

**Submission
No 42**

INQUIRY INTO WINE GRAPE MARKET AND PRICES

Organisation: Wine Grape Growers Australia

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NSW Legislative Council
Standing Committee on State Development
Inquiry into the wine grape market and prices

Submission from Wine Grape Growers Australia

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Recommendations to the Legislative Council Standing Committee:

- Determine that evidence should be collected on the drivers of stickiness of Coastal-Temperate oversupply and appropriate measures be taken, based on this evidence, to address this stickiness.
- Monitor the wine industry's efforts to implement a voluntary Code that is widely adopted but to be prepared to consider a mandatory Code in the event that adoption levels among winemakers remains low for a protracted period of time.
- Legislate for the basic requirements of contractual standards; written contracts, stated price or price determining method and terms of payment.
- Facilitate viable economic regional communities by promoting and resourcing knowledge and skill development among winegrape growers.
- Support a NSW levy of grape growers to boost both local and national resources that can be employed to improve products and services to winegrape growers and to build grower business capacity for better outcomes in the Australian wine sector.

1. Introduction

This submission will discuss three of the inquiry's Terms of Reference –

- a. Price formation, including factors affecting supply and demand.
- c. The potential for collective bargaining and/or codes of conduct to contribute to an efficient market.
- d. Whether there are any measures which could improve market signals.

These Terms of Reference will not be discussed separately but rather, because of their interaction and overlap, their discussion will be blended in the following passages.

This submission will focus on policy and programs at the national level. As a WGGA submission, the content will necessarily bring a national perspective to the issues discussed. Regional winegrape grower organizations are more acquainted with the practice of commercial behaviour, individual winegrape grower experience and local initiatives. These more localised matters will be left to submissions from regional winegrape growing organizations.

Underlying the following comments is the reality that current poor price outcomes in the Australian wine sector are at core, a reflection of supply and demand imbalance. There are nevertheless aspects of ethical commercial behaviour that is driven by factors other than supply and demand.

In regard to supply and demand balances, there is an argument that 'market forces will sort it' and it is true that they will, but in the interplay between market forces and the public policy that governs social expectations of behaviour, there are several factors that mean market forces are not the only perspective that should be brought to bear in dealing with the current situation. These include –

- market failure in price determination,
- the argument that the market may not reflect social expectations and that social policy should set the environment in which the market find solutions that reflect these expectations, and
- whether, according to social expectations, the market can achieve goals in a satisfactory timeframe.

In each of these dimensions, government has a role and for this reason, the Standing Committee's Inquiry is welcomed.

2. System level influences on price formation and responses to improve market signals and to create efficient markets

2.1. Supply and demand adjustment

The primary driver of currently unsustainable winegrape prices is oversupply. An important part of the solution is therefore to bring supply and demand back into balance. To achieve balance there needs to be supply contraction and/or demand expansion. Addressing both dimensions is required, neither of them by itself, will be sufficient. In terms of sequencing, supply contraction is more achievable and necessary in the short-term than demand expansion. The latter takes longer to develop and it can be argued that it does not have the potential to take up the current oversupply in a reasonable timeframe.

The wine sector, in a collaborative activity between all the national organizations, has confronted the issue of oversupply through what is called the Wine Restructure Action Agenda (WRAA). This program

has had many facets including clear communications to the regions on the extent and magnitude of the oversupply problem. The industry is informed.

Whether it is through this activity or through more general market influences, there are early signs of adjustment. There is some debate about the magnitude of the adjustment but agreement on two issues of concern.

- The adjustment is slow.
- The adjustment is disproportionately evident in the warm inland (WI) districts.¹

If the latter is the case, the adjustment is inappropriate and indicates market failure. This market failure threatens the viability of warm inland production and at the same time, the profitability of the production outside the warm inland (mostly Coastal-Temperate (CT) by far), and thereby the sustainability of the industry, even after adjustment has occurred. The rationale for this assertion follows.

There is a difference in the magnitude and character of oversupply in the WI and CT districts. It seems apparent to most, that CT oversupply is greater than WI. Nevertheless, there is a disproportionate pressure on WI production to exit the industry because of apparent 'barriers to exit' for the oversupplied CT production. The quality of CT production means it is desirable and at depressed prices, even more so. CT fruit is taken in preference to lesser-quality WI fruit, thereby pushing the latter out of the market. However, at the low prices that CT production sells into traditional WI wine products, in order for these wines to meet the required price points in the market, means that some (most?) of it is sold at less than cost.

Thus the scenario is that the industry may contract as it needs to do, but legitimate production in the WI districts may be displaced by unprofitable production from CT districts. This situation is not satisfactory for either of these two districts or for the industry as a whole.

While considerable speculation exists about the causes of the barriers to exit of CT production, the magnitude and relative influence of each cause is not confidently known. Moreover, the mix of causes is likely to differ between regions.

A number of root causes can be speculated upon to explain the lack of adjustment occurring in CT supply.

- Off-farm income.
- The belief that things will get better and the need to simply survive until they do.
- Lack of knowledge of business fundamentals or ability to re-adjust these.
- Lack of alternative enterprises.
- Demand initiatives will fix it (China?).
- The WET rebate.
- The 'lifestyle' factor, hobby farmers – willing to pay the cost sub-performance as a payment for lifestyle.

¹ SA Riverland, NSW Riverina and Victorian and NSW Murray Valley

- Each-way betters – mothballing or minimum maintenance on a wait-and-see-how-it-goes basis.
- “Yes there’s a problem, but it’s not me its someone else (my neighbour, irrigators, the Corporates, MIS’s ...)”
- The prohibitive costs of removing vines as a barrier to exit.
- Inability to recoup existing debt by selling up.
- Demographic reasons – near retirement, no debt, operating-cost players, don’t want to lose retirement fund, can survive until it gets better.
- The timing of price signals – they come too late on a seasonal basis, a commitment has been made to a crop.
- Lack of exit mechanisms in non-irrigated districts equivalent to water buyback in irrigated districts.
- Water buy-back options provide insufficient incentives.
- The full extent of the pain hasn’t yet been felt in CT districts because the full extent of contract roll-off hasn't yet occurred.

With such a wide range of possible causes of CT stickiness it is more than likely the causes in any one region will be multiple. It is also likely each region will have a different mix of causes. The solutions to each individual cause will be different and may fall on any of government, industry or individual enterprises to take action.

The most salient point from this analysis is that the most effective solutions cannot be engaged if the causes are not understood and on a regional basis.

Recommendation to the Legislative Council Standing Committee:

Determine that evidence should be collected on the drivers of stickiness of Coastal-Temperate oversupply and appropriate measures be taken, based on this evidence, to address this stickiness.

2.2. Regulating commercial behaviour

While supply and demand balances set the scene for poor social outcomes it does not mandate unethical commercial behaviour (although it does create greater opportunity for it). What appears to be uncaring or even unethical commercial behaviour is more often than not, rational economic behaviour, neither ethical nor unethical. Nevertheless, unethical behaviour does occur and despite the fact that the opportunity for it is greater in times of oversupply, the causes are not supply and demand and need to be dealt with through regulation.

It is notable that current market forces disadvantage growers because the prevailing oversupply. Nevertheless, supply and demand imbalances are cyclic - what is unfavourable in one part of the cycle is likely to be favourable in another. Providing a regulatory framework therefore favours both parties in the buying and selling process.

A major failing in the current operating conditions is that the burden of risk in the financial arrangements between growers and producers falls on the grower. This is expressed in the evolution of things like

zero-minimum contracts or potentially worse, exposure to the spot market at a time when opportunistic buying is taking advantage of extremely low and undeniably unsustainable prices. Playing the spot market is nevertheless a business decision any grower can choose – times in the cycle when this pays off can be played off against those when they don't. However, when contracts do not portray minimum reasonable specifications, the distinction between contracted purchases and spot purchases becomes blurred. There needs to be a clear distinction between the two so that clear business decisions can be made between them.

Assistance to make the distinction clear, to be discussed here, takes two forms: systemic assistance in the form of a Code of Conduct and assistance to individuals in the form of capacity development in individual contract negotiation and dispute resolution.

2.2.1. Code of Conduct

A voluntary Code of Conduct has been negotiated cooperatively between the Winemakers Federation of Australia and Wine Grape Growers Australia following a recommendation by the 2005 Senate Rural and Regional Affairs and Transport References Committee. A review of the Code's operation by an experienced reviewer of both private and public regulatory arrangements, Mr Neill Buck, was commissioned by the Wine Industry Code of Conduct Administration Committee and a report became available on 30 June 2010.

Changes have been recommended by the Reviewer and are being discussed by the industry at this time. The Review reported that the Code is not yet widely adopted within the industry. Only 6 winemaking companies have signed up to the Code (four majors and two small companies). In the Reviewer's opinion, the current form of the Code is unlikely to be successful. Nevertheless, in the Reviewer's experience, there is a formative stage in the development of such Codes and recognition that it takes time for them to be adopted. Moreover, changes have been suggested to both improve the Code and to directly encourage adoption.

WGGA's position is that it will continue to support the Code's development and adoption but that measurable improvement in adoption by winemakers is required to sustain continued support. A significant proportion of very limited resources available to WGGA are being expended on the Code's development and administration and successful adoption in the near future will be required for this expenditure to continue to be warranted.

While hopeful of successful adoption of the Code, WGGA is concerned about the characteristics of its implementation that seem to indicate barriers to adoption. In its current form, the Code of Conduct is neither a Code of ethical behaviour (meaning a guide that does not create legal obligations) nor a prescriptive code of contract specifications. This lack of clear identity, results from, or leads to, a set of conditions that militate against its successful adoption.

Some of these conditions can be described as follows.

- Unethical winemakers, for whom the Code is intended, are not likely to become signatories, while ethical winemakers who will become signatories, don't need to.

- By signing, ethical winemakers place themselves at a financial disadvantage to unethical players in the marketplace, thereby advancing the cause of less desirable elements of the industry.
- If a signatory winemaker contravenes the Code, thereby demonstrating that they do not agree with the Code, the worst that can happen is that they will be removed as a signatory to the Code.
- The greater the amount of prescription in a voluntary Code, the less acceptable it is to unethical winemakers – the less prescriptive it is, the more acceptable it is. That is, to be acceptable to the targeted unethical winemakers, the Code will inevitably say little.
- The most fundamental tenets of ethical commercial behaviour are to act in a ‘fair and reasonable’ manner and ‘without prejudice’ in dispute resolution – yet inclusion of these terms in the wine industry’s Code continues to be debated – even after implementation.
- Despite the failure of most winemakers to sign up to the Code of Conduct, there is widespread agreement that winemakers will insist that grapegrowers sign up (at cost) to EntWine certification before their fruit can be contracted.
- While the Winemakers Federation of Australia endorses the Code of Conduct most of its members do not sign on.

The case for persisting with the development of the Code is the understanding that the development of Codes of codes takes time. Moreover, once developed and entrenched as an industry institution, the experience of some industry codes demonstrates that Code Committees can become constructive fora for discussing adversarial issues like prices (Mr John Dickie, inaugural Chair of the Film Exhibitors and Distributors Code of Conduct, personal communication). In such circumstances, these adversarial discussions are quarantined from other fora in which the issues are in common between the parties. The higher purpose served here is that adversarial issues do not taint the goodwill that should exist in for a where common interests are discussed.

The case against a voluntary Code of Conduct is the wine industry’s experience of low adoption levels despite the goodwill that exists to achieve adoption, and the existence of so many issues that put barriers in the way of adoption.

Recommendation to the Legislative Council Standing Committee:

Monitor the wine industry’s efforts to implement a voluntary Code that is widely adopted but to be prepared to consider a mandatory Code in the event that adoption levels among winemakers remains low for a protracted period of time.

2.2.2. Legislation

Recognising that in order to pass the tests of contractual law and that Codes do not unreasonably constrain fair and reasonable commercial practice, it is in the nature of mandatory Codes of Conduct that they naturally gravitate to the barest fundamentals of good commercial behaviour. For grape growers, these may be stated as

- A written contract,
- The statement of a price or a clear method of the method for determining the price when revealed,
- Terms of payment that are consistent with the industry standard of
 - A third at the end of the month following the month of delivery,
 - A third at the end of June,
 - A third at the end of September of the year that the first payment commenced.

In the event that a mandatory code is considered but rejected, it is possible to legislate for basic requirements that a mandatory code it likely to specify. Thus, for example, NSW is encouraged by WGGGA to enact of terms of payment legislation. A model for this legislation exists in the form of the South Australia Wine Grapes Industry Act 1991.

Recommendation to the Legislative Council Standing Committee:

Legislate for the basic requirements of contractual standards; written contracts, stated price or price determining method and terms of payment.

3. Contributing to an efficient market and price determination through action at the enterprise level

3.1. Build grower capacity in contract negotiation and dispute resolution

Commercial contracts are private arrangements between individuals and within limits, a grower can choose to forego any specifications set out in a voluntary Code. There several factors that may result in agreeing to a contract that contravenes a Code -

- ignorance,
- lack of market power, or
- because a benefit exists that cannot be anticipated in a Code.

In the case of lack of market power, regulation is required and the case has already been made for several forms this may take.

For the remaining reasons, ignorance and benefits that are not anticipated in a Code, grower capacity to conduct contract negotiations and dispute resolution is key.

In order for this to happen, key capabilities for each grower are –

- to know their market,
- to know their business,
- to know their bottom line,
- to know the attributes of the fruit they sell,
- to be able to promote the value of their offer,

- to know what they want in a contract,
- to be able to negotiate their desired outcome in a contract.

Within a regulated environment that specifies minimum standards, these capabilities make for a powerful combination that would enhance the operation of the market. More knowledgeable and capable growers will better understand the market and be capable of negotiating mutual benefit with a producer to meet market requirements, making the enterprise of both more efficient.

To this end, WGGGA has developed and promotes VineBiz, a business development program and financial ready reckoner. This tool enables the grower to assess their vineyard's current financial performance and to evaluate a range of operational scenarios for decision making about the future.

Recommendation to the Legislative Council Standing Committee:

Facilitate viable economic regional communities by promoting and resourcing knowledge and skill development among winegrape growers.

4. WGGGA activities that support supply and demand balance, more favourable price formation and improved market signals.

4.1. The WGGGA Strategic Plan

Four of the six key strategies adopted by WGGGA have a direct bearing on the issues of interest to this Inquiry. They are –

- Policy development and Advocacy

WGGGA recognizes that relationships and collaboration with the other industry organizations is vital to successful outcomes in policy development and advocacy. The other wine sector organizations also acknowledge and support the need for a strong winegrape grower voice at the national level.

- Management of critical grower issues (10 identified).

Of the 10 critical grower issues identified for management, five have a direct bearing on price formation and effective price signals.

- Supply and demand balance,
- Knowledge and capacity development,
- Code of Conduct,
- National Vineyard Database,
- Tax.
- Communication
- Cultivate relationships

WGGA therefore has a strong investment in the matters being considered by the Legislative Council's Standing Committee Inquiry. However, WGGA does not have a substantial foundation to promote and implement its ideas.

Since establishment in 2005, and staffing with an Executive Director, Chair and Executive Committee in 2006, WGGA is yet to achieve a broad national membership. The membership does not have a franchise across warm inland and coastal temperate production, across the states of Australia or across independent and winemaker grape growing. The mainstay of its membership, and funding, is based in South Australia through a voluntary levy on independent grape growers, administered on the behalf of the state's winegrape growing community by the South Australia government. Under these arrangements, the Wine Grape Council of South Australia is funded and half of the levy collected is paid as affiliation fees to Wine Grape Growers Australia. Significant affiliation fees and project-based funding are then received from the Murray Valley Winegrowers and NSW Wine Grapes Marketing Board respectively. Beyond this, minor funding is received from a smattering of affiliated regional bodies and individual growers who have taken out full membership.

The sum result is that WGGA attempts to provide a national winegrape grower voice and products and services on a budget that is around 2% to 6% the size of the other national wine sector organizations. Moreover, an unequal franchise across the nation's winegrape growing community affects both the quantum of funding available as well as the stability of the membership. The latter is destabilised by inequitable funding arrangements between regional and state groupings.

The unstable nature of WGGA membership and funding, places a burden on the organization's resources to bed down these matters. This effort distracts the organization and its modest resources from the programs, projects and services it seeks to provide its constituency.

Recommendation to the Legislative Council Standing Committee:

Support a NSW levy of grape growers to boost both local and national resources that can be employed to improve products and services to winegrape growers and to build grower business capacity for better outcomes in the Australian wine sector.

5. A review of the 2005 Senate Rural and Regional Affairs and Transport References Committee report

The Commonwealth of Australia's Rural and Regional Affairs and Transport References Committee in the Senate reported in October 2005 on the operation of the wine-making industry. The focus of that inquiry was on the problems created at a time when the symptoms of oversupply had begun to emerge. The report states that the focus of the "inquiry (was) the problems this situation ... created for the viability grape growers" and in addition, "the complaints growers make about their business relations with winemakers"

Sadly, the NSW Standing Committee on State Development Inquiry is motivated by similar concerns meaning that five years later, the difficulties continue. In one sense, this fact establishes a *prima facie* case that market failure is at play - a claim made in this submission. At the very least, wine grape growers continue to suffer poor business relations and economic circumstances and action is required to address the issues.

WGGA is aware that some of the issues and recommendations in the Senate Inquiry have been advanced, some have not and others may have gone backwards. To close this current submission, it is worth a stock take of the key findings in the Senate report, to provide some commentary on the current status of the issues and to relate this to the recommendations made by WGGA to the NSW Legislative Standing Committee.

5.1. Key findings and recommendations of the 2005 Senate report and responses

5.1.1. "Grapegrowing suffers the boom-bust cycle more than many agricultural industries because of the long lead time before vines come into production"

WGGA response:

Grapegrowers continue to be highly exposed to risk and the point is made in this submission that the whole-of-value-chain risk is being disproportionately born by grapegrowers. Even under desirable circumstances, 5-year contracts are the most likely optimal term available, given rational decision-making by all parties involved, yet even then, grapegrowers can reach break even in this time and then be left with a dead asset if the contract does not continue.

At the very least, during the term of the contract, the terms of the contract should be fair and reasonable and offer financial security during the contract's life. This submission makes the case for codes of conduct (voluntary or mandatory) and legislation of some of the most fundamental, good-practice contract provisions.

For the period beyond existing contracts, growers need knowledge and skills to know their businesses, know their operating environment, assess risk, promote their product and to negotiate contracts. WGGA has created a business assessment tool called VineBiz to cover-off on some of these matters. Other knowledge and skill development is also required.

5.1.2. "... given the underlying policy of allowing free enterprise in agriculture, there should not be government intervention in the market by controlling price or supply"

WGGA response:

The industry is justifiably proud of its self-determination in a free-market environment. On this basis the industry as a whole has undertaken the WRAA to facilitate the required adjustment. The activity will continue. However, based the experience of the last five years, this submission makes the strong point that there is evidence of market failure that needs to be better understood. The traditional role of government in this area is required to avoid further regional community and economic damage.

5.1.3. Possible initiatives to stabilize the industry include "better market information and business planning advice to growers"

WGGA response:

Regrettably in WGGA's view, the AWBC has recently downgraded its commitment to industry-wide analysis, particularly supply-side economic analysis that continues to be of most interest to winegrape growers. WGGA would take up the mantle in this area of vital interest but it is not adequately resourced (refer to comments elsewhere). Information is an essential requirement for markets to work. Government assistance is sought in this area.

5.1.4. *Possible initiatives to stabilize the industry include “improving productivity and economies of scale”*

WGGA response:

This point-of-view is supported. Some initiatives in this area could assist a dignified exit from the industry by marginal growers in the interest of others achieving larger scale.

5.1.5. *The committee recommends consulting “with state authorities and peak bodies with a view to establishing a national register of vines”*

WGGA response:

The industry, via AWBC facilitation, is examining the prospects of a National Vineyard Database (a ‘Register’ by another name). WGGA is a supporter of the initiative with the benefits seen to be; in providing information, facilitating biosecurity arrangements and as a resource for understanding membership potential. Subject to the research that the AWBC will conduct on this matter, NSW support for the initiatives may be sought.

5.1.6. *“Problems in relations between grapegrowers and winemakers ... should be a cause of concern”*

WGGA response:

The evidence exists that this concern remains.

5.1.7. *“The committee does not think there should be direct regulation by way of mandatory terms of trade”*

WGGA response:

WGGA does not agree with this position. WGGA takes the position that there is an argument for legislating in the areas of fundamental contractual specifications Terms of Trade are one of these. The South Australian model (Wine Grapes Industry Act 1991) is a well-respected and proven model for such arrangements and the support of the NSW parliament is sought to this end.

5.1.8. *“The bargaining position of growers may be improved by collective bargaining”*

WGGA response:

This proposition is supported by WGGA as a means of re-dressing the recognized imbalance of power between grapegrowers and winemakers.

5.1.9. *“The committee supports a mandatory code of conduct under the Trades Practices Act to regulate the sale of winegrapes ... the committee does not think that a voluntary code would be sufficient to protect growers with weak bargaining power.”*

WGGA response:

This submission advocates the monitoring of the industry’s efforts to successfully establish a voluntary code of conduct but in the absence of success within a reasonable time-frame, that a mandatory code is supported.

5.1.10. *“The committee supports current moves to establish a national winegrape growers’ body”*

WGGA response:

WGGA has been established but national and wider regional support is required to secure and consolidate the organisation’s existence and to facilitate the provision of programs and services.

NSW consideration of a grapegrower levy, possibly in the form of the arrangements that exist in South Australia, is sought.

5.1.11. "The committee also supports moves to establish a national wine industry body, with both growers and winemakers, to progress matters where they have shared interests." "The committee recommends that any national wine industry body should be separate from a winemakers' representative body."

WGGA response:

The industry, including WGGA, continues to discuss options for greater centralization of the national organizations. Co-location of the national organizations is being actively pursued at this time. Within this arrangement, and consistent with the 2005 Senate's position, WGGA advocates separation from the other organizations on representational and advocacy matters. At the same time, WGGA embraces the idea of collaborative activity in the many areas of common interest.

L Stanford
Executive Director,
Wine Grapes Growers Australia
1 October 2010