draft contract provisions with respect to the sale of MIA wine grapes to wineries, including provisions with respect to:
  - (i) the prices to be paid by wineries, and
  - (ii) the terms and conditions of payment to be observed by wineries, in relation to MIA wine grapes delivered to them by wine grape growers,
- (c) the promotion of private contracts for the sale of MIA wine grapes to wineries by wine grape growers,

The Code. To facilitate change to marketing arrangements suited to the needs of individual growers, the above-mentioned functions are designed to be highly complimentary. For example, the development of a code of conduct for contract negotiations between wine grape growers and wineries is in recognition of growers, having historically relied on the Board to undertake their grape marketing, potentially needing initial assistance in approaching the task of negotiating with wineries. Such a code would therefore include provisions which give guidance in relation to the process and timing of negotiations, grower representation and dispute resolution procedures.

The Contract. Also in recognition of many growers having historically relied on the Board to undertake their grape marketing, the development of draft contract provisions, or a template contract, for consideration by growers prior



to entering negotiations (as agreed in the voluntary code), was considered to be another appropriate function of the Board in facilitating the transition of growers to a less regulated marketing environment.

Importantly, these tasks assigned to the Board are seen as a necessary step in establishing those marketing arrangements which will ultimately offer the best opportunity for a profitable and sustainable wine grape industry. With the arrangements (marketing provisions only) due to expire on 1 January 2012, an important challenge facing the Board is to implement the proposed code and contract template as far as possible.

#### **4. ToR (c): Collective Bargaining and Codes of Conduct Uptake of the Voluntary Code in the Riverina**

Instead of progressing the development of its own regional code and contract provisions, the Board has sought to achieve this by way of adoption of the voluntary Australian Wine Industry Code of Conduct which was launched in December 2008 after being developed by Wine Grape Growers Australia (WGGGA) and the Winemakers' Federation of Australia (WFA). The Code aims to establish a common Australian wine grape supply contract framework and to provide a dispute resolution system to manage disagreements which exist over price or quality assessments. Wine grape purchasers have been invited to become signatories to the Code.

The Code was recently reviewed by Neill Buck & Associates Pty Ltd with the June 2010 final report finding that with only six winemakers signed up to the Code, it could not be considered successful. The review found, however, that the Code had not been well publicised and that there were a number of drafting and administrative shortcomings that needed to be addressed.

The Board's task of facilitating the adoption of the national voluntary code of conduct has been made difficult by a wine grape market characterised by ample supplies. The Board has also claimed that grower uptake of contracts has been weak because growers would be reluctant to challenge their winery buyers for fear of retribution in the form of cancellation of future contracts. This is a common claim and one that was repeatedly made to the Buck Review although the Review was unable to verify these claims.

The wine grape sector is presently pursuing the option of making the National Code mandatory under the Commonwealth *Trade Practices Act 1974*, in the same way as the Horticultural Code of Conduct is now mandatory for fresh fruit and vegetables transactions. While this is an option, if growers fear retribution, they may not exercise their rights under a mandatory code either.

#### **Collective bargaining**

As preciously described, collective bargaining is considered to be an efficient means of providing 'countervailing power' to producers. It is available to groups of producers, through the 'authorisation' process of the *Trade Practices Act 1974*, which is presently used by dairy farmers and chicken meat contract growers, among others, for the negotiation of prices and quality



parameters and could be a viable option for small wine grape growers dealing with a single winery.

It is worth noting that the Buck Review of the Australian Wine Industry Code of Conduct stated:

*I was also surprised at the lack of use by wine growers of the collective negotiation provisions under the Trade Practices Act. These provisions have been used in many industries across Australia and there are examples of how they can work in this industry.*

## **5. ToR (d): Other Measures**

Markets can sometimes fail if participants have poor information about market prices and alternative market opportunities. This problem can result in grower supply decisions becoming out of step with changes in consumer demand and hence growers being confronted with low price offerings. It is for these reasons that the “collection and dissemination of market and industry information” is another of the Board’s functions.

The wine industry presently conducts thorough and accurate reporting of prices paid for each variety in each wine growing area of Australia, and these are published between vintages. For instance, the *2010 Winegrape Purchases: Price Dispersion Report* was published at the beginning of July 2010 and is available to all wine makers and growers.

When the *Wine Grapes Marketing Board (Reconstitution) Act 2003* was passed by Parliament as a transition measure towards full deregulation, a number of provisions were included with the aim of increasing the flow of market information to growers to assist them in ‘shopping around’ for the best buyer for their grapes. These provisions included a requirement for wineries to lodge a price schedule with the Board by a given date and a requirement for advance notice to be given before any price reductions can take effect. These requirements were intended as a transitional measure to facilitate grower-winery price negotiations while the market developed new price formation systems. It was anticipated that growers would be willing to use the published prices to “shop around” for the best spot sale price for their grapes.

However, these provisions were removed following a review in 2007 in which a joint submission from the Board and the MIA Winemakers’ Association argued that these restrictions had resulted in wineries providing published price schedules with conservatively low prices, which set a lower base price than would otherwise be the case.

## **6. Other Related Matters**

Much of the recent intra-variety price variation can be explained by quality differentials. Even where variable prices have been paid for grapes of the same quality, feasible explanations include inter-winery differences in the level of stock on hand, or different marketing opportunities. Intra-winery price differentials could also be explained by a greater willingness to support preferred growers to maintain the growers’ viability and, consequently, ensure

a minimum level of future supply of preferred varieties and qualities to the winery.

Growers who deliver grapes on the spot market without any form of price assurance are likely to be disappointed with the eventual outcome in the current market circumstances, however, spot market sales should also be viewed as a normal component of most markets. In times of buoyant supply-side market conditions, some growers may prefer to shop around for the best price, rather than be tied to a particular contract arrangement.

Finally, in relation to the option of returning to regulated prices, not only would such an option be in breach of the NSW Government's National Reform Agenda commitments, it would also harm the industry. For example, if the price for wine grapes were artificially raised above the market-clearing price, Riverina wineries would likely source significant quantities of grapes from other growing areas, resulting in Riverina growers being able to sell lesser quantities of grapes than currently (noting that they would not legally be able to accept a price lower than the regulated price).

## **7. Conclusion**

The present difficulties being experienced in the wine grape market appear to be primarily related to high levels of grape production in the face of steady wine demand. In this environment, a proportion of growers will necessarily face difficulties in selling to wineries and the Board has a crucial role to play in assisting growers make efficient and effective production and marketing decisions.

The Board's information provision role, and its grower service functions relating to the implementation of a code of conduct for contract negotiations and a contract template, are considered important to growers decision making processes and promoting profitable and sustainable industry adjustment.