Winegrape and Wine Industry in Australia

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A Report by the Committee of Inquiry into the Winegrape and Wine Industry

> Final Report June 1995

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ABBREVIATIONS

AAB	Australian Associated Brewers
ABARE	Australian Bureau of Agricultural and Resource Economics
ABS	Australian Bureau of Statistics
ACV	Australian Council of Viticulture
ADA	Anti-Dumping Authority
AMA	Australian Medical Association
ANTA	Australian National Training Authority
ALRC	Australian Law Reform Committee
ALSA	Australian Liquor Stores Association
APMG	Alcohol Project Management Group
ASF	Australian Standards Framework
ATO	Australian Taxation Office
AWBC	Australian Wine and Brandy Corporation
AWEC	Australian Wine Export Council
AWF	Australian Winemakers' Forum
AWRI	Australian Wine Research Institute
CIE	Centre for International Economics
COAG	Council of Australian Governments
CRCs	Cooperative Research Centres
CRCV	Cooperative Research Centre for Viticulture
DSICA	Distilled Spirits Industry Council of Australia
EC	European Community
ECA	Environmental Contingency Allowance
EMDG	Export Market Development Grants
EPAC	Economic Planning Advisory Commission
EPA	Environmental Protection Agency (New South Wales)
FBT	Fringe Benefits Tax

GATT	General Agreement on Tariffs and Trade
GIC	Geographical Indications Committee
GWRC	Grape and Wine Research Council
GWRDC	Grape and Wine Research and Development Corporation
HES	Household Expenditure Survey
HIZ	High Salinity Impact Zone
IED	Income Equalisation Deposits
ITES	International Trade Enhancement Scheme
IWA	Independent Wineries Association
JAMA	Journal of the American Medical Association
LIP	Label Integrity Program
LIZ	Low Salinity Impact Zone
MDBC	Murray Darling Basin Commission
MIA	Murrumbidgee Irrigation Area
MIADMB	Murrumbidgee Irrigation Area and Districts Management Board
MRWIA	Margaret River Wine Industry Association
MVR	Murray Valley Regional Wine Grape Industry Development Committee
NCRPDA	National Centre for Research into the Prevention of Drug Abuse
NFA	National Food Authority
NHMRC	National Health and Medical Research Council
NLC	National Liquor Company
NSWWIA	New South Wales Wine Industry Association
OECD	Organisation for Economic Cooperation and Development
PSA	Prices Surveillance Authority
R&D	Research and Development
RDC	Rural Development Corporation
SAFF	South Australian Farmers Federation
SDE	Salinity Disposal Entitlements
TAFE	
	Technical and Further Education

TPC	Trade Practices Commission
TRA	Training Reform Agenda
TRIPS	Trade-Related Aspects of Intellectual Property Rights
TWE	Tradeable Water Entitlement
UDA	United Distillers (Aust) Limited
VAT	Value added tax
VWIA	Victorian Wine Industry Association
WBPA	Wine and Brandy Producers' Association of SA
WFA	Winemakers' Federation of Australia
WFWGC	Winemakers' Federation of Australia and the Winegrape Growers' Council of Australia
WGCA	Winegrape Growers' Council of Australia
WGMB	Wine Grapes Marketing Board
WHO	World Health Organisation
WIAWA	Wine Industry Association of Western Australia
WINETAC	Wine Industry National Education and Training Advisory Council
WST	Wholesale Sales Tax

PREFACE

The Australian winegrape and wine industry has changed significantly in the space of a decade. It now comprises over 3000 independent grapegrowers and around 800 wineries producing a diverse range of winegrapes and wines in locations scattered throughout all states of Australia. While the majority of wineries are small, seven large companies employing sophisticated mass production techniques account for about 75 per cent of production. Since the early 1980s, production has increased by nearly 50per cent. Technological advances combined with a capacity to innovate have facilitated an expansion in exports to some \$370 million in 1993-94. Indeed, the industry's future is now closely linked to its success in international markets. In these markets, competition is intense. Hence, it is imperative that the industry builds on the advances of the last decade and continues to improve its competitiveness. Governments in Australia also have a role to play. They must ensure the efficient operation and supply of infrastructure and services required by the industry. They must maintain pressures to lower barriers to international trade. And they must also ensure that the operations of the industry are not shackled by unwarranted regulation or saddled with other unnecessary imposts. The Government can also promote industry development by establishing more efficient, and more stable, taxation arrangements for wine.

Terms of Reference

The inquiry will examine the development potential of the wine grape and wine industry with particular regard to exports and the impact of taxation and cash grants on the industry. Matters to be taken into consideration shall include:

- (a) the current structure and competitiveness of the industry, including an identification of strengths and weaknesses;
- (b) an examination of the contribution of the industry to the Australian economy, including its contribution to the further development of regional economies;
- (c) the potential for further development of the industry, including the identification of export market opportunities;
- (d) identification of any impediments to growth and exports and any measures which could be undertaken to remove impediments or otherwise contribute to the growth or export development of the industry, in ways that are consistent with the principles of efficient resource use in the economy;
- (e) the appropriate form and level of taxation and cash grants for the industry, taking into account the ability of the industry to achieve its domestic and export potential and the taxation regimes applied to alcoholic beverages in Australia and other countries, and to all other Australian industries;
- (f) implementation strategies for any suggested measures; and
- (g) the effects on the industry, consumers, and the economy in general, of any measures recommended.

The inquiry is to be completed and a report submitted by 30 une 1995 or earlier if possible.

EXECUTIVE SUMMARY

This report is about the winegrape and wine industry ...

This report stems from an announcement by the Commonwealth Government in October 1993 that, following negotiations with the industry, a Committee would be formed to inquire into the Australian winegrape and wine industry. The terms of reference for the Inquiry require the Committee to focus on the industry's development potential, impediments to growth and the appropriate form and level of taxation for the industry in the context of improving the overall performance of the Australian economy.

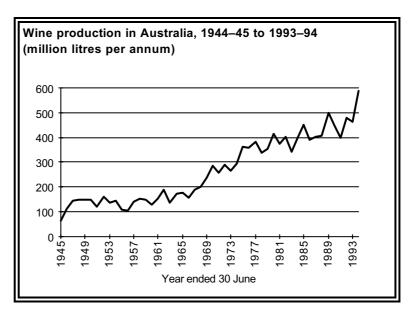
The Committee has not attempted to develop a 'blueprint' or an industry plan outlining future objectives and associated strategies. It considers that this is most appropriately undertaken by the industry itself. Indeed, the industry has accepted this responsibility and has already started to develop a plan which envisages an industry which, in 2009–10, is almost double the current size.

A record of growth

... which has grown substantially since the mid 1960s.

The performance of the industry was languid in the two decades following the end of the second world war. Production fluctuated around 150million litres per year, with only a small fraction— around 5 per cent— being exported.

In the second half of the 1960s, the first signs of what was to become an era of substantial change and transformation emerged. Fuelled by the influx of migrants from countries where drinking wine rather than beer was accepted practice and by innovative winemaking techniques, domestic demand began to increase steadily. During the 1970s, the introduction of the wine cask — and subsequently wine coolers — added to the impetus for growth, as did the 'mass marketing' techniques employed by a number of large multinational corporations that entered the industry (eg Rothmans, Heinz and Philip Morris). The availability of new grape varieties (eg chardonnay, pinot noir and sauvignon blanc) in the late 1970s and early 1980s broadened the range of locally made wines and further stimulated demand. Collectively, these developments contributed to a large increase in per capita consumption of wine— from 6 litres in the mid 1960s to over 20 litres in the early 1980s. In response, annual production soared to over 400 million litres.



Exports rose to \$370 million in 1993–94 and ...

The development of the industry entered a new phase in the mid 1980s. Aided by the availability of a surplus of premium grape varieties and by ownership changes which resulted in the exit of the multinationals and a further consolidation of ownership, the industry turned to the export market. Spectacular increases in exports followed. Despite high levels of government support available to many overseas competitors, exports of Australian wine increased from around 1 Imillion litres in 1985–86 to 125 million litres in 1993–94. In that year, exports were valued at about \$370million and represented nearly 30per cent of all sales (by volume). Exports of bottled wine now rival domestic sales of bottled wine. ... increased by a further 7% in 1994– 5. In the nine months to March 1995, the value of exports rose by 7 per cent, but the volume of exports fell by 7.5 per cent. The downturn in sales volumes was caused by a significant reduction in exports to New Zealand and Sweden. Most exports to these destinations are relatively low value bulk wine.

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Value of wine exports, 1980–81 to 1993–94,
($million — constant 1993–94 dollars)
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In 1993–94, domestic wine sales amounted to around 330 million litres with a retail value of some \$1.8 billion. Although higher than the volume of sales in preceding years, this level is a little below that of the mid 1980s when per capita consumption of wine peaked.

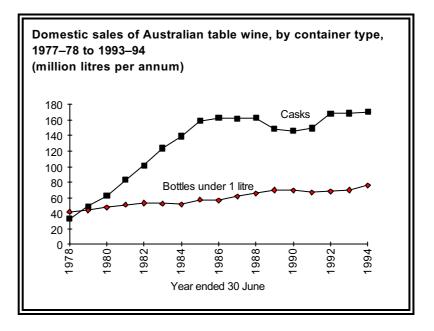
There have been some significant compositional shifts in domestic demand over the past decade. In particular, the market share of cask wine has declined and the share held by bottled (premium) wine has increased. In the last twelve months or so, the market share held by imports has also increased. The increase has been largely attributable to imports of non-premium wine by domestic producers in order to overcome shortages in local supply.

... sales of bottled wine and, more recently, imported wine has risen.

Per capita

fallen, but

consumption has



The industry is
geographicallyAustralia's winegrape and wine industry is now a large
export oriented industry. Although concentrated in the
south east of Australia, it has established a presence in
all states. There is relatively little reliable information
on employment, but the available data suggest that,
throughout Australia, there are in excess of 5500
persons employed in winemaking and over 4500
persons employed in all types of grapegrowing.

The characteristics of the industry in the different ... and varies greatly regions vary enormously. Some parts are located in within and between warm climate areas and rely extensively on irrigation to regions. grow grapes which underpin the production of cask wine. Others are in cool climate areas and specialise in producing for the bottled wine segment of the market. Some areas concentrate on grapegrowing, while others focus on winemaking activities. Large firms predominate in some regions, while in others there is a proliferation of small owner-operators, many pursuing 'lifestyle' rather than commercial objectives. Overall, the industry is characterised by an enormous heterogeneity of product and considerable innovation.

It is important to regional economies •••

The industry is particularly important to rural Australia. In some regions it is the dominant activity, attracting considerable investment and providing significant employment opportunities. Additional income and employment is generated by industry expenditure on locally supplied inputs (eg fertilisers and accounting services) and, perhaps more importantly, by the boost the industry provides to regional tourism.

Potential for development

The potential for the industry to develop further is On the demand side, much of the ... and has a number considerable. of competitive groundwork for further expansion has been done- the industry has established a foothold in many overseas markets. Overseas, Australia is seen as a supplier of high quality wines, as a technologically advanced and innovative producer, and as a supplier of a product that complies with the 'clean and green' image which is increasingly sought by overseas buyers. In terms of supply potential, there are constraints on expansion in some areas (eg a lack of suitable land in the lower Hunter and shortages of water in some areas along the Murray). Nonetheless, there is still potential to expand grapegrowing activity in areas having the necessary climatic conditions and soil types.

There is also considerable potential for the industry to build on these strengths and increase competitiveness. upon which it needs to build. For example, there is scope for the industry to increase expenditure on research and development (particularly in viticulture) to help ensure that productivity is improved and that Australia maintains its technological edge. There is also scope for improving managerial and workforce skills, and for further refining quality control procedures.

> Structural changes would also realise productivity benefits, particularly in the grapegrowing sector where a large proportion of grapes is still grown on blocks which are far too small to exploit the available scale economies. Although there has been considerable consolidation in the winemaking sector, the formation of

advantages ...

more medium to large companies would help in raising the capital needed to finance expansion and ongoing modernisation, and realise economies associated with a larger scale of operations. This is not to deny the role of small wineries. There will always be a place for small wineries selling into niche markets on the basis of quality rather than price. However, relatively high costs and limited financial resources constrain their capacity to participate in export markets.

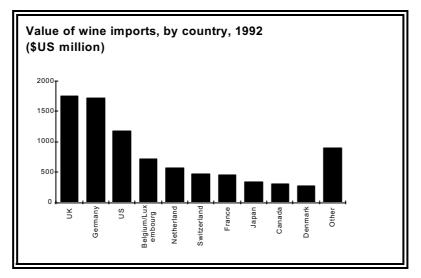
Improved coordination between grapegrowing and winemaking activities would also increase competitiveness. With the industry's increasing dependence on export markets, the need for stability of grape prices and reliability of both quality and quantity of supply is greater. Increased investment in vineyards by wineries themselves is one solution to the problem. However, the majority of grapes will continue to be sourced from independent growers for many years to come. In these circumstances, the challenge for the industry is to forge closer links between winemakers and growers. The introduction of better contracts will help, but contracts will not substitute for the development of a culture in which both parties recognise their mutual dependence and focus on working together rather than sparring for short term advantages at the expense of the other party.

Increased competitiveness will create new opportunities, predominantly in export markets. This will increase the exposure of the industry to the intense competition of international markets and to fluctuations in exchange rates, but the potential gains are large. There are opportunities to increase sales to Western Europe (eg Germany, Belgium/Luxembourg and the Netherlands) and to North America which collectively account for around 90per cent of all global imports of wine. Even in the United Kingdom and the United States — which together account for 60 per cent of the value of Australian exports— the market share held by Australian wines is modest (around 6 per cent and less than lper cent respectively).

Closer links between grapegrowers and winemakers ...

... will facilitate export growth.

In the medium to long term, opportunities will emerge in the Asian region where, as living standards rise, consumer interest in wine (and other western products) will increase. Australia is well placed to supply these markets.



Overseas competitors pose a threat. The capacity of the Australian winegrape and wine industry to capitalise on export opportunities will depend on its capacity to improve its competitiveness relative to its competitors and attract the capital required to expand vineyards and winemaking capacity. If competitiveness is not improved, export market opportunities will be seized by traditional wine exporting nations (eg France and Italy) and emerging exporters such as Chile, South Africa and some East European nations. In these circumstances, local producers' share of the domestic market could also fall.

Governments have a
role to play in
improving
competitiveness.Many of the measures required to improve
competitiveness—such as those relating to the uptake
of new technology and to the development of new
products — are most appropriately addressed by the
industry itself. However, the future competitiveness of
the industry will, to varying degrees, also depend on
actions by government, particularly in relation to
taxation, institutional arrangements, water availability
and certain state government regulation.

Taxation

Australia's indirect tax system is inefficient.

Taxes are justified to

Australia's indirect taxation system has evolved in an ad hoc fashion over many decades. As a result, it contains countless inconsistencies. For example, most services (eg airline travel, restaurant meals and health and recreational services) are not subject to wholesale sales tax (WST). On the other hand, WST applies to most goods, but there are notable exemptions (eg food And within the range of taxable and clothing). products there are large variations in the level of WST (eg some goods are taxed at the 'luxury' rate of 3per cent while others, such as maps and certain confectionery, attract WST of 12per cent). These disparate arrangements create significant economic costs by disturbing patterns of production and consumption throughout the economy.

Wine is taxed at a The 'random' nature of the current indirect taxation rate lower than beer arrangements has resulted in the tax levied on wine and spirits. being a contentious issue for some years, mainly because of the large discrepancies in the tax treatment of wine and other alcoholic beverages. At present, wine is subject to WST of 26per cent. WST of 22per cent applies to both beer and spirits, but both are subject to an excise — a tax on local production specified in volumetric terms. Collectively, these taxes are equivalent to a WST on regular beer and spirits of around 70 per cent and 187 per cent respectively. In addition, all alcoholic beverages are subject to state/territory licensing fees which range from 10 to 14 per cent.

> In framing its recommendations, the Committee has accepted that. first. present the system of Commonwealth Government indirect taxation is grossly inefficient and, second, that under its terms of reference appropriate it is not to make recommendations about the taxation of goods other than wine.

raise revenue and to
addressThe Committee has identified two central rationales for
the Commonwealth Government taxing wine. The first
is for revenue raising purposes. The second is to
counter the costs that excess consumption of alcohol
imposes on the broader community (eg costs to the
public health system, in the workplace and through
road

The form of the tax on wine should be changed.	caused by drivers who are under the influence of alcohol). In these circumstances, the Committee considers that the most efficient form of taxation of wine is a composite tax comprising an ad valorem component for revenue raising purposes and a specific rate (or 'volumetric') tax levied on alcohol content to address the external costs associated with alcohol consumption. Furthermore, for reasons of administrative simplicity, it considers that the specific rate tax should be levied at the same time as the existing WST, and not as an excise on production.
	While the Committee agrees on the structure of the tax, there is disagreement about the level of tax.
Two members propose the average level of tax be maintained	Mr Croser and ProfessorFreebairn consider there is no convincing evidence that a change in the aggregate level of taxation on wine will improve resource allocation. Consequently, they consider that the aggregate level of indirect tax collected from wine by the Commonwealth Government should approximate that realised by the WST of 26per cent. To this end, Mr Croser and ProfessorFreebairn recommend that wine should be subject to WST at a rate of 12per cent plus a specific rate tax of \$4per litre of alcohol.
but consider higher tax on non- premium wine will cause adjustment pressures.	The level of taxation proposed by Mr Croser and Professor Freebairn would provide some tax relief for both ultra-premium and premium wine. They would be taxed at rates equivalent to an ad valorem tax of 17 per cent and 22 per cent respectively. However, there would be some adverse repercussions for non-premium wine and regions that predominantly produce non- premium grape varieties. Under Mr Croser and Professor Freebairn's proposal, the tax on non- premium wine would be equivalent to an ad valorem tax of 39 per cent. This impact would be magnified by the Committee's proposal to increase the excise on brandy, which has traditionally been an outlet for surplus non-premium grapes. Adjustments that the industry would be required to make would, however, be facilitated by the phasing arrangements proposed by Mr Croser and Professor Freebairn, and by growth in the domestic market.

One member proposes the tax be increased over a five year period to the equivalent of 45 per cent ... Mr Scales disagrees with his colleagues about the appropriate level of tax that should apply to wine. He considers that the substitution between wine and other alcoholic beverages (particularly beer) is significantly stronger than between wine and other goods and services. Hence, he considers that there would be gains in economic efficiency from reducing the present disparities in tax treatment between wine and other alcoholic beverages. He proposes that wine be subject to a WST of 32 per cent and — in common with the other Committee members — a specific rate tax of \$4 per litre of alcohol. This would be equivalent to an ad valorem tax of 45per cent.

The level of taxation proposed by Mr Scales would impact most on non-premium wine (being equivalent to an ad valorem tax of 59 per cent) and least on ultra-premium wine (37 per cent). In Mr Scales' opinion, there is a number of factors which suggest that, given sufficient time, the industry can make the necessary adjustments without undue disruption. These are: first, the five year phasing arrangement; second, the large and growing proportion of the industry's output which is exported and is not subject to sales tax; and third, the underlying optimistic growth outlook for premium and ultra-premium wine which is already focusing investment in these sectors of the industry. Mr Scales considers that the implementation of his proposals would accelerate this trend.

Estimated retail price effects of Mr Scales' recommendations are shown below. As the estimates assume that all of the additional tax is passed on to consumers, the effects on prices are almost certainly overstated.

	\$8 four litre cask	\$5 bottle	\$10 bottle	\$15 bottle
Retail price increase (\$)	2.83	0.73	0.97	1.23
Percentage increase	28.8	14.6	9.7	8.2
Average annual increase (%)	5.76	2.92	1.94	1.64

...which could translate into annual retail price increases ranging from 2 to 6 per cent.

Other government involvement

Governments should intervene only where necessary. As a general principle, the Committee considers that exposing the industry to competitive market forces will provide it with the incentives and flexibility needed to respond to changes in technology and market conditions and to make the most of the opportunities for future development. However, in some areas, the operation of competitive forces can be facilitated by well targeted government intervention (eg limited regulation of exports, food standards and truth in labelling). Governments also have an important role to play in providing key infrastructure, particularly water.

Institutional arrangements

Two Commonwealth Government organisations— the Australian Wine and Brandy Corporation (AWBC) and the Grape and Wine Research and Development Corporation (GWRDC) — have been established to support the industry's activities. The industry is generally appreciative of the operations of these bodies. Nonetheless, in the light of recent changes in the industry — and likely future developments — it is consider whether appropriate to the present arrangements best suit the future needs of the industry and the community.

The AWBC

The AWBC is involved in both regulation and promotion ... The AWBC performs two major functions: it acts as a regulatory agency and it promotes Australian grape products. Its promotional activities — which are virtually all targeted at overseas buyers— are mainly funded by a levy on winemakers. Its regulatory role has broadened in recent years. It now encompasses the operation of a label integrity program to ensure that wine is accurately described, as well as its traditional function of controlling exports.

... which creates the potential for conflicts of interest. Combining promotion and regulatory functions in a single agency creates the potential for conflicts of interest. This largely reflects differences in the objectives of the two functions. Promotion is foremost about expanding sales and maximising returns while, in some circumstances, regulation can work in the opposite direction and constrain sales. In the case of the AWBC, the potential for conflicts of interest is reinforced by the composition of the AWBC's Board. The Board presently comprises a majority of members who currently hold, or who have held, senior positions in the industry. This places some Board members in the invidious position where they can be required to be a party to decisions which have commercial implications for their employer or for their competitors. It also creates a situation where the actions of the Board could be *perceived* as not being impartial.

Regulatory functions should be performed by a separate independent agency.

To overcome the possibility of these situations arising, the Committee proposes that all regulatory functions be undertaken by a separate agency. The Board of the new body, which would be chaired by a person with appropriate commercial experience, should comprise a majority of members who are independent of the winegrape and wine industry. The new body would administer the export controls, but it would only be able to deny permission to export if wine does not comply with Australian food standards, standards in the country of export or if it is spoiled. Existing provisions requiring that account be taken of specified characteristics of applicants for export licences (eg their financial standing and ability to obtain grape products) would be abolished, as would be certain other powers currently vested in the regulatory authority (eg the power to intervene in shipping contracts). The new regulatory body would also be responsible for regulations relating to the labelling of wine. It would be funded directly by the Commonwealth Government.

The GWRDC

The GWRDC disperses about \$3.5million annually to support research into grapes and wine. The funds are sourced from separate levies on winegrape growers and on winemakers, and from matching Commonwealth Government contributions.

Merging the AWBC The industry proposes that the AWBC and the GWRDC be merged. It sees this as a means of more closely and the GWRDC is not supported ... integrating the grapegrowing and winemaking sectors and of reducing costs associated with the operations of two separate corporations and two boards. Given the Committee's recommendation that а separate regulatory agency be established, it does not endorse the formation of a body encompassing the present functions of both the AWBC and the GWRDC. ... but promotion and However, it sees some merit in establishing a single *R&D* could be combined. body to perform both the promotional activity currently undertaken by the AWBC and the research functions discharged by the GWRDC.

The new organisation would comprise a Board responsible for determining policy and setting broad priorities. Board members, who would need to have appropriate skills, would be selected using the processes currently used for selecting members of the current GWRDC Board. Two sub-committees would report directly to the Board. One would be responsible for promotional activity and the other for research and development. As the form of organisation proposed by the Committee is new, it would be appropriate to review its effectiveness after three years.

research should be funded. The GWRDC has a national focus. Consequently, it does not fund projects into specific regional matters. This concerns some in the industry who believe that research into some regional problems is warranted. To allow for this possibility, the Committee proposes that regional winemakers' or grapegrowers' associations, or any other grouping of grapegrowers or winemakers, be permitted to collect addition funds for research in their region. Subject to GWRDC approval, revenue raised under these arrangements would be matched by Commonwealth Government funding.

Some regional

The Committee has not made any other proposals about the level of research funding available to the industry. The Commonwealth's role in promoting research and development is currently being reviewed by the Government.

State government regulation

Regulation in some states poses a threat to future development.

In the Murrumbidgee Irrigation Area, regulation limits Regulation relating land ownership and the Wine Grapes Marketing Board to vesting powers, (WGMB) has vesting powers (ie it can compulsorily ownership limits ... acquire all grape crops and act as a single seller in the region). The restriction on land ownership impairs growers' capacity to realise scale economies. The WGMB's vesting powers provide it with some capacity to increase grape prices in the region, but it stifles innovation and prevents individual growers from pursuing their own marketing strategies (eg entering into long term contracts with wineries). The Committee proposes that these regulations be abolished.

... and licencing laws need to be removed or modified. In Tasmania and Queensland, liquor licensing laws are antiquated and unnecessarily restrict new entrants. In particular, they discriminate against the establishment of specialist wine outlets in favour of existing outlets owned by the brewing industry. The regulations need to be reviewed with a view to removing or modifying restrictions which inhibit competition.

Water

Water entitlements should be tradeable... The large scale expansion envisaged in the winegrape and wine industry will require new plantings in the major irrigated areas along the Murray and Murrumbidgee Rivers. However, most of the water available for commercial uses in these river systems is already committed and, if proper account is taken of the water needed to maintain environmental volumes, future supplies could be less than that currently available. In these circumstances, it is essential that, subject to environmental constraints. water entitlements be transferable. This would permit water to be diverted from some relatively low yielding pastoral activities to higher yielding intensive cropping activities, such as grapegrowing. For this to occur, an essential prerequisite is the separation of water entitlements from land ownership.

... and the present restrictions removed as soon as possible.

Restrictions on transfers of water have been eased in recent years. However, some constraints continue to apply. For example, in some regions, transfers are only permissible on a short term basis. Spatial restrictions are also common. Although some are predicated on legitimate environmental grounds (ie restricting transfers into areas where there are existing salinity problems), others are mainly intended to preserve the systems viability of local irrigation and/or neighbouring communities. On a larger scale, the scope for transferring water between states is limited. In some instances, transfers are also inhibited by excessive administrative charges and by 'reduction factors' which result in a specified percentage of water entitlements being forfeited upon transfer.

Governments need to accelerate initiatives to reduce impediments to trade in water. This will require the determination of flow levels needed to meet environmental goals throughout river systems and the unambiguous specification of property rights for water allocations. This will require cooperative action by the New South Wales, South Australian and Victorian Governments.

Trade barriers

Ongoing pressure is
needed to reduceThe recent agreement with the European Economic
Community on trade in wine has removed many of the
non-tariff barriers to trade with European nations.
However, in Japan, China and a number of other Asian
nations, high tariffs and a range of non-tariff barriers
(eg labelling and technical requirements) constrain
export opportunities. Past experience illustrates the
difficulties in removing these barriers. Nonetheless,
there is clearly a continuing role for government in
negotiating reduced trade barriers in the context of
both multilateral and bilateral negotiations.

Training

The industry can contribute to training needs. Some sections of the industry are experiencing difficulties in acquiring suitably qualified staff, particularly for viticultural positions. According to participants, the problem largely reflects shortages of experienced lecturers within the TAFE system. Governments should continually review TAFE funding to ensure that resources are appropriately allocated both within the TAFE system and between the different disciplines taught by TAFEs. However, given overall funding constraints, this will not guarantee that the TAFE system (or other components of the education and training network) will satisfy the array of demands made upon it by industry.

In these circumstances, there is scope for the winegrape and wine industry — which would be a major beneficiary of increased resources being devoted to viticultural courses — to contribute to vocational training. This could involve cooperative actions such as direct funding, the provision of experienced staff to help teach in TAFEs or increased in-house training by the larger companies.

Packaging

Competition in the supply of packaging is limited.

There is limited competition in the supply of paper packaging and glass bottles to the industry. There is only one producer of bottles and production of paperboard cartons is dominated by two firms. Moreover, there is little scope for substituting alternative forms of packaging.

In this situation, local producers of packaging possess considerable market power. To counter this, local winemakers (especially smaller wineries) could form regional purchasing groups to buy in bulk and, in the case of bottles, to consider the scope for cutting costs by reducing the number of different bottle types required. Alternatively, the industry could seek authorisation from the Trade Practices Commission to collectively negotiate for the supply of bottles.

RECOMMENDATIONS

Commonwealth Government regulation

- 1. A new Commonwealth Government body be established to perform regulatory functions currently undertaken by the Australian Wine and Brandy Corporation.
- 2. The Act relating to the new regulatory body specify an underlying objective of promoting the efficient operation of the winegrape and wine industry with the minimum of regulation.
- 3. The Board of the new body comprise five persons. The majority of members of the Board be persons nominated by the Minister for Primary Industries and Energy and be independent of the winegrape and wine industry. The chair be a person with extensive commercial experience. The Winemakers' Federation of Australia and the Winegrape Growers' Council of Australia each be entitled to appoint one member to the Board.
- 4. The new regulatory body be required to formally consult with industry and the community generally about any new regulation, or proposed modification to existing regulation.
- 5. The new regulatory body be funded by the Commonwealth Government.
- 6. Applications for export certificates for grape products be refused only if it can be demonstrated that:
 - the products to be exported do not comply with the standards of the country of export; or
 - if such standards do not exist, with Australian food standards; or
 - the products are spoiled.
- 7. In issuing export licences and cerificates, no distinction be made between levy payers and other applicants.
- 8. Existing powers to determine export prices and quantities be limited to situations where importing countries restrict the volume of wine imports and/or specify minimum import prices.
- 9. The Australian Wine and Brandy Corporation's current powers to:
 - determine the variety of grapes from which wine can be manufactured;

- trade in grape products;
- intervene in shipping contracts; and
- approve overseas purchasers of grape products

be abolished and not be transferred to any other Commonwealth Government body engaged in regulation, promotion or research and development funding of the Australian winegrape and wine industry.

10. If it is decided to retain the Australian Wine and Brandy Corporation in its existing form, export controls be modified in accordance with the recommendations outlined above (ie recommendations 6 to 9).

Research and development and promotion

- 11. A single organisation be established to perform promotional activities currently being undertaken by the Australian Wine and Brandy Corporation and the disbursement of research and development funds presently undertaken by the Grape and Wine Research and Development Corporation.
- 12. Membership of the Board of the new organisation be determined according to the existing process used for determining membership of the Board of the Grape and Wine Research and Development Corporation.
- 13. A mechanism be established to permit regional winemaking associations and grapegrowing associations, or any other grouping of grapegrowers and winemakers, to collect funds to undertake research and development relevant to their region. Subject to the proposed research being approved by the successor to the Grape and Wine Research and Development Corporation, these funds be matched by Commonwealth Government grants.
- 14. The levy arrangements to fund the promotion of grape products be reviewed after three years.
- 15. The efficiency of the new institutional arrangements for promotion activity and research and development funding be reviewed after three years.

Commonwealth Government taxation and cash grants

16. All grape wine and grape wine products falling into Australian Food Standards P4, P5 and P6 be subject to a composite tax comprising an ad valorem wholesale sales tax and a volumetric tax based on alcohol content. The ad valorem component be adjusted in accordance with any future adjustments to the general rate of wholesale sales tax. The volumetric component be:

- indexed to the consumer price index; and
- levied on wholesale sales in conjunction with the wholesale sales tax, and not as an excise on production.
- 17. The volumetric component of the proposed taxation arrangements apply to the alcohol contained in the fortifying spirit used to fortify wine as well as to the alcohol content of the base wine.
- 18. For the purposes of calculating the volumetric component of the tax, grape wine and grape wine products be deemed to have an alcohol content as follows:

•	products with an alcohol content no more than 1.15 per cent	0 per cent
•	products with an alcohol content over 1.15 per cent but no more than 5 per cent	3.5 per cent
•	products with an alcohol content over 5 per cen but no more than 8 per cent	6 per cent
•	products with an alcohol content over 8 per cent but no more than 15.5 per cent	11 per cent
•	products with an alcohol content over 15.5 per cent	17 per cent

- 19. Mr Croser and Professor Freebairn propose that the wholesale sales tax be set at 12 per cent and that the volumetric tax be set at \$4per litre of alcohol. Subject to indexation of the volumetric tax from July 1996, the following phasing arrangements apply:
 - from 1 July 1997 19 per cent plus \$2 per litre of alcohol
 - from 1 July 2000 12 per cent plus \$4 per litre of alcohol
- 20. Mr Scales proposes that the wholesale sales tax be set at 3per cent and that the volumetric tax be set at \$4per litre of alcohol. Subject to indexation of the volumetric tax from July 1996, the following phasing arrangements apply;

•	from 1 July 1996	32 per cent
•	from 1 July 1997	32 per cent plus \$1 per litre of alcohol
•	from 1 July 1998	32 per cent plus \$2 per litre of alcohol

- from 1 July 1999 32 per cent plus \$3 per litre of alcohol
- from 1 July 2000 32 per cent plus \$4 per litre of alcohol
- 21. The excise on brandy be set at the same rate as that applying to other distilled spirits.
- 22. The Australian Taxation Office examine the possibility of introducing a wholesale sales threshold in place of the existing tax liability threshold for small businesses.
- 23. Write-off provisions for expenditure incurred in establishing grape vines for production in Australia on leased land be modified to accord with those applying to grape vines established on land owned by the developer.
- 24. The Income Equalisation Deposits Scheme be modified so that it operates on an accrual basis with grapegrowers' incomes and income equalisation deposits assessed on a fiscal year basis.
- 25. Cash grants to winemakers not be extended once the existing program terminates in 1997.

State and territory government matters

- 26. State governments assess the merit of continuing to exempt cellar door sales from liquor licence fees. If such exemptions are warranted on the grounds of promoting regional development, consideration be given to employing more direct measures to the regions in question, such as direct development grants.
- 27. State and territory governments remove the licence fee exemption applying to all wine sold by mail order.
- 28. State and territory governments jointly negotiate with a view to removing remaining inconsistencies in liquor licensing requirements that exist between jurisdictions.
- 29. State governments review their liquor licensing regulations with a view to removing or modifying provisions which act to protect existing suppliers and inhibit competition in retailing of wine and other alcoholic beverages.
- 30. The Western Austalian, South Australian and New South Wales Governments permit winemakers holding a vigneron's or similar licence to, at their discretion, charge for cellar door tastings without the need to obtain a licence to sell liquor.

- 31. The Tasmanian Government consider abolishing the legislated appellation system applying in Tasmania. If it is decided to maintain an appellation system, consideration be given to making it a voluntary scheme operated and funded by the winegrape and wine industry.
- 32. The Tasmanian Government remove restrictions applying to the sale by liquor stores in Tasmania of wine produced in other jurisdictions and of other alcoholic beverages.
- 33. Government initiatives to facilitate intrastate and interstate movement of water allocations be accelerated. In particular:
 - entitlements to water be separate from land ownership;
 - concise specification of property rights over water allocations be a high priority; and
 - property rights detail the quantity of water available, security of supply, tenure of permitted access and conditions under which transfers are allowed.
- 34. Irrigation infrastructure be provided and operated by a separate infrastructure service entity. Such entities not be permitted to restrict transfers out of the region.
- 35. Governments minimise transactions costs and other restrictions imposed on water transfers.
- 36. Where practicable, irrigation charges be structured to acount for the external costs imposed by irrigation-sourced salinity increases. Where such charges are not feasible, or adequate differentiation of charges is not possible, restrictions on water transfers between recognised 'low' and 'high' salinity impact areas be considered.
- 37. Governments, in conjunction with relevant water authorities and multijurisdictional bodies such as the Murray Darling Basin Commission, identify the environmental requirements of river systems and quantify the minimum flow levels necessary to meet these requirements.
- 38. Where existing environmental flows are insufficient, governments repurchase necessary water entitlements.
- 39. The New South Wales Government act as soon as possible to implement its decision to remove restrictions on land ownership in the Murrumbidgee Irrigation Area.
- 40. The compulsory acquisition powers of the Wine Grape Marketing Board not be extended beyond 1995.

Training

- 41. The industry consider cooperative actions to increase its contribution to vocational training.
- 42. The Commonwealth Government consider extending funding for the position of national coordinator under the Vocational Training System Pilot Project for a further three years.

Attention is drawn to the Committee's comments on:

- the possibility of establishing a quality assurance scheme to allow accredited firms to export grape products without prior testing (Section 7.7);
- factors influencing the supply of glass bottles and paper packaging (Section 9.1);
- supply relationships between grapegrowers and winemakers (Section 9.3);
- the need for further research into the effects of alcohol abuse (Section 10.5);
- the significant inefficiencies inherent in the system of indirect taxation currently applying in Australia (Section 11.5); and
- the disparities in the taxation treatment of pre-mixed spirit drinks and other substitute alcoholic beverages (Section 12.5), and between certain spirits and alleged wine based imitations (Section 12.6).

1 NATURE AND SCOPE OF INQUIRY

The Committee spent considerable time visiting many of the regions of Australia in which the winegrape and wine industry is located, talking to a wide range of people and reviewing and assessing the large volume of information available to the inquiry. While this revealed many insights about the industry, the manner in which it functions and the environment in which it operates, the rapid transformation of the industry over the last twenty to thirty years stands out.

In the 1960s, the winegrape and wine industry was of a modest size, located in a few key geographical areas and focussed almost exclusively on the domestic market. Today's industry is 200per cent larger with wholesale sales of around \$1.4 billion. In terms of firm type and products produced, the industry is now remarkably diverse. It is active in many regions throughout Australia and a fierce competitor in a growing number of international markets. While most of the growth in the domestic market occurred in the 1970s, the expansion of export markets has been concentrated in the last decade. Exports increased from levels of around 8 million litres in the mid 1980s to 125 million litres-nearly 30 per cent of all sales — in 1993–94. Export sales in that year amounted to nearly \$370 million. In 1994–95, exports are likely to be around \$400 million.

The rapid growth and international success enjoyed by the industry indicates that it is internationally competitive. Indeed, many suggest that, in some respects, Australia leads the world, particularly in regard to its viticultural and oenological practices and its demonstrated commitment to innovation and new technology.

The industry possesses a number of other strengths which add to its international competitiveness, but it also has some weaknesses and faces some threats which could see its competitive edge eroded. (Some of the more important factors which currently do, or have the potential to, promote or hinder the development of the industry are summarised in Box.1 below and discussed in greater detail in Chapter5.) Consequently, if the industry is to capitalise on opportunities for further growth it will have to build on its strengths and develop strategies to overcome those factors which could jeopardise its future competitiveness. As discussed in subsequent chapters of this report, this will require action by both the industry and governments.

Box 1.1: Major strengths, weaknesses, opportunities and threats Strengths Weaknesses • soil and climate • concentration of exports technology and resources • grape price variability industry diversity • scale of grapegrowing 'clean-green' image • grapegrower and winemaker relationships • lags in obtaining returns on investments **Opportunities** Threats • export market development • emerging competitors • rationalisation • excessive regulation • maturing domestic market • health concerns improved technologies • water availability

Origins of the inquiry

The inquiry has its origins in an agreement reached by the industry and the Commonwealth Government in October 1993. The agreement followed a Government proposal (announced as part of the 1993–94 Budget) to increase the wholesale sales tax on wine from 20 per cent to 31 per cent. The increase was opposed by opposition parties and the industry. Subsequent negotiations resulted in the higher level of sales tax applying only for the period to 20 October 1993, after which sales tax was reduced to 22 per cent, with annual two percentage point increases to 26 per cent by 1 July 1995. At that time, agreement was also reached on a package of measures to assist the industry. The package included cash grants to eligible winemakers, the conversion of a loan of \$1.5 million to a grant and an independent inquiry into the development potential of the industry. The terms of reference for the inquiry and the composition of the Inquiry Committee were announced in April 1994.

Inquiry terms of reference

The terms of reference for the inquiry required the Committee to consider the industry's development potential, with particular regard to exports, and the appropriate form and level of taxation and cash grants for the industry. Matters to be taken into consideration included: the current structure and competitiveness of the industry; the contribution of the industry to the national and to regional economies; and impediments to growth and means of overcoming any such impediments. The inquiry was also required to take account of the effects on the industry, consumers and the economy in general of any measures recommended. The Committee interpreted this to mean that

proposals for change should be assessed from the perspective of the economy as a whole, and not simply that of the winegrape and wine industry.

The terms of reference for the inquiry are shown in full on page xvi.

In responding to the draft report, a number of participants requested that the Committee develop a vision for the future and a 'blueprint', or an industry plan, outlining strategies that would enable the industry to attain its future objectives. For example, Southcorp (sub149, p. 2) stated:

First and foremost we are concerned by the absence in the report of an industry plan for the future development of the Australian wine industry.

Similarly, the Australian Winemakers' Forum (AWF) (sub181, p. 5) stated that it believed the:

... Inquiry was originally sanctioned by Government and Industry (as part of the deal struck 20 months ago) with a view to the creation of an Australian Winegrape and Wine Industry strategy or blueprint plan which would be used to enable industry to achieve its potential in the medium to long term.

Participants' perceptions about the nature of an industry plan varied markedly. Some saw it as encompassing only broad longer term objectives, while others envisaged a comprehensive set of plans outlining detailed objectives and strategies for each wine producing region.

From the industry's perspective, there is likely to be some merit in the development of an industry plan which reflects broad industry views and contains considered assessments about the future directions of the industry. It could help identify obstacles to future growth, and ways and means of combating such obstacles. It could also promote greater cohesion, unity and a sense of industry pride in similar fashion to that fostered by the adoption of the industry promoted \$1 billion dollar export target. However, given the diversity of the industry, certain elements of an industry plan may not be relevant or appropriate for some producers. In this sense, the plan should be seen only as a framework within which individual producers would need to make decisions based on their own commercial judgement.

The availability of an industry plan could also benefit other stakeholders. For example, it could provide financiers with better information— and perhaps a greater degree of confidence— in assessing applications by industry for capital funding. Similarly, it could assist suppliers to the industry— such as producers of packaging and irrigation systems— to anticipate future industry needs and to plan accordingly. Ultimately, this would also benefit the winegrape and wine industry. However, if such benefits are to be realised, the plan would have to be seen as credible and not as an immutable set of

objectives. It would need to be regularly reassessed in the light of changing supply and demand conditions. Even in these circumstances, uncertainties resulting from the industry's exposure to natural hazards and to fluctuations in international markets would limit the precision of forecasts encompassed in the plan.

As a Government appointed Committee, this Committee does not consider it appropriate that it prepare a plan on behalf of the industry. If it were to do so, it may create expectations that the Government would assume responsibility for ensuring the achievement of the industry's goals. It could also imply that the Government would 'compensate' the industry if its objectives were not fulfilled. In the Committee's view, the industry, and not the Government, should assume these responsibilities.

Practical factors also mitigate against the Committee preparing an industry plan. For example, in preparing a plan, account needs to be taken of the great diversity within the industry — there are large and small producers; producers of premium wines and grape varieties, producers of non-premium wines and grapes, and producers of both; producers that sell only on the domestic market and others that have made a substantial commitment to export markets; and producers in the industry for commercial motives as distinct from the 'lifestyle' objectives pursued by many small wineries. There is, of course, also significant variation between regions. In addition, there is considerable uncertainty about the future— for example, about exchange rate movements and improvements in competitiveness of nations such as Chile and South Africa. Furthermore, the process needs to be iterative in the sense that those responsible for preparing the plan would, at different stages during the development process, need to obtain feedback from a wide range of industry members. Given the other matters that need to be addressed in this inquiry, the time required to follow this process and to assimilate all of the information needed to prepare a comprehensive and detailed plan would exceed that available to the Committee

In these circumstances, the Committee believes that an industry plan is most appropriately prepared by industry personnel that have an intimate knowledge of the industry and its markets.

Following discussion at the draft report hearings, there was some agreement that an industry plan*is* most appropriately prepared by industry itself. For example, the Winemakers' Federation of Australia and the Winegrape Growers' Council of Australia (WFWGC) (transcript, p. 1242) stated that:

... we do agree with the Committee's view, as expressed as recently as at the Sydney hearings, that its ultimately the industry's responsibility to determine the vision content of a plan.

In this context, the South Australian Farmers Federation (subl71, p.3) commented that it now believes:

... that it would be not only impossible but incorrect for us to expect the Industry Inquiry to deliver a fully integrated, insightful and sound Industry Plan.

In its submission to the draft report hearings, the WFWGC stated that it had undertaken some of the preliminary work needed to prepare a comprehensive industry plan. The plan, which the WFWGC considers encompasses conservative growth estimates, envisages growth in wine production and wine exports exceeding 70 and 300per cent respectively between 1993–94 and 2010¹ (see Box 1.2). Critical success factors underpinning the growth forecasts include a range of issues relating to: business climate; supply expansion infrastructure; competitive advantage; investment; and government facilitation. The WFWGC said that it aimed to finalise the plan in time for the 'Wine Australia '96' promotion to be held in June of next year.

Box 1.2: Wine industry plan for 2010 — Key aggregates							
	1993–94	2009–10	% change				
Winegrapes ('000 ha)	43.2	77.7	84				
Grape production (kt) Grape value (1993– 94 \$m)	777 339	1337 528	72 56				
Wine production (million litres)	587	1003	71				
Wine value (1993–94 \$m)	1320	2575	95				
Export volume (million litres)	131	529	304				
Export value (1993–94 \$m)	359	1665	364				
Employment growth							
- grapegrowing	-	-	50				
- winemaking	-	-	63				
Source: WFWGC (sub. 181, p. 7).							

It is clear from the evidence submitted to the inquiry that there is wide industry support for the preparation of an industry plan. Consequently, the Committee supports the WFWGC's initiative to build on its preliminary work and develop a meaningful plan for the industry over the period to 2010.

While the Committee itself has not attempted to prepare a comprehensive industry plan, this report addresses a range of issues which will need to be considered by the industry in developing its plan. For example, it points to

¹ The plan forecasts investment over the period of \$1.3 billion and \$2.5 billion in grapegrowing and winemaking respectively.

impediments to growth in the form of water availability, restrictions on land ownership and liquor licensing regulations in some states. More importantly, it makes recommendations in these areas which, if implemented, would help the industry achieve its growth forecasts.

Participants indicated that one of the outcomes sought from an industry plan was a degree of certainty and stability, especially in relation to taxation. Industry representatives stressed that, largely because of long lead times associated with vineyard investments, some degree of certainty about future taxation arrangements is essential to maintain investor confidence. While it can never be guaranteed that government will not change taxation arrangements, (especially in view of continuing differences in the taxation treatment of different alcoholic beverages), to the extent that the inquiry can contribute to the implementation of a more logical tax structure, it may reduce the extent of uncertainty.

At the draft report hearings, some participants contended that the growth and development prospects of the industry would be enhanced if the Committee recommended measures to selectively assist the industry (eg providing preferred access to the 150per cent tax concession for research and development expenditure). However, largely because of its terms of reference which require that the Committee have regard to efficient resource use in the economy generally, the Committee has not proposed selective assistance measures for the winegrape and wine industries. Rather, it has focussed on removing unnecessary regulation and impediments so that the industry can compete with other industries for resources such as land and capital on a more equal footing. Similarly, it has not proposed measures which are primarily intended to promote the growth of one section of the industry over any other section (although this would be a consequence of some recommendations).

Committee members

The Inquiry Committee was chaired by Mr Bill Scales, Chairman of the Industry Commission. The other members were Mr Brian Croser– Executive Chairman of Petaluma Limited— and Professor John Freebairn of Monash University.

Secretarial support for the Committee was provided by Industry Commission staff.

Inquiry processes

The Committee adopted procedures which were intended to facilitate participation in the inquiry by all interested organisations and individuals and allow the maximum degree of public scrutiny.

Shortly after commencing the inquiry in early July 1994, advertisements were placed in newspapers in all states and territories announcing the inquiry and inviting interested parties to register their interest with the Committee. In addition, a circular was despatched to over 1500 individuals and organisations identified as potentially having an interest in the inquiry (eg government bodies, regional associations, winemakers, grapegrowers, importers and producers of other alcoholic beverages).

After visiting a number of interested parties— including representatives of major wine companies and grapegrower and wine industry associations— an Issues Paper was released in late July 1994. The paper, which invited written submissions to the inquiry by all interested parties, provided information to assist individuals and organisations to prepare submissions to the inquiry.

Extensive visits to discuss inquiry issues with a cross-section of interested parties were undertaken throughout Australia in August. Public forums to enable participants to express and discuss their views with Committee members were held during September in Melbourne, Mildura, Perth, the Barossa Valley and Sydney.

A draft report was released in March 1995. Public hearings to receive comments on the draft report were held in late April and early May in Melbourne, Perth, Adelaide and Sydney.

During the course of the inquiry, two consultancies were undertaken on behalf of the Committee. Ernst & Young provided advise on strategies that could be adopted by the Committee to ensure effective consultation and mediation of industry views to the inquiry. The Centre for International Economics developed an economic model and undertook associated analytical work which was intended to help illustrate the effects of changes in taxation and in market conditions on both the winegrape and wine industry and the economy generally.

Structure of the report

The report is divided into three parts. Parl contains this introductory chapter. Part II contains chapters outlining details of the industry and its markets (Chapters 2 to 4) and a discussion of factors impinging on the indstry's potential for development (Chapter5). Part III canvasses a range of areas in which the Committee has made recommendations for change, namely: the institutional arrangements (Chapters6 and 7); water supplies (Chapter8); other impediments to development (Chapter9); external effects of wine consumption (Chapter10); and taxation issues (Chapters11 and 12).

2 THE AUSTRALIAN WINEGRAPE AND WINE INDUSTRY

Although winemaking has a long history in Australia, it was only in the 1970s that it began to emerge as a significant industry in its own right. For most of its existence, the industry has focused on the domestic market. This focus changed dramatically in the mid 1980s when exports commenced to expand rapidly. Fuelled by Australia's export success, the industry is now involved in further expansion of grapegrowing and winemaking capacity to meet export demand.

The industry itself is very diverse, comprising independent growers of winegrapes, specialist wine producers and integrated grapegrowing and winemaking operations spread over a wide geographic area— from the cool climate areas such as Tasmania, the Yarra Valley and southern Western Australia to the warm irrigated areas along the Murray and Murrumbidgee Rivers. Many grape varieties are grown and processed into a wide range of wines which differ in style quite considerably between regions. In numerical terms, the industry is dominated by small and medium sized integrated grapegrowers and winemakers, although rationalisation in recent years has seen the emergence of large integrated companies. About ten wine companies are now listed on the Australian stock exchange.

This chapter provides a brief profile of the major features of the Australian winegrape and wine industry. Regional aspects of winegrape growing and winemaking are discussed in the following chapter.

¹ For the purposes of this inquiry, wine sold in bottles of size one litre or less is generally referred to as 'premium wine'. Within the premium wine category, bottles retailing at over \$10 per bottle are referred to as 'ultra-premium' wine. Wine sold in other containers (eg paperboard casks and glass flagons) is termed 'non-premium' wine.

In this inquiry, grape varieties are also categorised as 'ultra-premium', 'premium' or 'non-premium'. 'Ultra-premium' grapes are defined as premium varieties grown in traditional cool climate dry land regions. 'Premium' grapes are defined as premium varieties grown in the warm inland irrigated regions. 'Non-premium' grapes are defined as non-premium varieties grown in any region.

2.1 Grapegrowing

Production

The grape industry comprises over 3500 individual establishments supplying grapes for use in winemaking, drying and fresh consumption. It is Australia's largest fruit growing industry, with a total gross value of production at the farm gate of around \$530 million in 1993–94. Winegrape growing is the most important sector. It contributed around 70 per cent, or \$370 million, of the total value of grape production in 1993–94.

Production of grapes used for all purposes (ie winemaking, drying and fresh consumption) has grown steadily in recent years, reaching a peak of almost one million tonnes in 1991–92. After a relatively poor year in 1992–93– when total grape production fell to 791 000 tonnes— production again grew, reaching almost 945 000 tonnes in 1993–94.

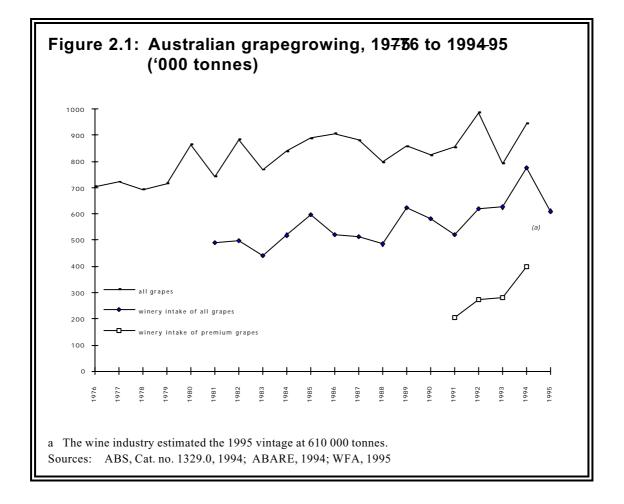
The production of grapes used for winemaking has risen steadily over the past twenty five years, from around 330 000 tonnes per year in the early 1970s to a record 777 000 tonnes in 1993–94— over 80 per cent of all grapes grown in that year.² There was a substantial increase in the production of grapes used for winemaking in 1994— some 24 per cent higher than the previous year reflecting recent plantings of premium winegrapes and a considerable diversion of multi-purpose grapes to winemaking. The output of grapes used for winemaking fell by almost the same amount in 1995, with the industry estimating production in 1995 at 610 000 tonnes (WFA, 1995). The pattern of growth in the quantity of grapes produced for winemaking and grapes produced for all purposes (ie for drying, fresh consumption and winemaking) is illustrated in Figure 2.1.

Available evidence suggests that future increases in grape production will be primarily of ultra-premium and premium winegrape varieties. ABARE's (1994, p. 11) projections suggest that the overall production of winegrapes will increase in the three years to 1996–97 by about 97 000 tonnes (or 13 per cent).

About two-thirds of Australia's grapes are produced in three warm irrigated regions along the Murray and Murrumbidgee Rivers— the Riverland in South

² For several years, it has been evident that the primary statistical collection reporting grape production, the ABS *Viticulture Australia* series, has under-reported production of grapes used for winemaking. ABARE considers that statistics on the production of grapes used in winemaking are most accurately reflected by the ABS winery intake census – which collects data on grapes used for winemaking by wineries crushing more than 50 tonnes per year.

Australia, Sunraysia in Victoria and New South Wales and the Murrumbidgee Irrigation Area (MIA) in New South Wales. Yields are highly variable as a result of the sensitivity to influences such as the weather and disease. For example, yields per hectare of cabernet sauvignon, grenache and sultana grapes fell by 26per cent, 33 per cent and 34 per cent respectively between 1991–92 and 1992–93. Furthermore, the 1994–95 downturn was more marked for white varieties than for red varieties— with winery intake of white and red grapes falling by 25 per cent and 12 per cent respectively compared to 1993– 94. Further information on the production of grapes used for winemaking by region is provided in the following chapter.



The strong winery demand for grapes evident over the past few years has been driven, in large part, by the success of Australian wine on export markets, although the domestic market— which accounted for over 70 per cent of total sales of Australian wine in 1993–94— remains the largest market. Exports

were valued at \$368 million in 1993–94, a more than tenfold increase since 1985–86 (see Chapter4).

The area planted to vines increased substantially during the 1990s after having declined to its lowest level in the late 1980s following the Vine Pull Scheme. In 1993–94, almost 68000 hectares were under vine, with some 62 000 of these bearing fruit. Compared with 1992–93, this represented an increase in the total area under vine of over 8 per cent and an increase in the area bearing fruit of over 6 per cent.

New planting of vines is continuing at a high level. Plantings in 1993– at around 3900 hectares— were double those of the previous year. There were further significant plantings in 1994? A survey of winegrape growers undertaken for the Committee in late 1994 by the Centre for International Economics (CIE) estimated intended Australian plantings to 1996–97 at approximately 17 000 hectares.

The CIE survey indicated that most expansion is expected in South Australia (45 per cent of all expected plantings) and New South Wales (33 per cent). At a regional level, the most rapid growth is expected in the MIA, the South Australian regions of the Barossa District, the Riverland District, the South Eastern District and the Central District, and the Victorian Sunraysia. Factors influencing the expansion of grapegrowing, such as water availability, are discussed in subsequent chapters.

Grape varieties used for winemaking

Many different types of grapes are grown in Australia. Some are grown for a specific end use — either wine production, drying or fresh consumption— while others are multi-purpose and can be switched between different end uses. Winegrape varieties are classified according to quality as 'premium' or 'non-premium'. Premium varieties used for red wine production include shiraz, cabernet sauvignon, merlot, malbec and pinot noir. For white wine production, chardonnay, semillon, riesling, chenin blanc, colombard, crouchen, muscadelle, sauvignon blanc, traminer and verdelho are regarded as premium varieties. Grenache and mataro are used for non-premium red wine production. Doradillo, muscat blanc, palomino, pedro ximenes and trebbiano are used for non-premium white wine production. Multi-purpose grapes used for winemaking are primarily sultana and muscat gordo blanco.

In recent years, most of the grape crop— more than 70 per cent of all grapes grown in 1993–94— has been used for winemaking. A combination of strong

³ ABARE (1995, p. 269).

winery demand for sultana grapes and the relatively poor season in 1993 has seen a decline in the use of grapes for dried vine fruit production in recent years. For example, the proportion of the grape crop used for dried vine fruit production fell from a record 38 per cent in 1991–92 to about 23 per cent in 1993–94. Some 5–6 per cent of grapes grown in recent years have been used for fresh consumption. The lower than expected vintage in 1995 suggests that the proportion of the grape crop used for winemaking will again be high.

Approximately three-quarters of all grapes grown are white and one-quarter are red. The wine crush reflects this distribution. For example, some 72 per cent of grapes crushed by wineries in 1993–94 were white varieties. In 1992–93, the most recent year for which end-use data for Australia's total grape output are available, some 85 percent of red grapes and 64 per cent of white grapes were used for winemaking.

The relative importance of the different types of grapes used for wine production is illustrated in Figure 2.2. In 1993–94, around one-third of all grapes used for winemaking were premium white grapes and just over onefifth were premium red. Chardonnay is the most popular premium white variety, having taken over from riesling in the late 1980s. Shiraz is the most popular premium red variety, although cabernet sauvignon is gaining in importance.

Non-premium and multi-purpose grapes play an important role in the industry, particularly during periods of increasing wine production. In 1993–94, around 12 per cent of all grapes used for winemaking were non-premium grapes, while some34 per cent were multi-purpose grapes.

ABARE anticipates that the industry's reliance on premium winegrapes will continue to increase in the future. It projects that the proportion of both premium white and premium red grapes used for winemaking will grow, whereas the proportion of non-premium grapes and multi-purpose grapes used for winemaking will decline. For example, ABARE's projections show that, in 1996–97, around 36 per cent of grapes produced for winemaking will be premium white winegrapes and 22 per cent will be premium red. A further 10 per cent is expected to be non-premium grapes, about 27 per cent multi-purpose grapes and about 5 per cent other varieties. (Recent trends in the production of grapes used for winemaking, by region, are shown in the following chapter.)

ABARE projects that much of the future growth in winegrape production will occur amongst the premium varieties. For example, in 1996–97, it expects production of premium white grapes to be 64 000 tonnes greater than in 1993–94, and production of premium red grapes to be almost 30 000 tonnes higher. ABARE predicts most of the increase in premium white grapes to occur among

chardonnay, colombard and riesling. For premium red grapes, the two dominant varieties — cabernet sauvignon and shiraz — are expected to account for much of the increase in grape output in 199697. In contrast, ABARE projects aggregate production of non-premium grapes for winemaking to remain about the same— with white varieties declining by about 6200 tonnes (13 per cent) and red varieties increasing by 5400 tonnes (16 per cent).

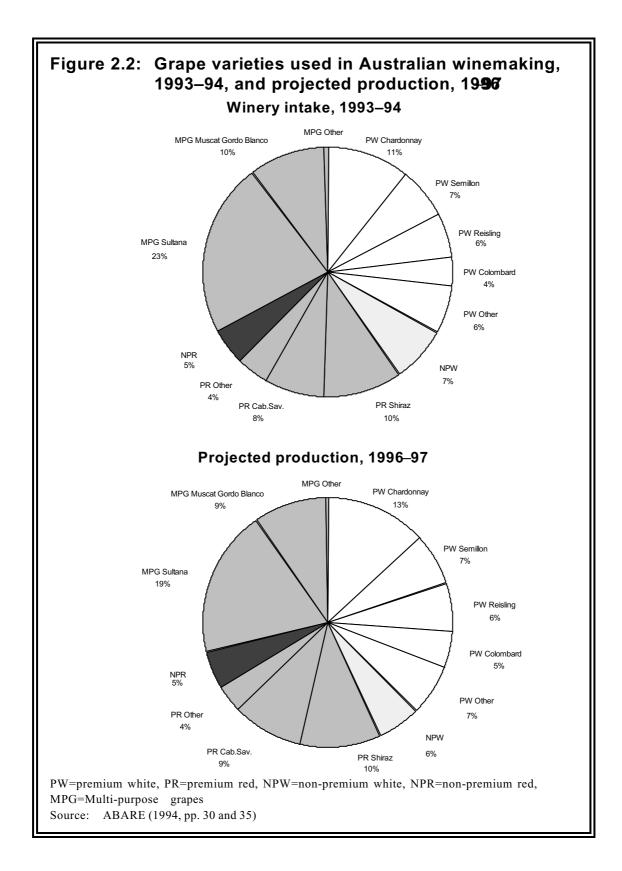
Employment

The grapegrowing sector is characterised by a large number of small independent growers, many of whom are also winemakers.

There is a paucity of employment data. However, the 1991 ABS Population Census identified 4358 persons whose main job was grapegrowing. Of these, almost half were farmers and farm managers and 35 per cent were farm hands. The Murray Valley Region Wine Grape Industry Development Committee (MVR) stated that there are over 4000 independent grapegrowers— with many located in irrigated areas producing grapes for the non-premium wine market.

According to the 1991 Census, almost 50 per cent of grapegrowers are either employers or self employed. The majority— about three-quarters of all persons employed in grapegrowing— work on a full-time basis.

There is significant reliance, particularly among growers with smaller vineyards and limited use of machinery, on casual labour for seasonal tasks such as harvesting, pruning and trellis training. As a result, employment in the grapegrowing sector increases sharply at these times. For example, the Mudgee Wine Grape Growers' Association stated that, at harvest, 200–300 casual labourers are required to augment the 80 permanent staff in the region.



Australian vineyards

Size and productivity

Vineyards are for the most part small in size. For example, in South Australia, the average vineyard size is 11.6 hectares. Almost 70 per cent of South Australian vineyards are 10 hectares or less in size and 90 per cent are less than 20 hectares. Large vineyards – which are generally owned and operated by wine companies – can range up to several hundred hectares in size. However, these are relatively few in number. For example, only 3 per cent of South Australian vineyards are 40 hectares or greater in size.

The small size of vineyards reflects mostly historical factors. In particular, many vineyards in the major irrigated areas trace back to resettlement schemes for armed services personnel introduced after World War I. Family ties and, in some instances, regulations preventing corporate ownership have constrained attempts to consolidate blocks into larger holdings.

Vineyard size, coupled with lead times of around three to four years before vines bear fruit, discourage change in the level and composition of grape supply. Many growers have neither sufficient cash to support themselves until vines reach bearing stage if they replace their current vineyards, nor enough unused land to plant new vines. The South Australian Government expressed concern that small holdings in the State's Riverland area, which grows about 50 per cent of Australia's non-premium grapes, affected vineyard redevelopment. It stated (sub. 41, pp. 44–5) that:

The proliferation of small holdings in the Riverland has acted as a barrier to redevelopment. ... over 70 per cent of Riverland vineyards are 10 hectares or less in size (over 90 per cent in the Renmark district).

Small properties limit the ability of growers to redevelop efficiently as it is difficult to establish long rows or remove furrows set up for irrigation if small blocks of around 0.2 hectares are being redeveloped at any one time.

However, the Wine Grapes Marketing Board (WGMB) believes that the current high prices arising from recent grape shortages will encourage expansion in the size of grapegrowing enterprises. It considers this increase will come about as land is converted to winegrape growing from other horticultural uses. It (sub.136, p. 2) stated:

As the drive to export more Australian wine has intensified, grape shortages have emerged and prices have been forced up sharply. As a result, the pace of structural change is increasing more and more rapidly as new land is opened up on a scale much greater than in the past. In the Riverina, for example, the Wine Grapes Marketing Board anticipates the average planting of grapes to increase from 12 hectares to 24 hectares by the turn of the century as rice farms are converted to grapes, farm amalgamations occur or growers shift from the citrus and canning fruit industries.

Nonetheless, the WGMB rejects any implication that small vineyard size is indicative of inefficient production. In this context, it noted that, by world standards, Australian grape growing enterprises are not small. According to the WGMB, many growers produce horticultural commodities in addition to grapes, enabling more intensive use of labour and equipment which might otherwise remain idle for large parts of the year. Increasing use of specialist contractors by small growers is also said to reduce some of the cost disadvantages associated with smaller vineyards.

Weather and disease have the greatest influence on vineyard output. However, in recent years, other factors— notably the grubbing of relatively unproductive vines in the 1980s and the development to full bearing of newly planted areas— have contributed to increases in yields. On a world scale, grape yields in Australia are higher than in most other wine producing countries. For example, in 1992 the average yield in Australia was 16.2 tonnes per hectare— behind only the United States and Germany, and far greater than the major wine producing countries (ie Italy, France and Spain). This outcome, in part, reflects Australia's use for winemaking of high yielding sultana grapes.

Vineyard cost structure

The costs of winegrape growing vary considerably depending on a range of factors, including regional characteristics (eg soil and climatic conditions), vineyard size, the variety of grape planted, the viticultural technologies employed and cultivation, pruning and harvesting practices. The WFWGC estimates vineyard set-up costs to be in the order of \$30 000 per hectare (excluding land), with the major components being the cost of the vines and the cost of establishing irrigation systems (including the purchase of water rights) and trellising.

Typical costs facing winegrape growers across different regions are shown in Table 2.1. Labour is a significant cost, although an increasing number of growers are seeking to reduce labour costs through mechanisation, including mechanical pruning and harvesting, and chemical cultivation. Chemicals, fuel and fertiliser are the other major input costs.

Table 2.1: Cost structu (percentage	Cost structure (percentage of	re of grapegrowing regions of total costs)	wing re	gions				
Region				Cc	Costs			
	Fertiliser	Chemicals	Fuel	Power	Other materials/ services	Labour	Gross operating surplus	Total
Hunter Valley NSW	1.3	3.3	1.9	1	11.4	37.6	43.4	100
Murrumbidgee NSW	2.5	3.1	2	4.5	20.8	15	52	100
Sunraysia NSW	2.5	3.1	2	4.5	20.8	15	52	100
Rest of NSW	2.3	8.1	1.6	1.5	14	33.8	38.8	100
Sunraysia Vic	3.2	3.3	2.5	4.2	17.4	17.7	51.6	100
Kerang/Swan Hill	3.2	3.3	2.5	4.2	17.4	17.7	51.6	100
Vic								
Rest of Vic	1	3.6	1.2	13.9	2.9	32.5	45	100
Central District SA	3.3	4.9	1.4	1.1	7.9	49.3	32.1	100
Barossa District SA	4.6	7.2	2.3	1.8	9.9	42	32.2	100
Riverland SA	2.5	5.1	3.6	1.8	23.1	11.7	52.2	100
Northern District SA	3.3	9.2	2.3	1.5	12.1	42.6	29	100
South Eastern SA	6	2.8	0.7	0.7	12.4	21.2	53.2	100
Swan Shire WA	4	3.9	2.1	5.9	7.3	23.8	52.9	100
Margaret River WA	4	3.9	2.1	5.9	7.3	23.8	52.9	100
Rest of WA	4	3.9	2.1	5.9	7.3	23.8	52.9	100
Queensland	5	7.7	2.5	1.9	11.9	45	26	100
Tasmania	5	7.7	2.5	1.9	11.9	45	26	100
All Australia	3.6	4.4	2.2	2.4	15.9	24.8	46.7	100
Source: CIE (1995, p. 8)								

Technology

The mechanical harvester has been the most significant technological advance in the grapegrowing industry over the past 30 years. The move to mechanical harvesting first occurred in the late 1960s in response to shortages of casual labour. Approximately 80 per cent of Australia's winegrape crop is now mechanically harvested. It is estimated that the technology has reduced the overall cost of harvesting grapes by some \$1500 per hectare.

The mechanical harvester has reduced growers' demand for casual labour, which has been important in those regions where there are uncertainties in harvest labour availability. It has also assisted growers to maintain fruit quality by enabling them to harvest and transport grapes at night when temperatures are lower. Rapid harvesting and transporting at cooler times means that grapes can be moved over large areas at optimal ripeness and with little damage. This is important because the international market now demands that Australia produce competitively priced, consistent quality blended wines.

Some indication of the range of modern technology available to Australian grapegrowers is presented in Box 2.1.

Box 2.1: Modern vineyard technology

Technology available for use in Australian vineyards includes:

- mechanical harvesting;
- mechanical pruning;
- tall trellis systems which accommodate light pruning technologies;
- minimal chemical use through the adoption of light pruning, leading to more open canopies for better microclimate and spray penetration, and integrated pest and disease management strategies;
- efficient irrigation technologies, including increasing use of deficit irrigation technology to enhance grape juice quality;
- quality planting material of the best varieties and clones; and
- use of nemato de tolerant rootstocks.

Sources: CSIRO (sub. 9, p. 3); industry sources

Arrangements for sourcing grape supply

Australian winemakers either own their own vineyards, have contractual arrangements with growers and/or compete on the open market for the crops of independent grapegrowers. It is estimated that, for all types of winegrapes, about 25 per cent of grapes used for wine production are currently sourced from winery owned vineyards, with the remaining 75 per cent obtained from independent growers.

Winemakers tend to source non-premium grapes from external vineyards much more than they do premium grapes. The Orlando Wyndham group– a major producer of non-premium wine— grows around 15 per cent of its own grapes and obtains the remainder from independent growers, although the other large companies tend to source a larger proportion of grapes from their own vineyards.

With some exceptions (eg there are restrictions on land holding in the MIA), the market for grapes is largely unregulated, which winemakers see as an advantage. The WFWGC (sub. 30, p. 34) stated:

The Australian industry has evolved with the practice of free trade in grape supplies, juice and wine. ... One of the advantages for the wine industry is that multi-purpose grapes can be drawn into the industry as required ... to ameliorate cyclical swings in supply requirements. ... Overall the winegrape resource base is quite open and therefore responsive to market forces.

The price of winegrapes varies across regions. For example, in 1992–93, the average price of ultra-premium grapes in the Barossa District was about \$630 per tonne, whereas the average price of ultra-premium grapes in the Hunter Valley was around \$980 per tonne. On a national basis, there was a 100 per cent differential between the prices of dry land and irrigated grapes in 1992–93. Average grape prices across the different regions for 1992–93 are shown in Table 2.2.

The contractual arrangements entered into between grapegrowers and winemakers are generally for around three to five years, and sometimes for up to ten years.⁴ About half the grapes sourced from outside the winery are purchased under contract and half on the spot market.

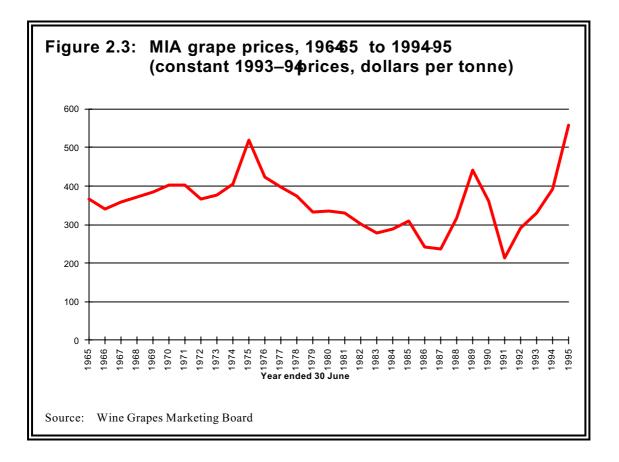
⁴ Contractual arrangements between growers and winemakers are discussed in Chapter 9.

Region	Ultra-premium	Premium	Non-premium	Multi-purpose
Hunter Valley NSW	981.4	na	526.9	300.0
Murrumbidgee NSW	na	386.3	249.9	279.5
Sunraysia NSW	na	445.6	233.2	246.4
Rest of NSW	836.8	na	352.1	231.2
Sunraysia Vic	na	481.3	284.1	297.8
Kerang-Swan Hill Vic	na	448.3	286.9	290.4
Rest of Vic	1083.6	na	506.1	400.0
Central District SA	784.5	na	385.7	288.1
Barossa District SA	628.6	na	294.5	343.0
Riverland District SA	na	386.2	219.9	225.2
Northern District SA	682.7	na	291.3	215.9
South East District SA	904.8	na	376.6	na
Swan Shire WA	787.9	na	313.0	300.0
Margaret River WA	753.0	na	302.0	na
Rest of WA	740.1	na	304.0	300.0
Queensland	809.3	na	350.0	220.2
Tasmania	847.3	na	350.0	na
All regions	817.0	404.9	295.5	273.7

The market for winegrapes is often volatile with significant year to year variation in price. This volatility is indicated in Figure 2.3, which shows changes in prices for MIA grapes between 1964-65 and 1994-95, expressed in constant 1993-94 prices. For MIA grapes, prices (expressed in constant 1993–94 dollar terms) generally rose during the 1960s and early 1970s, reaching a high point around 1975. Grape prices generally declined over the period to 1987. Since then, prices have been extremely volatile- rising in 1989 to almost \$450 per tonne, falling in 1991 to about half this price, and subsequently increasing rapidly. Today, the price of MIA grapes is at its highest ever level.

Many wineries are now seeking to secure grape supplies by expanding their own vineyards, partly because of uncertainties about future grape supplies, but also because they consider that they can produce grapes of the desired standard more economically. Coldstream Hills (sub. 86, p. 3) explained that it was expanding its own vineyard holdings because:

There is and seems likely to remain insufficient acreage planted in the Yarra Valley to meet both intra and extra valley demand, and the particular nature of the climate requires a very high level of viticultural expertise to produce grapes of the desired quality and style.



Some independent growers believe that their own livelihoods may be threatened by the increased plantings of wineries if the export market does not continue to expand. For example, the King Valley Grapegrowers' Association expressed concern that those wineries which predominantly produce their own grapes will reduce the amount of fruit they buy from independent growers in the event that the demand for wine does not increase as forecast.

2.2 Wine production

Industry structure

Australia has a tradition of small family owned wineries— many with typically less than 20 tonnes crush— offering a wide range of styles of bottled wine direct to the public from their cellar door. However, since the mid 1970s there have been significant changes in the structure of the industry.

In recent years, there has been a doubling in the number of small 'boutique' wineries focusing on producing small amounts of quality bottled wine. In many cases, proprietors of these wineries have entered the industry mainly for lifestyle reasons.

Today, there are around 800 companies in Australia manufacturing, blending or selling wine, although not all have their own winery. Most of these are small producers of bottled wine. For example, in 1993–94 there were 203 companies operating 234 wineries crushing over 50 tonnes annually. Less than half of these wineries— some 106— crushed more than 400 tonnes. The remaining 600 companies produced little more than 2 per cent of Australia's beverage wine in 1993–94. In contrast, the non-premium sector— the more significant sector of the Australian industry in volume of production terms is highly concentrated, with four or five companies dominating production.

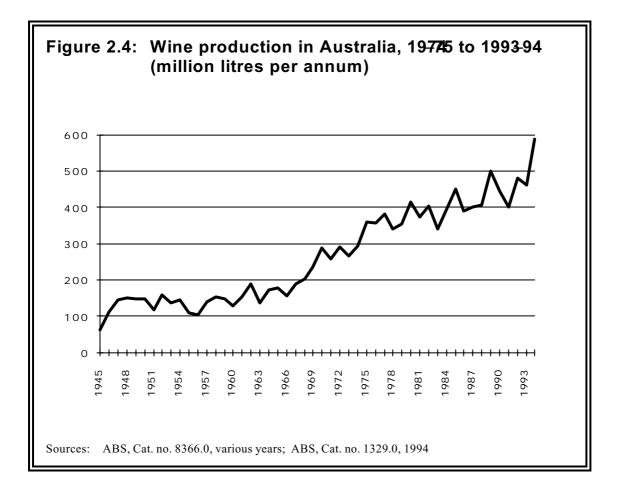
Another significant change has been the emergence of a number of large publicly owned winemaking corporations. Company rationalisations, which began in the 1970s as large corporations invested in the expanding wine industry, have resulted in the development of large diversified companies. Today, seven companies account for around 75 per cent of Australia's wine production.

Production of wine

Australia's wine output (including for distillation) has increased steadily this century, reaching high points in 1988–89, when almost 500 million litres were produced, and 1993–94 when 587 million litres were produced. Annual output has fluctuated in recent years, largely reflecting variations in grape supply. For example, in 1990–91, production fell to a level 20 per cent below that in 1988–89. Wine production in 1993–94 — the highest ever recorded — was some 27 per cent higher than in 1992–93. The smaller than expected 1995 vintage suggests that wine production in 1994–95 will fall from the previous year's record level. Figure 2.4 illustrates the longer term growth of the wine industry.

In value terms, a significant upward trend has been evident. For example, gross product at factor cost — a measure of value added or net output — more than doubled (in constant 1989–90 prices) from \$188 million in 1977–78 to \$386 million in 1991–925

⁵ The ABS derives gross product at factor cost for each industry using manufacturing census data for value added and adjusted value added. In brief, value added is calculated as turnover plus the change in the value of stocks, less purchases, transfers in and significant other expenses (eg including rent, leasing and hiring costs).

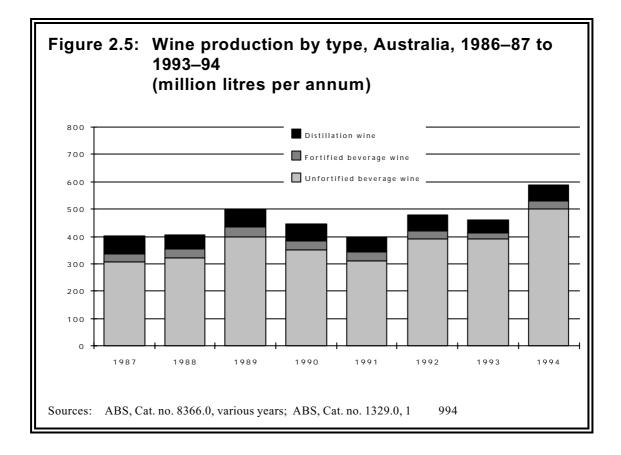


Australia's wine output in 1993–94 comprised 530.5 million litres of unfortified beverage wine and 56.8 million litres of distillation wine. The increase in production of beverage wine— by some 27 per cent over the previous year— was the main contributor to the record output. Production of fortified wine, while generally falling in recent years, increased by 37 per cent to 30.5 million litres in 1993–94. Australia's output of beverage wine (both fortified and unfortified) and distillation wine over the period 1986–87 to 1993–94 is shown in Figure 2.5. In addition, a small amount of 'wine' is made from fruit such as apples, stone fruits, berries and mangoes, and also from honey.

Brandy production increased in 1993–94, rising by 20 per cent to 1.5 million litres of alcohol. Grape spirit production also increased in 1993–94, to 6.2

Adjusted value added is calculated as value added less land tax, payroll tax, insurance premiums and other business expenses.

million litres of alcohol. These increases followed several years of declining production (largely due to poor quality sultana crops).



Stocks of wine

A very high level of stocks is a significant feature of the wine industry. At 30 June 1994, winemakers held a record 670million litres of beverage wine stocks — equivalent to 150 per cent of sales in 1993–94. Stock levels have shown some volatility in recent years. At the end of June 1994, the stock of beverage wine was some 70 million litres (or 12 per cent) higher than the 30 June 1993 level, and 100 million litres higher than the level of 30 June 1990. Stocks of fortified wine have been gradually declining in line with changes in output.

The level of stock holding in the wine industry is far higher than in most other industries (eg the value of stocks in the motor vehicle industry is typically equivalent to about 10-15 per cent of sales, about one-tenth the level of stock holding in the wine industry). High stock holding reflects a number of factors, including winemakers' commercial judgments about the desirability of

making wine requiring long maturation periods, and the timing of the vintage which allows winemakers little time to dispose of stock prior to 30 June each year.

Employment

ABS manufacturing census data show that employment in the wine and brandy industry has grown steadily in recent years, having increased from around 3 000 in 1968–69 to over 5 600 at 30 June 1993 (see Figure 2.6). As this figure relates to the end of June 1993, it significantly understates employment at other times during the year. For example, employment is substantially higher during the vintage when significant numbers of casual workers are employed. The data also exclude wineries operated by sole proprietors and partnerships not employing others.



Costs of production

The analysis of winemaking costs, undertaken by the CIE in consultation with the industry, shows that the most significant cost items for winemakers are the

cost of grapes, packaging (ie glass products, and paperboard and plastics) and labour.

On average, grape costs account for 24 per cent of the cost of producing ultrapremium wine, 33 per cent of the cost of producing other premium wine and 31 per cent of the cost of producing non-premium wine. Packaging costsincluding glass, paperboard and plastics— typically represent 17 per cent, 18 per cent and 28 per cent respectively of the cost of producing ultra-premium, premium and non-premium wine. Labour costs represent between 8 and 11 per cent of production costs. Gross operating surplus, on average, ranges from about 20 per cent for non-premium wine to about 33 per cent for ultrapremium wine.

The relative importance of each of the components of cost for ultra-premium, premium and non-premium wine is shown in Table 2.3.

Table 2.3: Winemaking cost structure (percentage of total cost)							
Input	Ultra- premium	Premium	Non- premium	Total			
Ultra premium grapes	24.0	27.6	0.0	17.0			
Premium grapes	0.0	5.0	9.9	6.0			
Non-premium grapes	0.0	0.0	10.0	3.6			
Multi-purpose grapes	0.0	0.0	11.4	4.1			
Glass products	14.4	15.0	0.0	9.5			
Bags, etc	3.0	3.0	14.0	7.0			
Plastics, etc	0.0	0.0	14.0	5.1			
Other materials	17.2	17.7	9.5	14.6			
Services	0.5	0.5	0.5	0.5			
Wages	8.1	8.5	11.0	9.3			
Gross operating surplus	32.8	22.7	19.7	23.3			
Total	100.0	100.0	100.0	100.0			

The influence of winery size

According to the industry, scale-related cost reductions have been very important to Australia's recent export growth. The WFWGC submitted (sub. 30, p. 31) that:

Economies of scale have been rated alongside low cost grape production, advanced technology and quality as a major driving force behind Australia's ongoing export success.

The WFWGC's assessment of optimum scale for a winery is an annual crush of 30 000 to 40 000 tonnes. A throughput of at least 450 tonnes is considered necessary for a winery to be viable on a 'stand alone' basis. Wineries with throughput lower than 450 tonnes employ a range of strategies to remain viable. These strategies include own-vineyard sourcing of grapes, use of family labour, use of contract services rather than purchasing expensive equipment items, and running associated operations— such as cellar door sales or on-site eating facilities or bottling, crushing or winemaking for others.

Small wineries — categorised by the WFWGC as those crushing less than 10 000 tonnes a year— have the highest per unit processing costs. Non-grape processing costs are generally around \$20 per case and overheads are about \$10 per case. The ex-winery price of the small winery product is typically around \$70 per case, leaving an operating surplus of \$28 (about 40 per cent of the ex-winery price) after taking into account the cost of grapes. This suggests that small wineries, to return a profit, must operate principally in the premium end of the market, selling a distinctive, relatively high priced product.

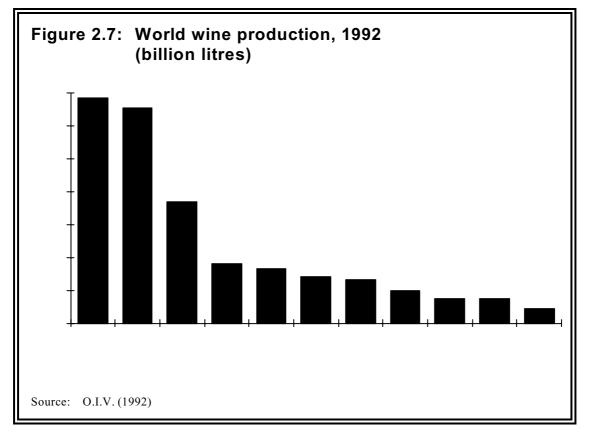
The move to a medium sized winery (30–40 000 tonnes) reduces per unit production costs. Non-grape processing costs are estimated to be approximately \$12.50 per case. With the ex-winery price generally about \$30 per case, and after taking account of the cost of grapes, the operating surplus is in the order of \$10 per case, or 33 per cent. The medium sized winery generally sells a differentiated product and does not rely greatly on cask sales.

Most of the larger Australian winemaking companies have a network of medium sized plants located in grapegrowing regions rather than one (or few) very large operations. Cost savings are achieved through centralised bottling and warehousing, and savings in the cost of overheads and promotion. However, there are additions to freight costs from operating geographically separated networks. According to the WFWGC, unit labour costs also tend to be higher in large wineries. The most likely reason for this is that large wineries, despite increased mechanisation and reduced rigidities in work practices achieved through enterprise bargaining, employ significant numbers of permanent staff and lack the flexibility of smaller wineries which tend to rely more heavily on family labour.

According to the WFWGC, the estimated average per case production cost for a large winery network is \$18.50 and the per case price is \$22. This provides an operating surplus of \$3.50, or 16 per cent of the ex-winery case price. These returns suggest that large winery networks, which are also significant exporters, rely on a high volume of sales of a relatively lower priced product.

Australia's place as a world producer

In terms of volume of wine output, Australia is dwarfed by the world's leading wine producers— Italy, France and Spain— which together produced around 60 per cent of the world's wine in 1992. World production of wine totalled some 30 billion litres in 1992— an estimated increase of 16 percent over the previous year. Australia ranked eleventh in the world as a wine producer in 1992 (see Figure 2.7.) with around 1.6 percent of the volume of world production. The WFWGC estimated that Australia's share of world wine production is now around 2 per cent.



3 REGIONAL SIGNIFICANCE

The wine and winegrape industry has been important to rural Australia for many decades. However, the industry has become far more prominent over the last ten years or so. Large investments have led to significant expansion in traditional wine producing and winegrape growing areas (eg the South Australian Riverland, the MIA and the Barossa and Hunter Valleys), and closer linkages have been forged with the surrounding regions (eg through joint ventures with local communities to capitalise on the tourism potential provided by wineries). In addition, the industry has established a foothold in many new areas, some of which previously had been considered unsuitable for grapegrowing (eg cool climate regions).

To help understand the implications of future changes in the growth pattern of the winegrape and wine industry for the regions in which it is located, this chapter outlines the regional characteristics of the industry and its linkages with rural economies. It emphasises significant contributions made by the industry to regions in which it is located, the considerable diversity that exists between winegrape and wine producing regions, and the rapid and significant changes which are occurring in most of the regions. As there is little published data at the regional level, the discussion largely relies on information supplied by participants. In these circumstances, there are necessarily some inconsistencies in the data reproduced in this chapter.

3.1 Regional dispersion

In the early 1970s, much of the industry's activity was centred around a number of well established wine producing centres in South Australia and New South Wales and the irrigated grapegrowing areas in those states (ie the MIA and Riverland regions). While these areas remain pivotal to the industry's activities (eg South Australia and New South Wales still account for around 80 per cent of Australia's total wine production and a slightly higher proportion of winegrape output), many other areas have assumed increased significance.

Victoria

The expansion of the industry into new areas can be illustrated by reference to Victoria. Traditional product from grapegrowing and wine producing areas along the Murray (eg Rutherglen, Robinvale and Mildura) is now augmented

by wine produced in every major region in the State. In the Yarra Valley, for instance, vines were first planted in the 1830s, but by the 1920's most of the vineyards had disappeared. However, interest in the area was rekindled during the 1960s and, following a period of steady growth, investment accelerated sharply in the late 1970s and the 1980s. According to the Yarra Valley Wine Growers Association, it now has over 30 members and production of wine is expected to exceed 2.5 million litres in 1995 (see Box 3.1).

Box 3.1: The Yarra Valley region

Production of winegrapes and wine in the Yarra Valley has grown significantly over the last decade. Membership of the regional winegrape growers' association now encompasses:

- over 30 wineries;
- approximately 500 ha of vineyards, with another 200 ha planned;
- expected production of 2.5 million litres in 1995;
- retail value of production of around \$50 million;
- 130 full-time employees and 520 casual workers; and
- a projected output of 4.2 million litres in 2000.

Grape production costs in the area generally range between \$800 — \$1300 per tonne.

Source: Yarra Valley Wine Growers Association (sub. 98).

Vineyards have been established and/or expanded in many other regions in Victoria including:

- the far south west (eg Hamilton and Portland);
- the Otways (eg in the vicinity of Geelong and Werribee);
- Western Victoria (eg the Grampians and Pyrenees regions);
- Central Victoria (eg Bendigo/Heathcote and Macedon);
- Gippsland (eg near Bairnsdale and Leongatha);
- the north east (eg the King and Ovens Valleys); and
- the Mornington Peninsular (mainly near Dromana and Merricks).

Western Australia

Although grapegrowing and winemaking is confined to the south west of the State, the industry has also developed markedly in Western Australia. The main areas are Margaret River, the Swan Valley and the Great Southern region around Mt Barker. The industry in Western Australia is one of Australia's oldest — it was established in the 1830s. Like some of the newer areas in Victoria, it is characterised by small, family owned winegrape producers and small wineries, mainly producing premium wines (see Box 3.2). Although expanding, the industry in Western Australia is still very small relative to that in the major producing states (ie it produces only about 1.5 per cent of the total volume of Australian wine production, but a higher proportion of premium wine).

Box 3.2: The WA wine industry

Although the industry has existed in some regions for over 100 years, during the last decade new areas have been established (eg around Pemberton) and output has expanded. In the major producing area — Margaret River — winegrapes are the fourth largest agricultural output with a value of about \$4.5 million. The value of wine produced is higher — about \$26 million (before sales tax). Some key features of the Western Australian industry are shown below.

•	Number of growers/p	oroducers • A	rea under	vines
	- 300 winegrape	growers -	2600	ha
	- 87 wineries	• A	verage yie	ld
•	Wine regions and out	put levels	-	6.4 tonnes/ha
	- Margaret River	$r (3.5m litres) \cdot V$	ineyard siz	ze
	- Great Southern		80% 1	ess than 10 ha
	- Swan Valley (1	• .4)	Winer	ry crush
	- North east Pert	h (1.1) -	60%1	ess than 100 tonnes
	- South west Coa	• • •	Expor	rts
	- Pemberton (0.2	2) - 13	3% of prod	luction (\$9m)
	- Perth Hills (0.1	-	3% of	Australian exports
urce. V	ling Industry Assoc	viation of WA (su h	1 0)	

Source: Wine Industry Association of WA (su b. 40).

Other states/territories

In Tasmania, Queensland and the area surrounding the ACT, the industry is small and many of the vineyards are relatively new. In keeping with some of the newer regions in Victoria and Western Australia, a large proportion are operated by proprietors on a part-time basis. Although many have entered the industry because of its 'lifestyle', commercial necessity dictates that they endeavour to produce high quality wine in order to attract prices which will recover their operating costs. Significant future growth is expected. For example, the Queensland Government (sub. 101, p.1) stated that:

The proposed development of new wine producing regions in the Burnett and St George areas would substantially expand the industry

The Tasmanian Government estimates that Tasmania's wine production will double in the period to the year 2000, albeit from a small base.

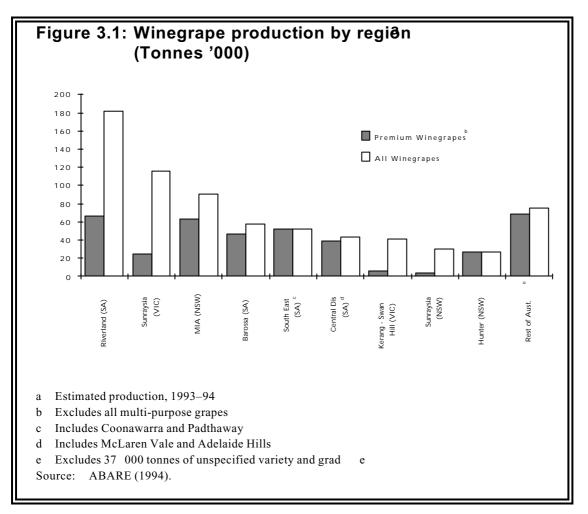
Some of the more prominent features of the industry in Queensland, Tasmania and in the ACT area are shown in Box 3.3.

Box	Box 3.3: The wine industry in Tas, Qld and the ACT region							
	The industry in each of these regions is still in the development phase, and mainly comprises small producers.							
Que	eensla	and	<u>Ta</u>	asmania				
•	size		•	size				
	-	38 wine producers		- about 40 winegrape growers				
	-	grape crush		- approximately 25 wineries				
		- 800 tonnes		- turnover - \$7.5m pa				
		- average 24 tonnes		- 330 ha planted				
	-	turnover: \$6m pa		- grape production - 1100 tonnes				
•	loca	ation	•	location				
	-	mainly Stanthorpe		- mainly Pipers River & Tamar Valley				
				- 5 smaller regions				
AC	T Reg	<u>gion</u>	•	sales				
•	size			- about 5% exported				
	-	16 producers		- 75% sold in Tasmania				
•	loca	ation						
	-	Murrumbateman-Bungendo	re					
•	grap	pe yields						
	-	average about 8 tonnes/ha						

Source: Based on information in participants' submissions .

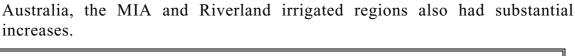
Major grapegrowing regions

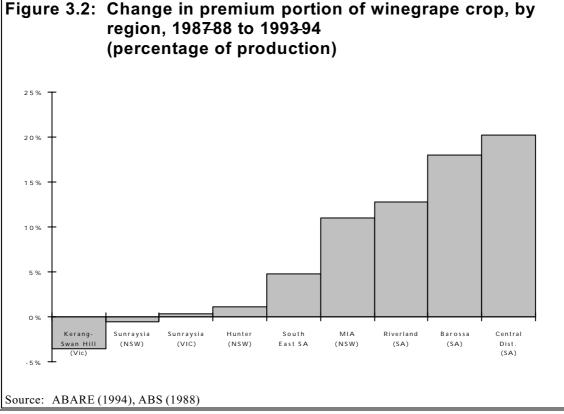
There is some official data showing the regional distribution of grapegrowing activity. The most comprehensive data are those compiled by ABARE (1994) relating to winegrape production (see Figure 3.1). The data highlight the substantial inputs from the large irrigation areas— the Riverland, the MIA and Sunraysia. Collectively, these areas provide around 55 per cent of all winegrapes used in Australia. The proportion of premium grade winegrapes sourced from these areas is somewhat lower— approximately 40 per cent. This mainly reflects the large volume of multipurpose and non-premium grapes grown in the Riverland and Sunraysia— around 60 per cent and 80 per cent respectively of all winegrapes. In contrast, premium winegrapes as a proportion of all winegrapes sourced from the south east region in South Australia and the Hunter Valley is around 95 per cent.



A feature of the grapegrowing sector over the last five to ten years has been the increasing emphasis on premium grape varieties. Between 1987–88 and 1993–94, premium grape tonnage increased by some 16**0**00 tonnes in the larger winegrape regions. However, while non-premium tonnages fell in the non-irrigated areas, in areas along the Murray non-premium tonnages (including multipurpose grapes) increased by some 95 000 onnes over the same period. Nonetheless, the proportion of premium grape varieties increased over the period from 47per cent to 54 per cent of total winegrape production.

The regions with the lowest premium orientation— Kerang-Swan Hill, Victorian Sunraysia and New South Wales Sunraysia— had the smallest increases in premium proportions (see Figure3.2 below). Not surprisingly, those regions which already had very high premium orientations also had only small increases. (Harvests in south east South Australia and the Hunter Valley were already above 94per cent premium in 1987–88.) While the greatest increases in premium orientation were in the traditional areas in South





In a number of regions (eg the MIA), the increased output of premium varieties has been partially at the expense of non-premium varieties (ie non-premium vines have been grubbed). In other areas, such as the south east of South Australia, increased tonnages mainly reflect increased land under vines.

Apart from the level and composition of output, considerable structural and other differences exist between winegrape producing areas. For example:

• the size of holdings varies considerably. For example, the average for the Mornington Peninsular is about 2.5ha compared with about 18–19 ha in the Riverland and a little over 20 ha in the MIA;

¹ Winery owned vineyards are generally substantially larger than independently owned vineyards. According to the South Australian Government, the average size of winery owned vineyards in the Hunter and Mudgee, the Riverland and the remainder of South Australia is 67 ha, 65 ha and 120 ha respectively.

- yields fluctuate depending on a range of factors including soil and climatic conditions and the viticultural techniques employed. Average yields are less than 4 tonnes per ha in Tasmania and the Pemberton area compared with around 20 tonnes per ha in the MIA and 25 tonnes per ha in the Riverland;
- for the same variety of grape, there are substantial variations in quality between regions. This is reflected in large price differentials. For example, the average price in 1993 for chardonnay grapes grown in the Riverland was \$659 per tonne compared with \$1686 per tonne for chardonnay grown in the Adelaide Hills. The corresponding figures for cabernet sauvignon were \$492 and \$1742; and
- in newer areas, grapes are more likely to be produced by winemakers whereas, in the large irrigated areas, most winegrapes are produced by independent growers who sell their output to wineries.

The regional dispersion of wine production does not mirror that of grapegrowing, mainly because there is considerable inter-regional trade in grapes. For instance, around 50 per centof the winegrapes produced in the Riverland — the largest producer of winegrapes— is shipped to wineries in other regions (eg the Barossa and Mildura) for processing. This frequently involves blending with grapes from other regions. The extent of such transfers is reflected in wine production in the Barossa Valley being over double that of the Riverland, even though production of winegrapes in the Barossa is less than half that of the Riverland. In contrast to the Riverland, the MIA — the third biggest winegrape producing region— is a net importer of winegrapes.

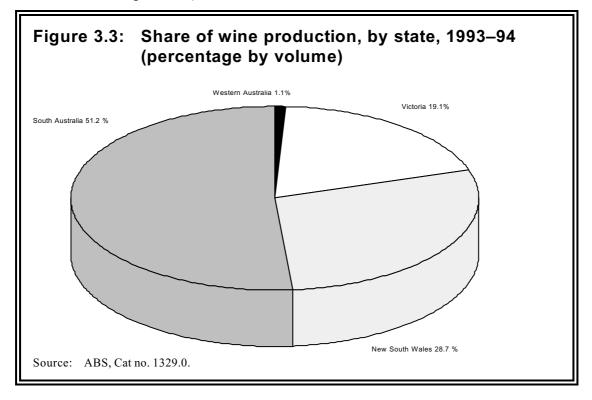
The different outcomes for these two regions which have a number of common features (eg both are warm climate, irrigated areas) in a large part reflects location. While it is economic to transport winegrapes from the Riverland to wineries in the Barossa, the longer distances between the MIA and the main wine producing regions detracts from the viability of shipping grapes to other regions.

Other significant grape flows include:

- from McLaren Vale to other regions (about 50 per cent of McLaren Vale's output is processed in other areas;)
- from South Australia's south east region to other regions (about 25 per cent is processed elsewhere);
- from Cowra and the MIA into the Hunter Valley; and
- from Western Australia to the eastern states.

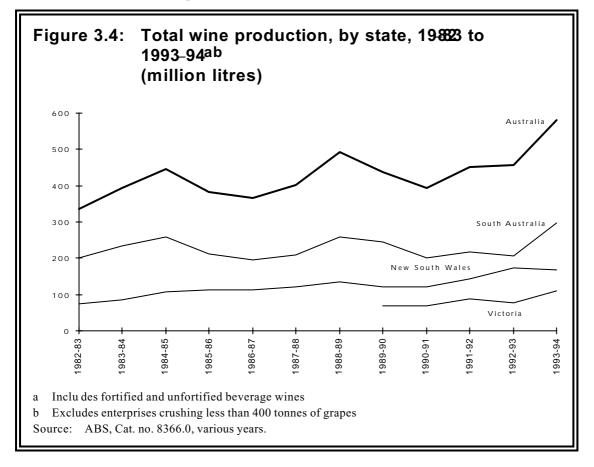
Major wine producing regions

There are no reliable data showing wine production by region. However, the ABS publishes details of production by state (see Figure 3.3). According to this data, around 80 per cent of Australian wine output (in terms of volume) is produced by wineries located in South Australia (5 per cent) and New South Wales (29 per cent). Wine produced by all other states (mainly Victor) has maintained a relatively constant share of output over the last decade (ie around 15 to 20 per cent).²



South Australia has traditionally been the largest wine producing state. However, over the last decade its share of the total volume of production has declined (see Figure 3.4). In contrast, New South Wales production has increased steadily over the last decade. In 1992–93, following a slump in South Australia's production, New South Wales accounted for 38 per cent of the total volume of Australian wine production. However, in 1993–94, production in South Australia increased by 45 per cent, and its share of total

² As a large proportion of new wineries in these states are relatively small (ie crushing less than 50 tonnes annually) and are not included in the ABS data, the share of output attributed to states other than South Australia and New South Wales could be slightly understated.



wine production increased from 45 per cent to 51 per cent and New South Wales' share fell to 29 per cent.

In terms of both sales*value* (ie turnover) and employment, South Australia still dominates the industry. For example, according to ABS industry statistics,³ turnover for the South Australian industry in 1992–93 was \$555 million compared with \$276 million and \$291 million for New South Wales and Victoria respectively.

In South Australia, wine is seen as an important component of the Government's strategy to promote employment growth. Wine accounted for around 7 per cent of the value of South Australian exports in 1993–94 and about 7.5 per cent of container traffic from Port Adelaide. The South Australian Government (sub.169, p. 41) stated that:

Through the growth of the wine industry South Australia is expanding its exports, thereby reducing the State's dependence on interstate trade (which has left the State highly exposed to domestic recession).

³ ABS, Special Data Service, Industry Class 2183, preliminary data.

3.2 Contribution to regional economies

The contribution of the winegrape and wine industry to regional economies varies substantially. In some regions (eg areas where the industry is in its infancy), the contribution is relatively minor. On the other hand, in other regions (eg the Barossa Valley and the Riverlands area of South Australia), the industry is arguably the dominant activity. Benefits associated with the industry include the direct employment opportunities it provides in vineyards and wineries and the employment it generates in supplier industries and tourist related businesses.

Some participants pointed out that the impetus to economic growth provided by the industry also leads to less tangible benefits in the form of greater investor confidence in the region, better management of community boards, local councils etc and a higher quality of life generally. For example, the South Australia Government (sub. 41, p26) stated:

The winemakers from the small wineries often provide the leadership required for regional projects and development ... In the Barossa, Riverland and Southern Vales, the local winemakers have been instrumental in developing the strategies that provide for retention of the rural environment and aid in further regional development.

Direct employment

Although there are no available small area ABS data, there are some manufacturing census employment data at the state level (see Table 3.1). However, the data cover only those establishments that are predominantly engaged in winemaking (ie employment by establishments classified for statistical purposes as specialist winegrape growers is excluded). At the end of June 1993, aggregate employment was over 5600 persons, the highest level recorded by the ABS. However, as this figure relates to 30 une 1993, it significantly understates employment at some other times of the year. Employment would be substantially higher at pruning and vintage time when large numbers of casual labour are employed.

According to the ABS data, South Australia accounted for 51 per cent of total employment. Employment in Victoria, New South Wales and Western Australia accounted for 21 per cent, 18 per cent and 10 per cent respectively.

Т		Employmen by state, 30			ng establi	ishments
	NSW	Qld	SA	Vic	WA	Tas
	No.	No.	No.	No.	No.	No.
	989	13	2876	1182	563	6
a b So	•	a coprietors and partne cial Data Service.	erships not employ	ing others		

As noted in the preceding chapter, the only ABS data on employment in grapegrowing are those collected in the 1991 Population Census. These data, which are collected on a different basis to manufacturing census data, suggest there were about 4500 persons employed in grapegrowing (including working proprietors) throughout Australia.

Some participants provided estimates of regional employment to illustrate the significance of the industry to their region (see Box 3.4).

Some participants suggested that the presence of the winegrape and wine industry in their region had provided greater job stability by 'smoothing' fluctuations in regional employment and, in some instances, by extending the employment base. For example, the Pemberton Wine Region Association (sub. 39, p. 2) commented that:

The Warren Valley Region has been historically dependent on the timber industry for employment ... the wine industry broadens the horticultural base of the area thus increasing its economic stability.

Similarly, the North East Victoria Winegrowers' Association pointed to the advantages provided by an expanding wine industry at a time when many tobacco growers in the Ovens and King Valleys are being forced to find alternative uses for their land. The growth of the industry has also been important to the Riverlands area in which there has been a significant downturn in production of citrus and stonefruits.

Box 3.4: Participants' estimates of regional employment

⁴ The information upon which the estimates are based, and the method of compilation, varies between participants. Hence, the estimates do not provide precise indications of the relative size of the industry in each region.

North east zone Victoria

Employment is estimated to exceed 1200 (including seasonal employment). The industry is the major employer in Oxley Shire (32 per cent of Shire employment) and the second largest in Rutherglen Shire (15 per cent) (sub. 97, p. 17).

Margaret River, WA

The industry provides 200 full time jobs and creates 1500 permanent part time, casual or seasonal jobs (including employment in winery cafes, restaurants etc) (sub. 40, pp. 22–23).

Queensland

The industry provides full-time employment for about 75 persons, mainly in the Stanthorpe area (sub. 108, p. 60).

Saddleworth and Auburn, SA

The two major wineries in the area employ 53 full time employees, 83 permanent casuals and a further 184 casuals at pruning and vintage times (sub. 23, p. 1).

Mudgee, NSW

The industry employs around 80 full time people. In addition, 200-300 are employed during harvesting and between 100-200 during pruning (sub. 105, p.5).

Pipers River, Tas

Employment is around 30 full time workers, 60 part time and 130 causal/seasonal workers (sub. 36, p. 23).

Great Southern, WA

Direct employment is estimated to be 80 full time and 500 part time persons (sub. 40, pp. 27–28).

MIA, NSW

Wineries employ 651 persons on a permanent basis and 692 during the vintage. On-farm employment (growers) is estimated to be 750. Collectively, this represents over 10 per cent of the laborforce in the Griffith and Leeton areas (sub. 47, p. 10).

Murray Valley, Vic/NSW

There are 600 permanent jobs in wineries. A further 850 are employed during harvest. Grapegrowers employ 2200 on a permanent basis, and a further 2000 at harvest time (sub. 18, p. 5).

Coonawarra, SA

Approximately 520 full time and 1500 casual jobs are provided (Meyers Strategy Group 1994, Appendix 8, p. 161).

Hunter Valley, NSW

Approximately 850 jobs are provided. The number swells by about 1200 during vintage (sub. 58, p. 6).

Yarra Valley, Vic

Wineries employ 130 people full time and 520 on a casual basis (sub. 98, p. 2).

Pemberton, WA

Full time employment (including working proprietors) is 76. An additional 176 jobs are available on a part time/casual basis (sub. 39, p. 2).

McLaren Vale, SA

Full time employment is about 1000, with an additional 600 jobs being provided at vintage (sub. 45, p. 3).

Stawell, Vic

Southcorp's Great Western winery is the largest private employer in the Shire of Stawell (sub. 8, p.71).

Sources: Participants' submissions and Meyers Strategy Group 1994.

At the draft report hearings, the Victorian Wine Industry Association (transcript, p. 758) referred to the significance of wineries to Nagambie during the recent drought:

... the town simply would not have survived the drought and the recession without these two wineries.

Mention was also made of the effect that growing employment opportunities in vineyards and wineries is having on maintaining family ties. In this context, the Shire Clerk of Augusta-Margaret River (subl4, AppendixB) stated that:

The job opportunities created by the industry is a godsend to our area. As with most country towns, many young people leave for the city to find work, however, I know of at least five families that have been able to have their children placed in industry work. It is important to those families to retain a close family liaison, and having work for our youth is very important to the area.

Indirect employment

The operations of the industry also generate significant regional employment opportunities in tourism related activities (motels, clubs, restaurants, art and craft centres etc) and in a range of local industries that support the winegrape and wine industry. Additional jobs are created in other regions (eg some inputs — such as glass bottles — are supplied from other regions).

Participants' estimates of the relationship between the number of jobs in the winegrape and wine industry and the number created elsewhere in the region differed considerably. The estimates imply regional employment multipliers ranging from about 0.2 (ie one job in the winegrape and wine industry creates 0.2 jobs elsewhere in the region) to over seven. The Committee has reservations about estimates at the higher end of this range. It considers that some of the estimates based on empirical studies— which estimate more modest employment multipliers— are more plausible. For example, the Riverina Wine Industry (sub. 47, p. 6) contended that:

 \dots 2 jobs per every ten jobs at wineries and one per every three on farm are attributed to the wine industry.

Information based on a regional inputoutput study submitted by the Hunter Valley Vineyard Association (sub. 58, p6) suggests an employment multiplier of two:

[For] each of the 850 (non-seasonal) jobs created directly in the industry, an *additional* two jobs (1700 in total) will be created in other areas of the Hunter's economy, as inputs for the production processes are purchased from within the Region, and wages, salaries and profits earned are spent in the Region.

The Southern Downs Regional Development Group commissioned a regional input-output study of the Queensland wine industry. The study estimated that, for every job in the Stanthorpe shire, approximately one job is created elsewhere in the shire (ie the employment multiplier is about one).

The nature of the relationships between the winegrape and wine industry and other industries is discussed below, first in relation to tourism and, subsequently, with regard to other industries.

Tourism

Many participants pointed to strong linkages between the wine and tourist industries, and stressed the implications for the tourist industry— and the surrounding region— of any downturn in the wine industry. For example, the Wine Industry Association of Western Australia (WIAWA) (sub40, p. 15) submitted that:

... increases to the present taxation structure of the industry may undermine the catalytic effect of the industry in establishing and supporting the development of regional tourism infrastructure of national economic importance.

Wineries clearly add to the attractions of the regions in which they are located and attract tourists from adjacent areas, interstate and overseas. The development of improved tourist facilities by wineries (eg tasting areas, restaurants, outside eating areas, shops (often promoting local art and craft) and, in some cases, accommodation) and by tourist operators, local businesses and local shires seeking to capitalise on the tourist potential have resulted in significant increases in tourist numbers and related expenditure. In many regions, festivals developed around the vineyards and wines are important occasions for local communities and major tourist attractions (eg the Wine and Food Festival in Griffith, the Barossa Valley Vintage Festival, the Clare Gourmet Weekend and the Leeuwin Concert). In some states (eg South Australia and Victoria), major festivals have state government support.

In some regions, participants claim that the presence of the wine industry is the major reason for tourists visiting the region. For example, the Margaret River Wine Industry Association (sub.14, Appendix 1, p.1) stated that:

Margaret River is the most visited tourism destination in the state of Western Australia recording over 158,000 visitors in 1993. This is the highest visitation rate of any bureau in the state. Of the visitors coming through the doors, it is estimated by the bureau staff, close to 80% of customers seek information about the vineyards.

On the other hand, the industry in other location *adds* to the attraction of the region, but is not the major factor promoting tourism. For example, in relation to the Great Southern region, WIAWA (sub. 40, p.28) commented:

The wine industry in the Great Southern ... has added an additional activity for tourists visiting the Great Southern region to enjoy its natural beauty and rugged coast lines.

There is clearly a high degree of interdependence between the wine industry and tourism. In their marketing activities, the two industries reinforce each other. However, it is difficult to quantify the contribution made by the wine industry to tourism (and vice-versa) and the resultant benefits that flow to the regional and the national economy. Data submitted by participants suggest that, in some instances, the benefits are substantial.

- According to the South Australian Government, over the 5 years to June 1993, the Barossa Valley attracted an annual average of 147 000 visitors that stayed for one night or longer. Interstate and international visitors accounted for 32 per cent and 15 per cent of visitor nights respectively. Over a third (37 per cent) of all international visitors to South Australia in 1992 visited the Barossa Valley.
- The Hunter Valley Vineyard Association estimates that there are at least 500 000 visitors to the Hunter Valley vineyards each year. Based on average expenditure of \$246, total tourist expenditure generated by the wine industry is \$123 million per annum. It estimates that, in turn, this generates additional expenditure in the region of \$158 million.
- The Grampians and Pyrenees Vignerons' Association cited research by the Victorian Wine Tourism Council that suggests 1.6 million visitors to wine industry sites in Victoria contributed \$100 million to the Victorian economy.
- The McLaren Vale Winemakers' estimates that the value of the region's tourism industry is in excess of \$50million annually, of which around \$8.7 million is attributed to wine sales. A signifiant proportion of the 500 000 visitors to the region each year visit the wineries.

Other industries

A range of businesses has been established in the vicinity of vineyards and wineries to supply them with materials and services. Some cater exclusively for grapegrowers or wineries (eg harvesting contractors, bottling companies and fermentation equipment suppliers), but many also supply other industries in the region (although the wine industry may be their major customer). Included in this latter category are: transport companies; metal fabricators (eg manufacturers of stainless steel tanks); manufacturers of viticultural machinery; label manufacturers; suppliers of fertilisers and chemicals; consultants specialising in viticulture services; accounting and legal firms; and suppliers of packaging materials. Box 3.5 outlines the major suppliers supported by the wine industry in the Barossa Valley.

The South Australian Government noted the contribution to both the South Australia economy and regional economies made by the Institutions located in the State that undertake industry training and related research and development.

In some regions, the development of the industry has enabled the region to develop 'the critical mass' required to support improved services for the community generally. For example, the WIAWA (sub. 40, p43) stated that:

The Cowaramup post office continues to operate because of the wine industry. Without the parcel post throughput generated by the wine industry there would be insufficient volume to keep the post office operational. This provides a considerable benefit to the locals in keeping this service going.

It also noted (sub. 40, p.42) that:

There is now a range of tradespeople in the region that weren't there before the wine industry was developed. There are electricians, refrigeration engineers, irrigation specialists and stainless steel fabricators. These tradespeople are also available for other businesses in the region.

Box 3.5: Major suppliers located in the Barsa Valley

According to the Barossa Grape Growers' Council, large service companies supported by the industry in the Barossa include:

- a major bottling company;
- the largest cooperage in Australia;
- two stainless steel tank manufacturers;
- two manufacturers of labels;
- a wine racks manufacturer; and
- two large wine haulage companies.

The Nuriootpa Campus of the Murray Institute TAFE College encompasses courses for trainees in viticulture and winemaking practice. A major wine interpretative campus is to be built at Tanunda.

Source: Barossa Grape Growers' Council (sub. 45, p. 1).

3.3 Summary

Although concentrated in the south east of Australia, the winegrape and wine industry has now established a presence in all states. While data quantifying the significance of the industry in individual regions is sparse, it is evident that the industry is a major activity— and a leading employer— in a number of regions (eg the Barossa Valley, the Riverlands, the MIA and the Rutherglen area).

In some areas, the industry is a significant employer, but is small relative to employment in other activities. For example, while the industry in the Hunter Valley is estimated to provide direct permanent employment for around 850 persons (including sales and distribution personnel), this is significantly less than employment provided by the iron and steel, coal and electricity generation industries located in the region. In those regions where the industry is still in its infancy (eg the Tamar Valley in Tasmania and the Stanthorpe area in Queensland), the direct contribution of the industry to the local economy is naturally quite modest.

The industry also generates considerable indirect or 'second-round' effects. For example, like all economic activities, it creates additional demand in the region for inputs of goods and services (eg for fertilisers, chemicals and accounting services). In this context, one feature of the wine industry, which is not shared with most other industries, is its capacity to attract tourists and boost activity in regional tourism ventures. Of course, in many regions this is 'a two way street' in the sense that tourists attracted to the area for other reasons (eg the forests, beaches and scenery in the case of Margaret River) also add to cellar door sales at local wineries.

Any turnaround in the fortunes of the winegrape and wine industries could conceivably result in only a slowdown in the rapid growth that the industry has enjoyed in recent years. On the other hand, it could result in some contraction in activity. If this were the case, the effects on regional economies would depend on a range of factors, including the extent of the contraction and the characteristics of the region. For example, the capacity of regional resources to be redeployed to alternative uses would, at least partially, offset any downturn in the wine industry (eg in some regions, grapes used for winemaking could be diverted to other uses or, alternatively, vineyard land could be used for other agricultural pursuits). Unless the downturn was substantial, the effect on regional tourism would most probably be minor. For instance, a (say) 5per cent average decrease in sales by wineries in a region would not affect the attraction of a region to tourists. In contrast, a downturn in sales which resulted in the closure of some wineries could well affect tourism in some regions.

4 WINE MARKETS

The rapid growth achieved by the Australian wine industry over the past twenty years has been fuelled by a large increase in domestic per capita wine consumption and, since the mid 1980s, spectacular increases in export sales. This chapter outlines the trends that have developed in both domestic and export markets over this period and identifies key factors underlining the changes. Because there are relatively few reliable data collected on a value basis, volume data has been used to quantify most of the changes that have occurred.

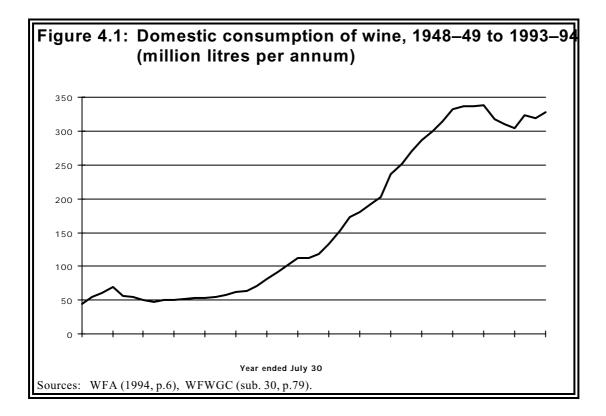
4.1 The domestic market

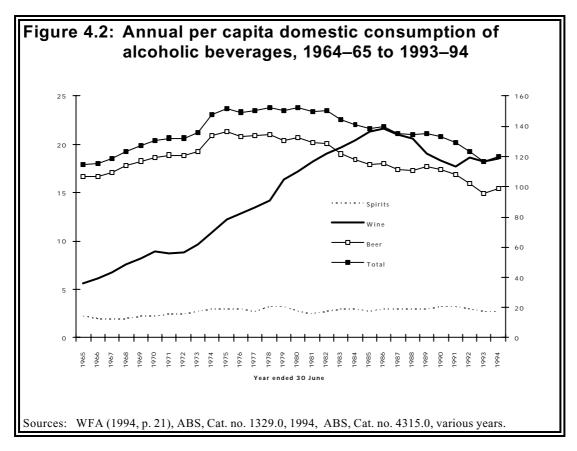
The domestic market for wine experienced a major growth phase between the early 1960s and the mid 1980s (see Figure 4.1). Local sales of all types of wine increased from around 70 million litres in 1964–65 to nearly 340 million litres in the mid 1980s. Domestic consumption subsequently slipped to around 305 million litres in 1990–91, but has since edged up to some 328 million litres in 1993–94.¹ In that year, the value of retail sales was estimated to be in the vicinity of \$1.8 billion. As noted in subsequent sections, the growth in demand has been accompanied by significant changes in the composition of demand (eg a shift in demand toward premium (or bottled) wine and a relative fall in consumption of non-premium (or cask) wine and most fortified wine.

Underlying the expansion in domestic wine sales has been a substantial increase in per capita consumption. Annual consumption increased from 5.6 litres per head in 1964–65 to a peak of 21.6 litres in 1985–86 (see Figure 4.2). While it subsequently fell to 17.7 litres in 1990–91, per capita consumption of wine increased to 18.5 litres in 1993–94.

For much of this period, per capita consumption of beer was in decline. Per capita beer consumption fell from 137 litres in 1974–75 to 99 litres in 1993–94. Aggregate Australian consumption of all forms of alcohol has also fallen over the last decade or so (from 9.8 litres of alcohol per head in 1981–82 to 7.8 litres in 1993–94).

¹ In the ten months to the end of April 1995, domestic consumption was almost identical to consumption in the corresponding period of the previous year.





In 1988–89 (the latest year for which data are available), average weekly household expenditure on all alcoholic beverages was \$16.90. This represented approximately 3.5 per cent of total expenditure on commodities and services by all Australian households. A little under 20 per cent of expenditure on alcoholic beverages— \$3.07 — was on wine. Expenditure on beer and spirits was \$9.74 and \$2.96 respectively. Household expenditure on wine was highest in the ACT (\$5.42 per week) and lowest in Tasmania (\$1.82).

Despite the rise in domestic per capita wine consumption during the 1970s and early 1980s, wine consumption in Australia still falls well below that of some European countries where wine drinking has been a long established tradition. Annual per capita consumption in some of these countries— most of which are major producers and exporters of wine— exceeds 50 litres (eg France, Italy and Portugal). However, per capita consumption of wine in these countries and some other traditional European winemaking nations (eg Spain and Greece) has been falling (eg between 1986 and 1992 consumption in France fell from 76 litres per head to 65 litres). Largely because of falling consumption in these countries, world consumption of wine in 1992 was about 20 per cent below that in 1979.

The changes that have occurred in Australian wine consumption over the last thirty years or so reflect the interaction of many factors. The significance of these factors varies considerably between the many different market segments which collectively comprise the Australian market for wine. However, factors which have contributed to the trends observed in the overall demand for Australian wine include:

- economic factors: a range of economic factors which influence living standards and the price of wine relative to other goods and services have been important in shaping the pattern of domestic demand. These include: changes in per capita income levels; changes in taxation arrangements (eg the introduction of the fringe benefits tax and modifications to sales tax to wine and other alcoholic beverages); and reductions in tariff assistance.
- social and demographic factors: demographic changes have been particularly important. A population of traditional wine drinkers developed with the wave of European migrants during the 1950s and the 1960s. As a consequence, the percentage of the population born in Europe (other than the British Isles) increased from 1.1 per cent in 1947 to 7.2 per cent in 1971. Health and social issues have also been important. For example, the enforcement of drink-driving restrictions has changed consumption patterns, as has changes in individuals' perceptions

about the benefits of living a 'healthy' life. For some, this has meant drinking (and eating) less.

- *technological developments:* technological changes (eg changes in wine production technology such as temperature and pressure controlled fermentation) have increased the capacity of wineries to successfully produce reliable quality wine at relatively low cost using grapes from high volume irrigated areas such as the Riverland and the MIA. Coupled with the introduction of the 'soft pack' or wine cask, this has provided Australian households with access to consistent wine at relatively low prices.
- *structural changes:* rationalisation in industry ownership associated with the entry during the 1970s of large multinational corporations (eg Heinz, Reckitt and Colman, and Rothmans) coupled with changes in the retail sector heralded a new era of supermarket selling of wine. This move towards 'mass marketing' was associated with significant discounting, especially for non-premium wines, as the large companies attempted to increase their market share.
- changing consumer preferences: an increasing preference for wine among some community groups reinforced the increase in domestic demand for wine during the 1970s. While this demand was largely met by increased supplies of non-premium (cask) wine, in recent years consumers have expressed a preference for higher quality premium wine (see later discussion).

4.2 Composition of demand

It is sometimes convenient to assume that wine is a homogeneous product selling in a single national market. However, this characterisation masks the considerable diversity that exists in wine products and, hence, in the demand for different types of wine. Consequently, to understand the underlying trends that have been developing in the industry, it is necessary to delve below the aggregate level and to examine trends in individual market segments. This section considers market trends in relation to sales of: bottled wine; cask wine; individual wine types; imported wine; and brandy.

Bottled wine

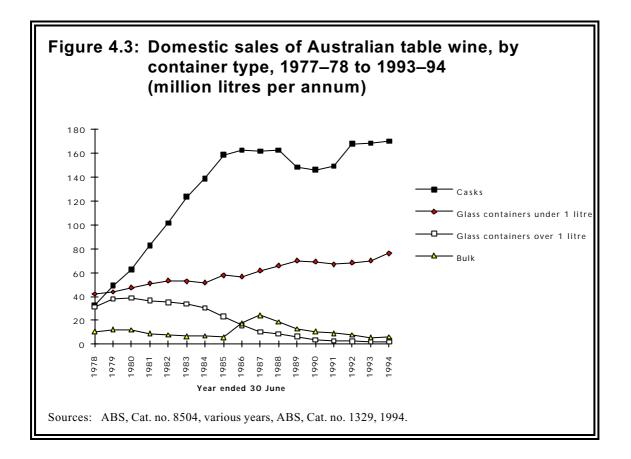
Within the domestic market for table wine— which accounts for about 80 per cent (by volume) of total domestic wine sales— two distinct segments are

evident. The first is the traditional bottle market (bottles of one litre and less, but predominantly 750ml bottles). The second is the cask market.

The most reliable data relating to the relative size of the two sectors is in volume terms. According to this measure, premium wine presently represents about 30 per cent of the sales of Australian table wine. However, a more meaningful measure of the significance of premium wine is provided by measuring market share on the basis of value. On a value basis, premium wine is estimated to represent around 70per cent of the market.

The total volume of sales of premium wine has increased steadily for many years. However, since the mid 1980s, the market*share* held by premium table wine has also tended to increase, mainly at the expense of non-premium wine sold in flagons and other bulk containers (see Figure 4.3). Between 1985–86 and 1993–94, the market share of premium table wine increased from 22 per cent to 30 per cent. This trend has continued in 1995. For the ten months to the end of April 1995, premium wine accounted for 32 per cent of sales of Australian table wine.

² A small proportion of table wine is sold in other containers (eg three litre bottles and flagons).



Cask wine

The expansion in total domestic wine sales since 1965 has reflected, to a large extent, the introduction of the wine cask. Cask wine sales increased rapidly from 32 million litres in 1977–78 to 163 million litres in 1985–86 (see Figure 4.3). In subsequent years, sales declined by about 10 per cent, before rising again in the 1990s to reach 170 million litres in 1993–94. In that year, cask wine sales represented approximately two-thirds of all Australian table wine and around 50 per cent of sales of all Australian wines.

In the ten months to April 1995, both the absolute level of cask wine sales and the share of total Australian table wine held by casks declined. Sales were about 4 per cent below that of the corresponding period in 199394.

Some of the expansion in sales of cask wine during the 1980s was at the expense of bottle sales over 1 litre (mainly flagons) which declined from 31 million litres in 1977–78 to 2 million litres in 1992–93. However, as the growth in cask sales has considerably exceeded the decline in flagons, it is clear that the introduction of the cask signalled a new market opening.

Cask wine retails at prices well below those of bottled wine. At the present time, discount prices of around \$2 per litre for cask wine are common. In contrast, only a small proportion of bottled wine currently retails for less than \$5 (ie equivalent to \$6.66 a litre)? The WGMB estimated that the average (pre-tax) wholesale prices of cask wine (including flagon and bulk table wine) and bottled table wine in 1993–94 were \$1.41 and \$5.26 per litre respectively.

The end of the rapid growth in cask wine sales in the mid–1980s can be attributed to a number of factors. Most new markets follow a pattern of rapid growth as the new market niche is discovered and developed. When that market is essentially fully developed, growth becomes slower, reflecting mainly longer term influences such as income and population growth. This may well be the case for the cask market in Australia. Increases in sales tax– to 10 per cent in 1984 and 20 per cent in 1986— would also have contributed to the slowdown in the growth of the cask market, especially as the demand for cask wine is considerably more price sensitive then demand for bottled wine. As noted by the WGMB, the rapid growth in exports during the latter half of the 1980s is also likely to have diverted product away from the cask market.

Other factors which may have contributed to declining sales in the late 1980s include ownership changes and associated changes in marketing philosophies (some of the multinationals left the industry in the mid 1980s), and changes in consumer preferences (ie some contend that tastes have changed— or 'matured'— over the last 7 or 8 years in favour of higher quality bottled wine).

The growth in cask sales during the early 1990s largely reflected the difficult economic conditions resulting from the recession and the extension of the cask market into higher quality wines (eg some 2 litre casks). During this period, the market share held by premium wines declined. In recent years, the availability of winegrapes has constrained cask wine production. Indeed, some producers have imported wine for sale in casks (see later discussion).

Individual wine types

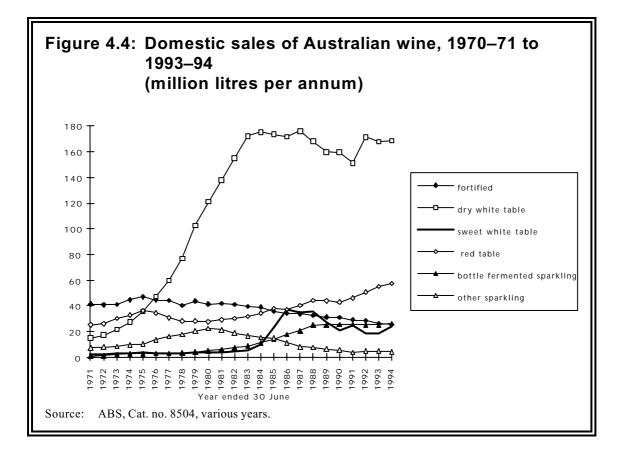
Significant changes have also occurred in the types of wine consumed domestically.

³ It was estimated that, in 1993, bottled wine retailing at less than \$5 comprised about 22 per cent by volume and 12 per cent by value of all domestic sales of bottled wine. In 1993, bottled wine selling for \$10 or more represented around 1&per cent of the volume and 32 per cent of the value of retail bottled wine sales. However, according to McWilliams (sub. 132, p. 11), these estimates understate the proportion of sales under \$5 because they are based on published price lists and do not take account of discounts.

During the 1960s and early 1970s, fortified wines outsold table wines in Australia, and red wine accounted for two-thirds of table wine sales. However, throughout the 1970s and early 1980s there was a sharp increase in demand for dry white table wines (see Figure 4.4).

Sales of white table wine— mainly in casks— accounted for around 85 per cent of the increase in the domestic wine market during its major growth phase in the 1970s and early 1980s. Conversely, white table wine— mainly cask wine— bore the brunt of the fall in wine consumption in the late 1980s. However, white wine is still by far the most popular wine in Australia. In 1993–94, white table wine accounted for approximately 60 per cent (by volume) of domestic sales of Australian wine.

Consumption of red table wine has increased steadily following a slump in sales in the late 1970s. In 1993–94, red wine represented 18 per cent of domestic sales of Australian wine.

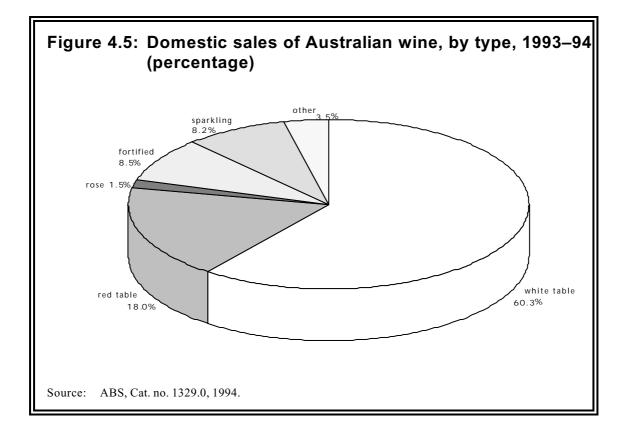


Sparkling wines presently represent about 9-10 per cent of the market- a share that has been relatively stable over the last 10 years. However, there has been a significant shift in demand, with sales of bottle fermented sparkling

wines substituting for bulk fermented sparkling wine. In 1993–94, bottled fermented product accounted for some 85 per cent of sales compared with around 40 per cent a decade earlier.

While sales of port have generally been maintained, there has been a shift in consumer preferences away from other fortified wines, in particular sherry. Suppliers to this segment of the market expect it to continue to decline. McWilliams, the main supplier, is expecting a 30 to 50 per cent decline over the next 10 years. Mildara-Blass stated that fortifieds overall had a long term decline of about 8 per cent per year. In 1993–94, fortified wines represented around 8 per cent of the volume of total domestic wine sales.

Domestic sales of Australian wine in 1993–94 classified by type of wine are shown in Figure 4.5.



Imports of wine

Imports have traditionally comprised only a small proportion of domestic market supplies of wine— around 2 per cent to 4 per cent since the early 1980's. In volume terms, imports have predominantly been of table wine.

However, in value terms, the most important component has generally been sparkling wine.

Largely because of the relatively high unit value of imported wines, imports in 1993–94 were estimated to represent about 5 per cent by value of the Australian market In terms of value, France was the major source of imported wine in 1993–94 although, in volume terms, Italy was the major supplier (supplying approximately 45 per cent compared with around 17 per cent for France).

During 1994–95, there has been a significant change in both the level and composition of imports. The level has increased sharply— over 11 million litres in the nine months to the end of March 1995 compared with 8.3 million litres in the preceding year. The increase mainly reflects considerable imports of bulk table wine by Australian wineries to overcome a shortage of locally produced cask wine.

Imports of bottled wine have also increased during 1994–95. This increase is likely to reflect maturing consumer tastes and a willingness to experiment and sample wines of other origins— such as wine from Chile and South Africa— as well as local supply conditions (ie availability and price).

Brandy

Domestic consumption of brandy significantly increased between the second world war and the early seventies, peaking at some 4.5 million litres in 1972–73. Since then, domestic consumption has trended down, with consumption falling to 1.9 million litres in 1993–94 (see Figure 4.6).

Local producers have borne most of the brunt of falling consumption, as imports of brandy have remained relatively constant. In 1993–94, imports accounted for a third of market supplies.

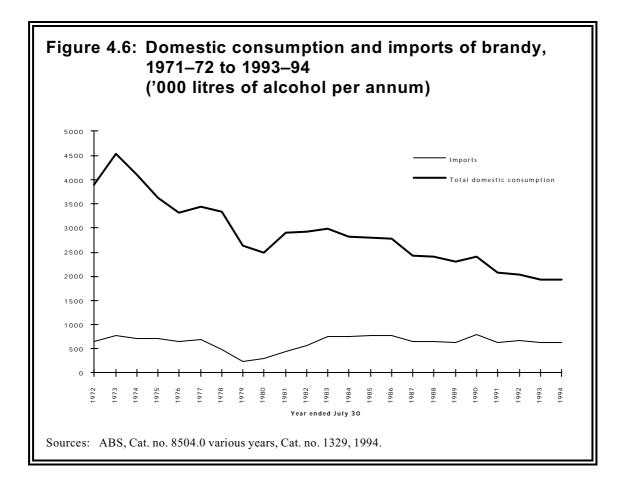
In part, the fall in brandy consumption is likely to reflect changing consumer preferences. Changes in taxation arrangements are also likely to have had an impact (ie there were increases in the wholesale sales tax, custom duties and the excise duty).

4.3 Distribution arrangements

The distribution arrangements have been markedly affected by ownership and related structural changes in the industry— in particular, the entry of a number of multinational corporations in the early 1970s and, more recently, the

emergence of three large companies— Southcorp, BRL-Hardy and Orlando-Wyndham — that now account for around 55percent of Australian wine production.

With large companies acquiring some of Australia's well known family owned wineries, increasing volumes of wine have been marketed through supermarket chains. This shift has been reinforced by the rationalisation of wholesaling into a limited number of distribution chains. Wholesaling activity is now dominated by a relatively small number of large companies. The largest–Australian Liquor Marketers — is a public company that operates in Queensland, Victoria, New South Wales and Western Australia.



Products supplied by wholesalers to supermarkets and other retail outlets (eg Liquorland, Macs, etc) are estimated to account for around 5β er cent of wine

⁴ Other large liquor wholesalers include: Queensland Independent Wholesalers; the Independent Liquor Group; Composite Buyers; Independent Holdings; and Chancellors.

sales. For these outlets, price and brand name are significant, with the focus of most promotions being on bottled wine in the \$4 to \$10 price range.

Smaller winemakers often do not have the capacity to compete with the larger wine companies in suppling the retail chains. Many concentrate on supplying licensed clubs, hotels and restaurants. These venues are often more interested in providing their clientele with a more unique, or exclusive selection of wines (ie the focus is on quality and brand image, not just price.). Sales to these 'on-premise' outlets — which are estimated to number in excess of 16000 (CS First Boston 1994, p. 19)— are estimated to comprise around 25 per cent to 30 per cent of the volume of total wine sales.

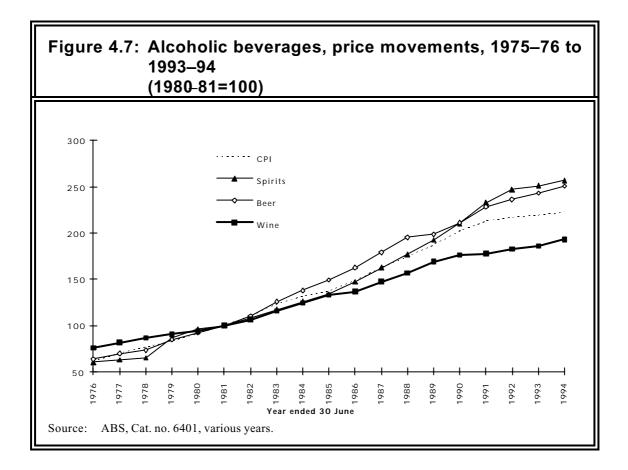
For smaller wineries— and some larger wineries— cellar door sales are also important. Indeed, some small winemakers sell virtually all of their wine through cellar door outlets.

Over recent years, mail order marketing has expanded significantly. According to WFWGC, it now represents approximately 15 per cent of domestic wine sales. The WFWGC (sub.30, p. 62) stated that:

Direct mail does offer several benefits to the consumer— often promoting lines not otherwise available through retail outlets, "pre-tasted" wines by experts who may endorse the selection as one of quality ...

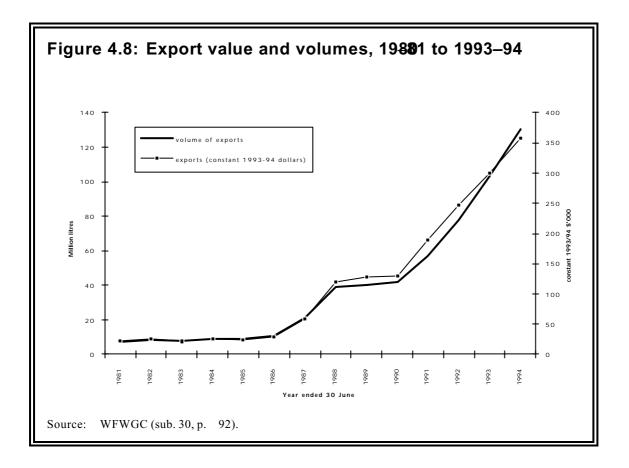
4.4 Domestic price trends

Despite the introduction of sales tax (at a rate of 10 per cent) in 1984 and a further increase to 20 per cent in 1986, since the mid 1970s the price of wine has increased at a lower rate than prices generally (as measured by the consumer price index) (see Figure 4.7). Wine prices have also increased at a lower rate than beer and spirits, which have also been subject to higher levels of taxation. In contrast to this longer term trend, increases in wine prices have exceeded the CPI in recent years (eg in the two year period to the December quarter 1994, wine prices increased by 10per cent compared with an increase of 4.5 per cent in the CPI).



4.5 The export market

Australia's exports of wine have increased dramatically over the last decade. Exports increased from about 8 million litres in the early 1980s to 125 million litres in 1993–94 (see Figure 4.8). Over the same period, the value of exports rose from around \$13 million to \$368 million. Exports now comprise nearly 30 per cent of the volume of sales by Australian winemakers. This compares with only 3 per cent in the early 1980s. The majority of exports (over 90 per cent) are of table wine (mainly white).



In the nine months to the end of March 1995, the value of exports increased by 7 per cent compared to the same period in the previous year. However, over the same period, the volume of exports dropped by 7.5 per cent. The decrease was due to a significant decline in sales (mainly of relatively low value bulk wine) to New Zealand and Sweden. Exports to these destinations declined by around 35 per cent and 50 per cent respectively.

The substantial increase in exports since the mid 1980s is attributable to a number of factors. In the early stages of the boom— 1985–86 to 1987–88— export growth was fuelled by a surplus of premium grape varieties stemming from overplanting in the early 1980s. In contrast, a shortage of grapes— and corresponding increases in grape prices— were major factors in stifling export growth in the subsequent two years. The rapid expansion that resumed after that period was, in the first instance, aided by a decline in domestic demand for premium wine associated with the economic downturn, but has mainly reflected a conscious decision by wine companies to aggressively pursue export sales and an increase in grape plantings in response to the high prices prevailing in the late 1980s.

Despite the rapid expansion in exports, by world standards, Australia is still only a relatively small player. International trade in wine is dominated by France and Italy which collectively accounted for around two-thirds of the value of total world exports in 1992 and about 50 per cent of the volume of exports.

Although Australian exports were less than 5 per cent of the value of France's exports, it ranked as the worlds sixth biggest exporter of wine in 1992 (see Table 4.1). In that year, it accounted for 2.2 per cent of global exports. In volume terms, Australia was ranked ninth in the world in 1992.

Most Australian exports are targeted at the premium end of the market. Bottled wines currently comprise around 70 per cent of exports. This compares with about 60 per cent in 1992–93 and 1993–94. In value terms, the figure is considerably higher— around 85 per cent. Some wine is sold in bulk, mostly to Sweden, where it is subsequently bottled. Considerable quantities of cask wine are also exported, mainly to New Zealand.

Since the late 1980s, exports of bottled wine have accounted for over 80 per cent of the growth in total bottle sales, and over 60 per cent of the growth in total exports. In volume terms, exports of bottled wine now rival domestic sales of bottled wine.

Exports are dominated by the larger wine companies. The three largest– Orlando, Southcorp and BRL-Hardy— accounted for over 60 per cent of exports (by value) in 1992–93. In that year, the ten leading exporters accounted for over 85 per cent of the value of all wine exports. Other large exporters include Mildara-Blass, Yalumba, McWilliams, Mitchelton, Cranswick Smith, Rosemount and De Bortoli.

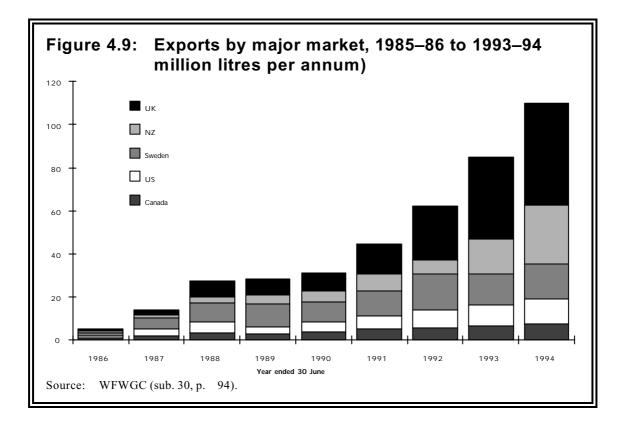
Australia exports most of its wine to the United Kingdom, United States, New Zealand, Sweden and Canada (see Figure 4.9). In 1993–94, these countries accounted for approximately 84 per cent of the volume of Australian exports and 82 per cent of exports by value. Average unit values of exports to the United Kingdom, the United States and Canada in 1993–94 were \$3.38, \$4.54 and \$3.16 per litre respectively. Exports to Sweden and New Zealand were far lower — \$1.50 and \$1.33 respectively— reflecting the significant proportion of bulk wine sold to these countries.

Major suppliers		Major buyers	
	US\$m		US\$m
France	4 265	UK	1 756
Italy	1 611	Germany	1 726
Spain	901	USA	1 183
Germany	527	Bel/Lux	711
Portugal	509	Netherlands	564
Australia	188	Switzerland	464
USA	171	France	457
Hungary	110	Japan	343
Bulgaria	84	Canada	304
Chile	74	Denmark	277
Other	246	Other	888
Total	8 686	Total	8 673

Table 4.1: Major suppliers and buyers of wine. 1992

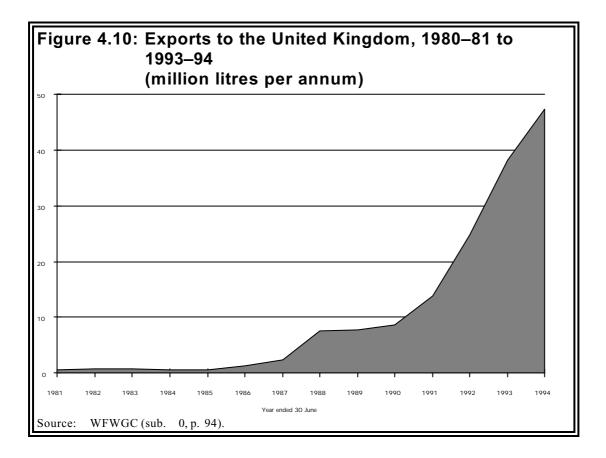
Exports to the United Kingdom have grown rapidly (see Figure 4.10). The United Kingdom is now by far the largest export market for Australian wines, representing 36 per cent by volume and 45 per cent by value of Australia's wine exports in 1993-94. Nonetheless, Australia's share of the total United Kingdom market is relatively modest— around 6 to 7 per cent.

Australia's exports to the United Kingdom are concentrated in the upper end of the market, with almost all sales above £3— presently equivalent to about A\$6.50. In excess of 50 per cent of the United Kingdom market is below this point. According to the WFWGC, only 4 per cent of wines in the United Kingdom sell at more than £5 per bottle. The Australian share of some higher price brackets is thus significant. For example, Australia outsells France in the profitable £6 to £10 bracket, and has 20 per cent of all sales in this category. An Orlando product — Jacob's Creek — is the largest selling bottled wine brand in the United Kingdom.



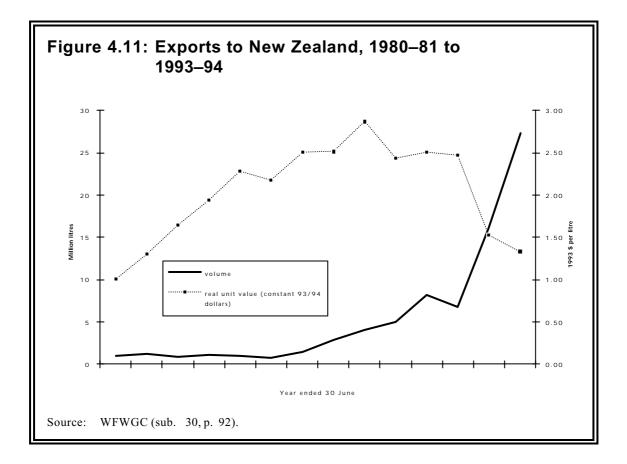
The volume of Australian exports to the United States is only about 40 per cent of that exported to New Zealand but, because of the relatively high unit value of export sales, it ranks as Australia's second biggest customer in terms of value. Sales to the United States doubled between 1990–91 and 1993–94. In value terms, Australia supplied 4 per cent of all wine imported into the United States in 1993.

Although there has been a significant decline during 1994–95, exports to New Zealand have increased remarkably since 1986–87. In that year, exports were 1.1 million litres. In 1993–94, exports were 27.3 million litres. As much of the increase has been in cask wine, the increase in the value of exports– although substantial — has not been as great (\$5 million to \$36 million). This is reflected in the unit value of exports to New Zealand falling from \$3.22 to \$1.33 per litre over the period (see Figure 4.11). In 199394, Australia supplied approximately 90 per cent of the volume of all wine imported into New Zealand. This compared with less than 70 per cent three years ago. The gain was achieved largely at the expense of sales of locally produced non-premium wine.



Unlike Australia's other major export markets, sales to Sweden have been relatively stable in recent years although, as noted above, sales have declined significantly during 1994-95. About 60 per cent of exports are shipped in bulk for bottling in Sweden. Offshore bottling enables importing nations to make use of cheaper bottles and larger bottling plants. The Committee was told that bottling costs in a new \$200 million plant in Sweden were about half the costs in Australia.

Exports to the only other non-English speaking market of any significance– Japan — have not matched the increases achieved in other markets. Sales have declined in recent years and, in 1993, Australia accounted for only 3 per cent of Japanese wine imports. In 1993–94, exports of Australian wine to Japan and other Asian countries represented less than half of one per cent of all Australian exports.



5 POTENTIAL FOR DEVELOPMENT

This chapter mainly focuses on the insights gained by the Committee from discussions with a wide range of organisations and individuals and from written submissions about factors influencing, and likely to influence, the industry's development potential. They are necessarily impressionistic and are not meant to be an exhaustive discussion of all factors that may affect the industry, nor an exhaustive discussion of each of the items identified. Prior to this discussion, the following section briefly looks at the market outlook for wine.

5.1 Market outlook

As outlined in Chapter 1, the industry is aiming to expand output by about 70 per cent over the period to 2010. This would involve wine production of 1 billion litres in 2010, valued (in current prices) at over \$2.5 billion.

While increased export sales are expected to be the major contributor to growth, the WGWGC forecasts imply average annual growth in domestic sales of around 2.5 per cent.

Demographic changes will help boost local sales. In the short term, annual population growth resulting from Australia's immigration program and natural increases is forecast to be between 1.2per cent and 1.4per cent. The population is expected to age— this is also likely to increase demand as market research cited by the WFWGC suggests that older people have a stronger preference for wine than the community generally.

Per capita consumption of wine in Australia is presently around 15 per cent below the peak of 21.6 litres in 1985–86. It is also substantially lower than average consumption in many European countries (eg per capita consumption in France, Italy and Portugal is over 50 litres). However, as many European countries have a long established tradition of drinking significant quantities of locally produced 'vin ordinaire'— particularly by people in lower income brackets — the higher consumption in European countries cannot be interpreted to imply that Australian per capita consumption will approach that observed in parts of Europe. Locally, future demand is more likely to reflect domestic market conditions, and Australian preferences and social attitudes. In this regard, so-called 'lifestyle' changes (eg greater concerns about diets and health) could place further downward pressure on per capita consumption. Over the period to 2010, there will clearly be some compositional shifts in domestic demand. For example, the WFWGC expects the shift from cask to bottled wine to continue, with growth in the bottled (premium) sector to be in the order of 5 per cent annually until the turn of the century. Demand for fortified and flavoured wines is expected to continue to diminish.

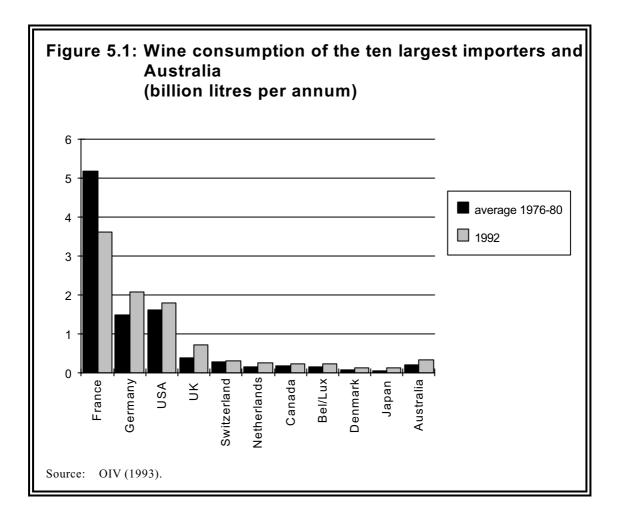
Under the WFWGC's scenario, the major impetus for growth will come from increased export sales. Annual exports are projected to increase to over 500 million litres — equivalent to about 5 per cent of the value of international trade in wine. In volume terms, this represents an increase of some 300 per cent between 1993–94 and 2009–10.

Internationally, consumption of wine has been in decline for some years. Consumption peaked in the late 1970s— averaging 28.6 billion litres between 1976 and 1980. Subsequent falls— particularly in the mid 1980s— saw consumption decrease to 23.1 billion litres in 1989. Since then, global consumption has stabilised. In 1992, consumption was 22.9 billion litres.

The decrease in world consumption mainly reflects significant falls in a small number of major consuming (and producing) nations. Indeed, much of the fall is explained by a decline in consumption in France, Italy and the former USSR. Collectively, these countries account for around 40 per cent of total world consumption. The decline is largely of wine which, by Australian standards, is generally of very low quality and produced predominantly for local consumption. In these circumstances, falling levels of global consumption do not necessarily imply reduced opportunities for Australia and other exporters of premium wine.

From Australia's perspective as a wine exporter, an important factor is consumption in the major importing countries (see Figure 5.1). Apart from France, each of the world's ten largest importers has increased consumption since the beginning of the eighties. Australia's other major customers, Sweden and New Zealand, have also increased their consumption over the period. Indeed, Australia's largest market— the United Kingdom— has had the world's largest increase in consumption over the period. Similarly, consumption has increased in Germany and the Netherlands— both of which have been targeted by the Australian industry as areas of likely export growth.

Australia has a locational advantage in supplying many Asian countries. Throughout the region, strong growth in demand for wine is expected (albeit from a relatively low base) in response to rising living standards and changing consumer tastes.



The fact that consumption in Australia's main export markets is not exhibiting the sharp declines observed in some European markets and the proximity of Australia to emerging Asian markets are points in favour of the Australian industry. Nonetheless, if it is to meet its growth targets, the industry will have to continue to improve its competitiveness to counter challenges that will inevitably emerge from established exporting nations that have lost market share to Australian exporters and from emerging exporters, such as Chile, South Africa and possibly Eastern European countries (eg Hungary). Just as importantly, the industry will need to attract the capital required to finance the substantial investments required to provide it with the grape supplies and productive capacity needed to fulfil its growth projections. To achieve these objectives, the industry will have to build on its present strengths and adopt strategies to overcome some apparent weaknesses and emerging threats. Factors which the Committee sees as strengths and weaknesses, and some of the threats and opportunities faced by the winegrape and wine industry are discussed in the following section.

5.2 Strengths, weaknesses, opportunities and threats

Strengths

The international competitiveness of the Australian industry is built on its ability to produce a wide range of relatively high quality wines at competitive prices, often referred to as good 'value for money' wines. This strength rests on a number of characteristics, some natural, some the result of the actions of individuals or firms in the industry, and some which are likely to be temporary.

Natural advantages

Australia has the soil and climate to enable it to grow grapes suitable for a highly sophisticated and diverse wine industry. In addition, land is both abundant and cheap in comparison to the traditional producers of Europe. Grapegrowing regions stretch across a vast geographical area from southern Queensland to the south west corner of Western Australia. This geographical diversity offers some protection from regional vintage variability caused by adverse weather conditions, pests and diseases. In addition, it allows Australia to produce a range of wine styles which, together with a willingness (and freedom) to blend to market tastes, enables Australian winemakers to produce a wide variety of products of consistent quality.

Technology and resources

On their own, natural advantages are unlikely to have been sufficient to build a successful, competitive industry. The actions of the people in the industry — and their willingness to support research and innovation— are of equal if not greater significance. Australia is recognised as being in the forefront of winemaking technology, both in terms of the development of that technology and in its adoption in grapegrowing and winemaking practice. In winemaking, the AWRI can be seen as one of the industry's strengths. A significant factor contributing to its success is its control by the industry. This ensures that its research is efficiently carried out and is relevant to the needs of the industry. Other research organisations— including publicly funded agencies such as the CSIRO— have also contributed to industry competitiveness, mostly in the grapegrowing area through research in areas such as mechanical harvesting and pruning.

Research is backed by what is widely regarded as world class viticultural and oenological education. Australian training is highly regarded, to the extent that there is a ready export market for Australian's with winemaking skills. The skilled personnel provided by the training institutions have also contributed to the adoption and spread of new technology.

The industry has exhibited a willingness to experiment and adopt new technologies. Consequently, there has been a rapid uptake of research results, which have translated into a competitive advantage for the more enterprising producers. In part, this commitment to innovation is due to the industry not being shackled by some of the stifling traditions in winemaking that pervade Europe. More specifically, it reflects the lack of restrictive regulation of grapegrowing and winemaking that has made the upgrading of the industry in Europe so difficult.

Large firms

Advantages in production are matched by strengths in organisation and marketing. The existence of large wine companies— ten wine companies are now listed on the Australian stock exchange— is a significant strength of the industry. The larger companies are able to realise some economies of scale. At the same time, they have the capacity to raise the funds, both through equity and borrowing, to finance the investment in new technology and the expansion of vineyards necessary for future growth. They also have the capacity and experience to deal with large overseas distribution networks and to provide the volume, variety and consistency of supply that larger distributors need.

Diversity

While the large firms have come to dominate the industry and, in large part, determine its overall competitiveness, the existing diversity of production, and the large number of smaller firms also represents an industry strength. The smaller firms are important to the image of the industry— a very important factor in wine marketing. Some smaller firms have successfully carved out niches for themselves on the export as well as the domestic market. Although an increasing proportion of winegrapes is being grown by winemakers, the contribution made by independent grapegrowers is a significant factor underlying the industry's success.

Domestic competition

Cut throat competition in the domestic market— particularly in the cask and lower priced bottle market segment— has also been a strength. Competitive pressures increased when some major multinational corporations entered the industry in the 1970s and commenced volume marketing through retail chains. These competitive pressures have forced local producers to make improvements in production and marketing. To the extent that the cask wine sector has contributed to the development of Australian wine companies, and continues to underpin their size advantages, its development can be seen as one of the industry's strengths.

Clean-green image

As well as a reputation for supplying good value for money wines, Australia benefits from a reputation as a supplier of a 'clean, green' product. In part, this is the result of Australia's climatic conditions which reduce the need for the use of chemicals, and in part the result of Australia's isolation that has protected it from some diseases that must be controlled by heavy chemical use in other countries. On the winemaking side, Australia has pioneered the use of clean winery technology. This has seen quality improvements achieved by means of engineering rather than greater use of chemicals.

Show system

Another factor that is said to be a strength of the Australian industry is the wine show system which provides a consistent and reliable indication of wine quality throughout the country and between vintages. It has provided a forum for winemakers to compete on technical grounds, and for the practical application of widely accepted benchmarking amongst all winemakers. It is a training ground for judges of fine wines, who in turn assist in educating producers and the Australian public about wine and winemaking. Assisted by the fact that success at shows can be converted into marketing advantages, the system has attracted strong industry support and has helped raise technical standards throughout the industry.

Industry leadership

Strong industry leadership is a strength of the industry. This has shown up in a coordinated approach to research and development, and to the promotion of wine, particularly on the export market. A sophisticated industry media has successfully promoted the positive image of the wine industry and contributed to the growth of wine consumption in Australia.

Temporary factors

Temporary factors — such as a surplus of premium grape varieties and a relatively low exchange rate— assisted the industry to expand exports in the mid to late 1980s and helped establish Australia's position in international markets. However, export success has eliminated any surplus and contributed to significant grape prices rises— and the Australian dollar has strengthened

since the late 1980s. Concessional tax treatment, particularly in comparison with other alcoholic beverages, which may have contributed to the establishment of the volume wine market, has been reduced with the progressive increase in wholesale sales tax from zero in the mid 1980s to 24 per cent today. However, the industry will increasingly need to rely on its underlying competitiveness and its production and marketing expertise to maintain and expand future exports. Both of these are fundamental strengths of the industry.

Weaknesses

The grapegrowing and winemaking industry, as do all industries, suffers from a number of weaknesses which undermine its competitiveness. They are not sufficient to seriously threaten the industry, and some can be addressed by industry and/ or government action. Others are features of production or marketing that simply have to be accommodated by the firms themselves.

Domestic marketing

In terms of wine consumption per capita, the domestic market has been generally in decline since 1986. This is within the context of a longer-term decline in alcohol consumption both in Australia and in other developed economies. Although per capita consumption has stabilised in recent years, there are few signs that this decline will be reversed in any significant way. Nonetheless, compositional changes within the wine market— notably the continued growth of bottled wine sales— will provide opportunities for some in the industry. In other market segments, such as fortified wine, a continued decline in demand is expected by most in the industry.

Limited variety in the domestic distribution system, resulting from the rationalisation of the wholesaling industry, could hinder development in some sectors of the industry. While it can open up the potential for significant sales once arrangements are made with wholesalers, it favours the larger firms and can make market entry for small firms more difficult.

The industry is also hindered by antiquated liquor licensing laws in a number of states, and the traditional, though declining, dominance of liquor distribution by the hotel industry, with its concentration on the sale of beer. In some cases, this dominance is reinforced by state government licensing regulations that favour the position of the hotel industry

The limited availability of low alcohol wine products can also be seen as a weakness of the industry, particularly at a time when consumers are becoming

more health conscious and governments are taking greater steps to reduce the adverse effects on society of excessive alcohol consumption.

Concentration of exports

On the export market, the key weakness is the dependence on only a few export markets for the bulk of sales, in particular the significance of one market, the United Kingdom. As well as the possibility of saturation in these markets limiting growth, there is the threat of a major fall in exports if demand for Australian wine declines in one of the key markets. As exports develop, however, this reliance on only a few markets is likely to diminish, thereby spreading the export risk for the local industry.

Australia's distance from key export markets is a disadvantage facing the local industry. It limits the export viability of higher volume, lower value wines, presently restricting Australia to the lower volume middle to upper segments of most overseas markets. As with many factors influencing the industry, this can be an advantage as well as a disadvantage. The benefit derives from the potential to establish a consistent quality image for Australian wine which, if successful, can provide a more secure market than one based solely on price.

Packaging costs

On the production side, the high cost of packaging undermines industry competitiveness (see Chapter 9). In part, this is a natural feature of the small size and wide geographical dispersion of the local industry, and of Australia's isolation which makes importing— of bottles in particular— difficult on a cost-effective basis. The small size of the market has resulted in the existence of a single bottle manufacturer, with corresponding concerns about a lack of competition and 'monopoly pricing'. This situation may not change unless the industry reaches a size where the establishment of a rival bottling plant becomes a viable proposition, or technological change permits economic bottle production to occur at lower volumes. A number of factors, such as the possibility of imports, cap bottle prices. Also, the larger wine companies appear to have sufficient market power to negotiate 'acceptable' prices. In this situation, smaller winemakers are likely to bear the brunt of any monopoly pricing that is occurring.

Scale of grapegrowing operations

In the grapegrowing area, the large number of very small scale operations represents a weakness for the industry. This is the product of a long history of the development of agriculture in Australia, particularly in the irrigated areas based on soldier-settler blocks along the Murray and the Murrumbidgee. The small size has a number of consequences that hinders development. These include: a limited ability to raise capital for expansion or the adoption of new technology and practices; difficulties in obtaining knowledge in a wide range of areas, including market development, new practices and opportunities for expansion; and a slowness to adapt to changes in the market— mainly stemming from the difficulties of obtaining and processing information. These problems are accentuated in some areas, such as the MIA, by restrictive regulations that limit the scope for rationalisation and the development of larger scale more efficient grapegrowing activity. These regulations are being reviewed, and in the case of the MIA, the New South Wales Government has indicated an intention to remove the restrictions. The changes need to be implemented as soon as possible to provide producers with the flexibility required to adapt to changing market conditions— a need that is particularly pressing given the planned expansion of the industry.

The fragmented nature of grapegrowing has also shown up in a less coherent and concerted view from the industry on such things as research and training, particularly in comparison to the wine industry which is particularly well organised. Research into grapegrowing, in comparison to that of winemaking, is generally perceived to be underfunded. At the same time, despite identified strengths in tertiary eduction, shortages of vocational training through the TAFE system has disadvantaged grapegrowing activity. This is a particular weakness at the moment with significant expansions in vineyards already commenced, and shortages of trained staff to manage their development.

Attitudes to change

Another constraint is caution on the part of independent grapegrowers, together with constraints on their ability to raise capital. The growers' reluctance stems from the history of the wine industry. Some growers appear to be locked into traditional family farming practices. Some are wary of the possibility of excess supply and low prices (as has occurred in the past). They are not sufficiently confident of the sustainability of export demand to commit themselves to a major increase in debt levels.

Availability of capital

The availability and cost of capital is a problem for many small grapegrowers — as it is for small businesses elsewhere in the economy. However, for the grapegrowing sector as a whole, access to capital is probably not a major weakness. Much of the planned plantings are being undertaken by the wineries themselves— motivated, in part, by desires to have greater control over their premium grape supplies and to stabilise costs. The largest of the wine companies are publicly listed companies, with a track record of being able to raise investment capital and with the size necessary to undertake significant borrowing. Significant other expansion is being undertaken by large scale commercial growers, often with contractual relationships with wineries arranged prior to development of the new area.

Rootstock

Longer term expansion requires the planting of considerable hectares of new vines. Much of this has begun, or is planned. A constraint in the form of shortages of rootstock, cuttings etc from nurseries has recently appeared. However, this is likely to be only a temporary constraint in the current period of particularly rapid growth.

Relationships between grapegrowers and winemakers

Although wineries are becoming more self-sufficient in grapes, there will always be a role for independent growers. Difficulties in developing an acceptable contract system between grapegrowers and winemakers are a weakness. In the past, this has resulted in sometimes bitter relationships between wineries and growers. The industry has often relied on informal relationships rather than on contractual arrangements. Such relationships inevitably come under strain at times of variability of vintage and price. Independent growers have suffered most in times of excess supply, either receiving very low prices on the 'spot market', or at times being unable to sell their product to the winery. Conversely, in times of shortage, spot prices can rise dramatically. Such price variability also places strain on any contract system aimed at stabilising prices. To the extent that there is tension in the relationship between growers and wineries, communication becomes less effective, and coordination, particularly of expansion plans, is not as effective as it could be. To some extent, this has been evident in the current expansion phase.

There now appears to be a greater willingness on the part of winemakers to develop longer term contractual arrangements with grapegrowers (see Chapter 9). In some instances, this has resulted in them underwriting minimum prices over a number of years to provide growers with the security needed to borrow funds needed for major vineyard expansions.

Grape price variability

Grape price instability is an inherent problem with the wine industry– and is one of its weaknesses. In the short term, it largely reflects variations in supply (mainly because of weather conditions). In the longer term, delays in responding to price signals and a lag between grape planting and the production of a marketable wine can result in accentuated price movements. Vines can take 2 to 3 years to be productive, and a significant proportion of wine takes at least another year to be saleable. In the past, this was not a major problem because the industry supplied mainly the domestic market, where all suppliers were essentially equally affected. This is no longer true– prices cannot be simply 'passed on' in export markets where local suppliers face fierce competition from a range of other countries. Unless wineries are prepared to produce the bulk of their grape needs, there is a need to increase communication between winemakers and grapegrowers, and to provide accurate and reliable information to help grapegrowers respond to changes in market conditions.

Low financial returns

A weakness identified by some participants is low returns on investment in winemaking. This is said to apply to both the large companies and the smaller winemakers. For the larger companies, it is a problem in that investment in winemaking must compete for funds with a range of other investments. For small producers, low returns may largely reflect the 'lifestyle' values that many gain by being in the industry. For larger producers, low returns could reflect the rapid change and high levels of investment as the industry seeks to expand. In this sense, low returns could be temporary, rather than a reflection of longer terms conditions.

Opportunities

The industry has developed rapidly over the last decade. Nonetheless, there are opportunities for further expansion. To capitalise on the available opportunities the industry will, however, have to ensure that, following the export successes of recent years, complacency doesn't reduce the industry's drive to maintain its competitive edge. Continued growth is likely to be contingent on the industry further increasing competitiveness and ensuring that pricing and quality continue to be appropriate to market needs.

Domestic market

On the domestic market, despite an overall decline in consumption, the bottled segment continues to grow. The maturing of the domestic market, the ageing of the population, and the associated evolution of consumer tastes, will also provide opportunities for local producers.

Export development

Based on Australia's fundamental competitiveness in wine production, the scope for export expansion is still great. However, the expansion opportunities may be in new, and more difficult markets, rather than in the familiar western markets, some of which may be approaching saturation levels in terms of their demand for Australian wine.

The Asian market has considerable potential. The Asian population is large, and the consumption of wine is only a fraction of that in western countries. Wine drinking does not form an integral part of Asian culture and few can afford what is seen as a luxury product. However, this is changing. Per capita income in many parts of Asia is increasing rapidly, accompanied by an increased interest in western products, including wine.

The proximity of Australia to Asia means that we are well placed to tap into this growing market. However, other countries will also be competing for this new market. Given that much of the new Asian demand represents newly wealthy consumers with little experience in wine, the brand name power of traditional suppliers, such as France, will be particularly strong. Australia's difficulties in selling to the Japanese market are an indication of the problems of competing in this type of market. Nevertheless, as the Asian market develops and matures, opportunities will open up for significant Australian exports. To make the most of these opportunities, Australian exporters will probably need to be prepared to make a medium term commitment, and perhaps to receive only low— or even negative— returns while developing a presence in Asian markets.

The opportunity, or perhaps more accurately, the challenge for the Australian wine industry is to evolve beyond being simply a supplier of good value for money wines into an industry with greater reliance on product differentiation and brand development. Once established, these advantages are more robust than simple price advantages.

Improving competitiveness

The potential for the further expansion of the export market provides the winegrape and wine industry with a major opportunity to increase the productivity and competitiveness of grapegrowing. It provides the opportunity for major new investments in large scale, state-of-the-art vineyards, with a corresponding significant shift in the cost structure and competitiveness of winegrape growing in Australia.

Opportunities to increase competitiveness also exist through continued innovation, one of the existing strengths of the industry. Technology, such as

genetic manipulation, raises the potential of improved grape varieties and enhanced disease resistance resulting in reduced need for chemical applications. This will enhance Australia's existing strength in producing 'clean, green' products. Current research into grape characteristics will improve grower/winery relationships and provide clearer incentives, and a more accurate means of improving fruit quality.

Rationalisation

Opportunities are likely to still exist for efficiency and scale gains from further rationalisation of winemaking production. While structural change of the scale witnessed in the 1970s and again in the late 1980s may not be repeated, continued growth of exports is likely to bring new pressures. Industry rationalisation is almost certainly not complete.

Threats

The Australian winegrape and wine industry faces a number of threats in its future.

Grape price increases

In the short term, grape price rises resulting from increased demand a result of export expansion and the recovery of the domestic market – could threaten export competitiveness. To some extent, grape price rises can be absorbed by the industry on the export market as a result of winemakers' selfufficiency in premium grape varieties. There is a further threat to the quality and reputation of Australian exports as a result of the temptation to reduce wine quality to minimise cost increases at a time of rising grape or other input costs.

Grape supplies

There is always the possibility of either an undersupply of grapes or an oversupply a few years in the future. Both of these conditions represent a different set of threats for the local industry. Undersupply will result in continued high grape prices, threatening competitiveness. Oversupply will result in low prices which, while good for export competitiveness, will undermine confidence in investment in grapegrowing in Australia and threaten future supplies.

Water availability

As with all irrigated industries, water availability represents one of the threats the industry faces. The industry's expansion plans envisage increased water use of around 75 per cent by 2010. The industry should be assisted by government moves to free up the transferability of water rights and create a more flexible market for irrigation water. However, if the pace of reform is not accelerated, limits on the availability of water could impede expansion plans. Increased pressure for the containment of runoff and the effects of salination, along with changes to tariff structures and to the overall level of charges, could also influence patterns of water usage by the industry.

Currency movements

A further threat is presented by increases in the value of the Australian dollar. Increased economic growth internationally usually translates into higher commodity prices, and the Australian dollar tends to track international commodity prices. However, while currency movements are inherently difficult to predict, mechanisms exist for exporters to hedge against currency movements in the short to medium term.

Taxation

Changes in domestic taxation represent a threat for the local industry. Indeed, the uncertainty surrounding taxation changes can be as damaging as any changes themselves. In practice, the threat that exists is one of increased taxation, and the likely level and timing of that increase. The uncertainty makes investment decisions more difficult, and could result in a lower level of investment than would otherwise be justified.

To some degree, all industries face uncertainty in their tax regime. However, this uncertainty is greater for the wine industry given the large differences in the tax treatment of wine and other alcoholic beverages. Although the Government's response to the recommendations of this inquiry may reduce some of the present uncertainty, a degree of uncertainty will persist as long as significant differences remain.

Disease

In the longer term, threats exist from the spread of diseases, or the introduction of new diseases from overseas. The industry and government agencies need to maintain vigilance against the spread of diseases, and not be tempted by shortcuts as a result of current temporary supply shortages.

Health concerns

Health concerns over the effects of alcohol consumption represent a long term threat to the industry. This may show up as a continued decline in the domestic market, and even in the export market. It will also result in continued pressure for higher levels of taxation on wine, and restrictions on marketing through increased regulation of advertising or other promotional activities. The industry can influence this debate by continuing to contribute actively to campaigns stressing moderate consumption, and by sponsoring research and the distribution of information on the health benefits of moderate consumption.

The cask market, which has been described above as a strength of the industry, in some senses also represents a threat to the industry. It attracts the attention of the health lobby, leading to pressures for increased taxation across all wines, and/or increased restrictions on marketing freedom. Government action in these areas would invariably reduce domestic demand.

External factors

On the export market, the success of Australian exports will inevitably result in a response from traditional suppliers such as France and Italy. These companies are already seeking to adopt Australian technology. Such competition will intensify.

A potentially more dangerous threat is the possible introduction of trade barriers designed to restrict Australian sales. Given recent developments in trade, these are more likely to take the form of non-tariff barriers (such as health or labelling restrictions) rather than direct limitations. Such indirect restrictions are notoriously hard to overcome once introduced. The recent EC/Australia wine trade agreement should reduce that threat from Europe, but both the industry and Government should be active in campaigning for the reduction of barriers and opposing any moves to introduce new trade restrictions.

Competition from other new world suppliers, particularly Chile, South Africa and, to a lesser extent, Eastern Europe, will also threaten Australia's export position. Chile is seen to be particularly competitive at the current time. Costs — particularly for grapes and labour— are relatively low and improved winemaking practices have led to higher quality levels.

Views on both the extent of this threat and the time it will take to appear vary widely. However, the consensus appears to be that, for a variety of reasons, most potential new competitors still lag behind the Australian industry. For South Africa, some refer to delays in introducing appropriate varieties. Problems of political instability and poor institutional development could hamper the development of the industry in Eastern Europe. In the case of Chile, it is claimed that improvements in supporting infrastructure are needed. However, none of these problems are insurmountable. Indeed, participants have said that Australia has a 2 to 4 year 'window of opportunity' to expand

and consolidate its position in its export markets before this competition becomes a serious threat.

Regulation

A longer term, and more subtle, threat to the Australian industry lies in the increase in domestic regulation. The dangers of this can be clearly seen in the experience of Europe, but regulation is nonetheless increasing in Australia, in each case based on perceived net benefits to the industry. Industry needs to remain wary of regulation and conscious that the combination of incremental change and accretion of controls could seriously threaten the very flexibility and innovativeness that is a key strength of the Australian industry.

6 RESEARCH AND DEVELOPMENT

Expenditure on research and development (R&D) by governments and by the winegrape and wine industry itself is small relative to industry turnover. Nevertheless, R&D contributes to the industry's competitiveness and, hence, is a determinant of its development potential.

This chapter considers a range of research and development issues and related institutional matters relevant to the winegrape and wine industry. It canvasses a number of issues raised by the industry at public forums, as well as broader matters to do with government support for research and development.

In considering the contribution of government, the Committee recognises that all industries must compete for limited Government research funding. Consequently, it is important that government funds (and, indeed, all research funding) be monitored to ensure that research priorities are appropriate and programs are undertaken in a least cost fashion.

6.1 Introduction

One of the strengths of the Australian winegrape and wine industry is the development and use of new processes and technologies. In grapegrowing, this has been highlighted by the rapid introduction of mechanical harvesting and pruning. In winemaking, the introduction of refrigeration has been important in contributing to efficiency and quality control in Australia's high volume warm climate wine regions. These particular technologies, however, represent only the most visible signs of a much deeper commitment by the industry to innovation and technology. The extent of the advantage is reflected in Australia's recent export success and in the high demand for Australian winemakers in both Europe and in other new-world wine regions.

In its joint submission, the WFWGC (sub. 30, p. 35) said:

Despite the importance of product demand, key long term success factors for the wine industry are to be found on the supply side where Australia has developed some important and sustainable competitive advantages through the appropriate use of technology.

According to the WFWGC, R&D undertaken locally has enabled the industry to obtain a competitive advantage in a number of areas including:

- low cost, high quality grape production;
- wine quality and cost; and
- product consistency and integrity.

Aided by these developments, the Australian wine industry has been able to significantly expand the domestic market and to successfully export wine characterised as being good value for money with consistent quality. The joint submission (sub. 30, p.36) also said:

... the Australian wine industry has established a competitive position based on a "culture of innovation" rather than "tradition".

This is seen as more than just the development of technology, but also the willingness and ability to use the technology. The preparedness of the industry to question 'traditional' winemaking practices and search for better alternatives supports this innovative culture.

The Australian Wine Research Institute (AWRI) saidhat Australia, in spite of its small production base and relative isolation, has an international reputation for the quality and extent of its wine research output by any measure.

Research and development relevant to the industry is conducted by a number of research organisations. Two organisations dominate, and have done so for many years. They are the CSIRO Division of Horticulture and the AWRI. Contributions to strategic research have also been made by the various state government departments of agriculture and the University of Adelaide. Charles Sturt University has begun to undertake research within the Cooperative Research Centre for Viticulture (CRCV) framework. Research and development is supported by viticultural and oenological (winemaking) education offered primarily through the University of Adelaide (Waite Campus) and Charles Sturt University (Wagga Wagga Campus). Courses formerly taught at Roseworthy Agricultural College, which ceased to exist at the end of 1990, are now the responsibility of the University of Adelaide.

Commonwealth contributions to research funding are channelled primarily through three organisations. The first is direct funding for the CSIRO, part of which is to the Division of Horticulture for grape research. The second organisation is the GWRDC, with funds of \$3.5 million in 1993–94, half of which is government contribution and half drawn from industry by way of levies. The GWRDC does not undertake research—its function is to evaluate and coordinate research projects and disburse funds to researchers and research organisations. The third organisation is the recently established CRCV, with Commonwealth funds of about \$2 million per annum over seven years, a total of \$12.8 million. Research funding by government is supported by the in-house research of the major wine companies, together with

considerable informal innovation and product development undertaken by individual wine companies throughout the industry. Such private research tends to concentrate at the short term problem solving end of the research spectrum, with the major research organisation being responsible for long term strategic research.

The following sections look at the major research organisations involved in the winegrape and wine industries and at participants' comments on the focus of their research activity. The appropriate role for government in industry R&D is then reviewed. This involves considering both the role and level of public contribution to industry research. Addition questions canvassed concern:

- whether the level of public funding should differ between grape and wine research; and
- the role for, and basis of, compulsory industry levies to fund R&D.

6.2 Rationale for public funding

In most countries, there is extensive government support for research in all sectors of the economy. The central rationale for government involvement is the existence of external or 'spillover' benefits commonly associated with research activity, particularly pure (or 'basic') research. Individual researchers cannot reap all the benefits of the research that they undertake-some benefits accrue to the broader community for which individual researchers or firms receive no compensation. In these circumstances, the incentive to undertake research is reduced and there is a likelihood that, from the community's perspective, there will be under-investment in research without some form of government intervention.

Government intervention has typically taken two broad forms. The first is the establishment of a patent system which provides researchers with a temporary monopoly on the results of research, to ensure that the benefits can be captured by those undertaking the research. Patents, however, even with their extension to cover such things as plant varieties, are not appropriate in all cases. This has led to a second form of government intervention by way of direct funding of certain R&D activities.

In the case of rural sector research, the concentration of research on natural resources (eg the use of land and water) raises the possibility of significant spillover benefits. The rationale for government support of rural research is also based on certain characteristics of most rural industries— in particular the large number of small producers and the homogeneity of many products

produced. Because most producers are small, they have difficulty in funding research, most of which is inherently high risk. Furthermore, the homogeneous nature of the outputs means that advances made by one producer invariably benefit most other producers. In this situation, it is often difficult to quarantine the benefits of research to those that undertake and fund the research. In this context, a recent report by the Allen Consulting Group (1994, p.5) commented as follows:

Traditionally rural R&D has been an area where the percentage of government funding has been high. This is true not just of Australia but also the US, Canada, UK and Western Europe. The private sector has only been significant in limited areas such as fertilisers, pesticides and agricultural machinery where the benefits can be captured by large private industrial companies. Elsewhere market failure is seen to be pervasive due to the small-scale nature of most rural producers, the difficulties of individual producers capturing the benefits of R&D and the presence of indivisibilities.

In response to these features of rural industries, the Commonwealth Government has reacted in two ways. Where the benefits of research would be captured by the industry as a whole, but the research would not be undertaken by individuals in the industry, the government has provided legislative backing for the introduction of compulsory levies to generate the necessary funds and ensure that all who benefit contribute to the cost. Where there are external benefits generated by research undertaken by the industry through, for example, research into such things as salinity problems or control of ground water, there is a prima facie case for a taxpayer contribution to reflect the benefits to both the industry and to the community generally. This has usually been provided to rural industries by the Government matching funds committed by industry on a \$2 for \$1 or \$1 for \$1 basis.

Government involvement, whether by way of legislative backing for compulsory levies or by the direct provision of public funds, brings with it certain responsibilities and obligations. In particular, there is generally a need to establish procedures for monitoring the use of funds to ensure that they are used responsibly and effectively.

On the other hand, where funding is on a voluntary basis by industry, there is no need for government involvement. The responsibility for monitoring the effectiveness of R&D funds is most appropriately left to industry.

In the case of compulsory levies, the essential overseeing role for government is to ensure that the funds are directed to projects that benefit the wider industry and ensuring that the R&D activity is not 'captured' by a particular firm(s) or group(s) within the industry. Notwithstanding this role for government, a high level of industry oversight and control of the use of the funds is required to ensure research is relevant, and to provide the expertise necessary to ensure informed evaluation of the results. In effect, this means ensuring that the organisation responsible for disbursing the levy funds has wide industry representation, and that a mechanism exists for broad industry input into decision making.

Where public funds are provided, the need for government and wider public scrutiny of the use of the funds becomes essential. Governments traditionally have an obligation to ensure that bodies receiving public monies account for its expenditure and demonstrate that it is efficiently targeted. Governments have typically done this by providing funds directly to government controlled research organisations such as the CSIRO and to universities, or more recently via the establishment of independent statutory research corporations vested with the responsibility of disbursing and monitoring funds and reporting publicly to government on the use of the funds. Where support for private research is provided, via the 150 per cent tax concession for research expenditure by firms, government relies on commercial pressures and the need for profitability in the private sector to ensure that the effort is undertaken efficiently and productively.

The emergence of rural research and development corporations in the mid 1980s followed a major change in the institutional arrangements for delivering rural R&D funding. The change flowed from concerns that R&D activity was too dominated by government and the research providers, and was thus insufficiently focused on useful outputs for industry. This dominance was seen as inherent in a system which contained a significant component of government funds being directed 'internally' to essentially government research organisations. It was also considered that greater autonomy in R&D decision making and a more demand-led system would provide the industries with greater 'ownership' of the R&D and, thus, encourage a greater willingness on the part of industry to contribute to R&D funding.

These concerns led to the establishment of R&D corporations in the rural area. An important objective was to establish research organisations as independent corporations, at arms length from both government and research providers. It was intended that the new corporations set priorities and 'contract out' research activities on a contestable basis— that is, assess competing proposals on the basis of merit and cost-effectiveness.

Certain basic principles were established aimed at:

• maximising the effectiveness and relevance of the taxpayers' investment in science and technology by strategically planning the investment over a minimum of a five year period and making publicly funded science and technology as relevant as possible to the end user;

- maximising the efficiency of research organisations through the use of contestable funding; and
- ensuring that boards comprise a mix of directors ranging from those that apply research results in business, to researchers, and to those with specialist commercial skills. Provision was also made for government representation on boards.

6.3 Grape and Wine Research and Development Corporation (GWRDC)

The institutional changes outlined above led to the establishment of the GWRDC. The GWRDC is the principal vehicle through which the Commonwealth Government provides assistance to R&D in the grape and wine industries. It is a Commonwealth statutory authority which came into existence on 2 July 1991 under the provisions of the *Primary Industries and Energy Research and Development Act 1989* Along with 12 other Corporations and five Councils, the GWRDC is part of a Commonwealth Government to joint industry/government funding of research and development in the primary industry sector. The GWRDC replaced the former Grape and Wine Research Council (GWRC) which, while a joint government/industry organisation, had been based within the Department of Primary Industries and Energy.

The GWRDC is administered by a Board comprising a chair (appointed by the Minister), 4 to 6 directors nominated by a selection committee, a government member and an executive director appointed by the Board. The selection committee comprises a chair nominated by the Minister and members representing the grapegrower and winemaker organisations. The Corporation is required to submit for Ministerial approval a 5 year research and development plan, an annual operational plan and an annual report. Reporting to industry is via presentation of an annual report and an address to the peak industry bodies — the Winegrape Growers' Council of Australia and the Winemakers' Federation of Australia. These organisations are also given a copy of the annual operational plan for comment and feedback.

The GWRDC provides separate funding for grape research and wine research. Funds are drawn from two separate levies and matching Commonwealth contributions. For grape research, the levy of \$0.90 per tonne on grapes delivered for wine production raised \$545 500 in 1993–94. For wine, the

¹ The levy is on fresh and dried grapes and grape juice delivered to an establishment for processing. Deliveries are not levied on grapes or juice delivered to an establishment which processes less than 20 tonnes (fresh grape equivalent) per year.

levy of \$1.90 per tonne collected on grapes converted into wine raised \$1 158 000 in 1993–94? Matching Commonwealth funding is provided to a limit of 0.5 per cent of the gross value of production. This resulted in expenditure in 1993–94 on the grape account of \$1 322 000, and on the wine account of \$2 168 000.³

The principal recipient of funds from the GWRDC is the AWRI. It received \$1.94 million in 1991–92 (73 per cent of total funds allocated) and \$1.96 million in 1992–93 (63 per cent of total funds and over 90 per cent of the wine account research funding).

Prior to the establishment of the GWRC, funding for the AWRI was by an annual grant from the AWBC, matching Commonwealth contributions from the Department of Primary Industry and CSIRO, and interest from the Wine Research Trust Fund. With the establishment of the GWRC in 1986, provision was made for AWRI funding to continue through the new organisation. This responsibility was transferred to the GWRDC on its establishment in 1991.

This funding of the AWRI's core overheads and operational expenses differs from the usual situation for funds disbursed through rural research corporations. When set up, Rural Development Corporation (RDC) funds were intended to provide 'top-up' funding to researchers and research organisations for specific projects, but not to fully fund a particular research organisation. However, over time, with declines in other sources of funds, greater reliance has been placed on RDCs as a major source of funds for research organisations.

6.4 Cooperative Research Centre for Viticulture (CRCV)

Cooperative Research Centres (CRCs) were introduced in 1991 to develop linkages between universities, government research agencies and industry. There are presently some 51 CRCs operating throughout Australia. Participating organisations contribute cash and/or in-kind resources to the centre, receive various levels of government funding, and collaborate in the

² The levy is on fresh grapes, dried grapes and grape juice used in manufacture of wine. Wineries using less than 10 tonnes (fresh grape equivalent) per year are exempt.

³ Total expenditure is not twice the industry levy receipts for a number of reasons. First, there is a fee payable to the Government for the collection of the levy; second, additional income is generated from interest and other minor sources; and third, the Corporation may, in any year, operate with a 'profit' or a 'loss' which is carried over into the next year.

management and production of research over a set time period, mostly seven years.

The move to establish CRCs had its genesis in a 1986 report by ASTEC, "The Core Capacity of Australian Science and Technology". The report concluded that government policies promoting linkages between private industry and public research had been effective in agriculture and mining, but that linkages within the manufacturing sector were still of concern. ASTEC recommended the establishment of interdisciplinary science and technology centres with funding from the Commonwealth, industry and the participating research organisation. It proposed that Commonwealth funding be withdrawn after a specified period (five or seven years), after which time the centres would be self supporting.

The CRC program was announced in March 1990. An important objective was to build larger integrated and cooperative research teams "building centres of research concentration". Another important objective was to develop industry input to ensure that the results of the research were useful to industry. However, the guidelines to applicants for CRC status (PM&C 1991) state that the program is aimed at the development of generic ideas and technologies with potential benefits to a range of users rather than being a specific research scheme for individual firms.

In total, the Commonwealth Government is providing \$700 million to the CRC program over seven years. The program thus represents a major commitment of government funds to research in Australia.

The CRCV was established in 1992 as an unincorporated joint venture between the following participants:

- The University of Adelaide;
- Charles Sturt University;
- The Australian Wine Research Institute;
- CSIRO Division of Horticulture;
- NSW Agriculture;
- Department of Agriculture, Victoria;
- Primary Industries (South Australia); and
- Phytotech Australia Pty Ltd.

While the CRCV does not include industry, its Board of Management includes representatives from the peak grapegrowing (wine grapes and dried fruits) organisations and the WFA, as well as representatives of the participating research organisations. The CRCV was set up following a successful application to the Government's CRC Program by the Australian Council of Viticulture (ACV). The ACV was established in 1991 to help form a CRC in the viticulture area, and remains as an advisory body to the Board of the CRCV. The ACV is made up of the principal research bodies and the peak grapegrower and winemaker organisations.

Participants have committed resources to the CRCV, principally by way of inkind contributions of staff, valued at some \$3 million per annum over seven years. Cash resources are being sourced from the Commonwealth via a CRC grant of about \$2 million per annum, totalling \$12.8 million over the seven years.

The principal objectives of the CRCV are:

- to encourage the efficient production of quality grapes with minimum residues;
- to enable the processing of grapes with minimum use of preservatives and processing aids; and
- to transfer information generated by activities of the Centre to grapegrowers and winemakers.

Research is grouped into four programs:

- biotechnology of improvement of grapes and grape products (University of Adelaide);
- low input viticulture— a systematic grapevine management system (NSW Agriculture);
- grape composition and grape product quality (AWRI); and
- education, transfer and adoption of technology (Charles Sturt University).

The joint submission (sub. 30, p.37) refers to the CRCV as:

... a significant step in the use of technology as a source of competitive advantage in the area of "clean and green" product. Objectives of minimising chemical inputs and quality advancement in grape growing through technology will be important contributors to Australia's ability to sustain competitive advantages.

The CRCV, in common with other CRCs, is not a permanent organisation with permanent funding from Government. All CRCs were established following application for funds under the CRC Program, and for the research proposals put forward by the applicants. Continued funding for individual CRCs beyond their current terms is not assured. Other organisations are able to put forward proposals for establishing a CRC in the same field as an existing CRC at the end of the seven year period, and CRCs must compete for funds with other research priorities under the CRC program.

Like the other CRCs, the CRCV is required to have a program of review of performance, including a major review two years before the end of the contracted period which will include overseas assessors. In addition, all CRCs must report annually and publicly on progress. The CRC program as a whole is to be evaluated in 1995–96.

6.5 Assessment of institutional arrangements

Level of R&D funding

The industry appears to be broadly satisfied with the level, focus and effectiveness of funding of grape and wine research and development, with the notable exception of access to funding for regional specific projects.

The level of industry levy relative to the gross value of production (gvp) is currently estimated at 0.18 per cent to 0.22 per cent for the grapegrowing sector, and 0.09 per cent to 0.18 per cent for winemaking. These are well below the 0.5 per cent of gvp at which matching government funds would cease to be provided. This could imply that, from the industry's perspective, the level of R&D funding (with some exceptions) is broadly appropriate.

This is most likely to be true in the area of wine research where the industry is well organised, capable of evaluating the need for, and benefits of, R&D, and capable of organising support for any levy increase.

The same probably cannot be said for grape research where the atomistic nature of the industry creates significant coordination and organisational difficulties, making it difficult to assess research needs and to adjust levy contributions. Indeed, the GWRDC said that viticulture research is considered to be underfunded. This view was shared by the South Australian Government (sub. 41, p. 92) which said:

The provision of research to support agricultural industries, including viticulture, is under increasing threat as State Governments reduce available appropriations and competition increases for the funds available from every source such as Commonwealth Research and Development Corporations. In the horticulture and grape and wine industries this is compounded by the fact that these industries are not as well organised as some of the other commodity based industries such as grain and wool. The more diverse and often fragmented nature of these industries results in greater difficulty in collecting equivalent funding.

Organised industry involvement in funding and directing grape research is relatively new, and grape research is still dominated by government research organisations, principally the CSIRO and state departments of agriculture. In the past, high levels of government involvement in both the provision of funds and the undertaking of research has lead to criticism that the research effort is too strongly dominated by the needs of the research providers and is not sufficiently relevant to industries commercial needs.

Stronger industry representation through greater funding of the Winegrape Growers' Council of Australia, together with the establishment of the CRCV, will enhance industry involvement in setting the agenda for grape research in the future. Government has assisted the grapegrowing industry in strengthening its representation through the provision of \$50 000 under the recent package of assistance to help establish a secretariat for the Winegrape Growers' Council. Ultimately, however, it is the responsibility of the industry to organise itself, identify research needs and marshal support for levy increases. Matching Commonwealth funds— which could double R&D funds in the grapegrowing area— are readily available once the industry organises its own contribution.

Wine research by contrast has been dominated by the private research organisation — the AWRI. As this organisation is controlled by the wine industry itself, its research is generally perceived to be relevant and sensitive to the industry's needs.

The joint submission (sub. 30, p.37) said:

The AWRI is recognised as one of the leading and more advanced wine technology organisations in the world and receives strong support from the industry.

The Yarra Valley Wine Growers' Association (sub. 98, p.5) said that it:

... wishes to emphasise the importance of and the effectiveness of the AWRI in carrying out a balance mixture of basic research and providing comprehensive practical assistance to Australian winemakers via its extension service. It is imperative that, regardless of the precise means, increased funds be provided to the AWRI on a certain, long term basis.

This view seems to be widespread in the Australian wine industry.

Funding for regional research

An area of concern to some participants is the inability to get funding from the GWRDC for research into regional specific matters. Some suggested that this could be accommodated by a reduction in the threshold level for tax deductibility under the 150 per cent tax deduction system for R&D expenditure. This particular form of assistance is discussed in Section 6.6.

The GWRDC stated that its charter requires it to provide funding for research activity that is of benefit to the industry generally, particularly as the levy collected for R&D is collected from all in the industry. Consequently,

research into issues which are unique to a particular region is not supported by the GWRDC, even though it could be beneficial to the region concerned.

One solution to this problem is to permit individual regions to impose a higher, or supplementary, levy on production in their region— and receive matching government funding— for research into topics of regional interest. The Horticulture Research and Development Corporation has a similar arrangement in place for producers of particular horticulture products. While this has been established essentially to accommodate the wide variety of products within the horticulture industry, similar arrangements could, in principal, apply to regional organisations within the grape and wine industries.

Participants to the inquiry gave broad support to the draft report proposal to establish a mechanism to gather funds for regional R&D. However, questions of whether this would involve voluntary or mandatory levies were raised, as was the question of the mechanism of identifying and approving regional projects.

Some participants asked that the responsibility for selecting projects for funding should rest solely with the region involved, with the GWRDC simply acting as an agent for distributing matching government funds.

The SAFF, however, (sub. 171, p. 8) said that:

... the regions would still have to comply with GWRDC Applications Guidelines which would ensure that the research being undertaken in a particular region does not copy research which is already being carried out ... This would allow the grape industry to have a focused national set of priorities and objectives ... It is absolutely vital that we do not return to the past situation where regional research funding is merely used to employ researchers in a particular region who are involved in merely ensuring security of employment ...

The GWRDC (sub. 160, pp. 2–3) stressed the need for a strongly integrated, planned and reviewed national program to ensure that any regional R&D is relevant and effective. The GWRDC proposed that regional R&D be limited to 25 per cent of the total industry R&D contribution (national plus any regional levies). In the GWRDC's view, such an approach would maintain the key strategic and basic research necessary for the successful application of regional projects.

The other question raised was whether regional funds should be collected on a mandatory or a voluntary basis. The Committee considers that mandatory levies at the regional levy would involve excessive administrative procedures. It would require acceptance of defined regions, such as those being set up by the GIC, and the establishment of a formal mechanism to collect levies. In view of the size of some regions, and the relatively small amounts of money envisaged, this would impose a significant bureaucratic and administrative

burden in relation to the funds likely to be involved. The Committee considers that a system allowing for voluntary levies is more practical. Although it will result in an incentive for some producers in a region to 'opt-out' and 'freeride' on the research funded by others, peer pressure would reduce this incentive. The voluntary arrangements could involve any combination of grapegrowers and winemakers getting together to provide funds and propose research projects for matching Commonwealth funding through the GWRDC. This would be in addition to funds raised by the current levy system.

The Committee recommends that a mechanism be established to permit regional winemaking and grapegrowing organisations, or any other grouping of grapegrowers and winemakers, to collect funds to undertake R&D of particular relevance to their region. These funds would be matched by the Commonwealth under the existing arrangements provided by the Primary Industries and Energy Act 1989, subject to the proposed research being approved by the GWRDC.

The role of levies and government funding

The grapegrowing industry in Australia exhibits many of the characteristics which have lead to the introduction of levies in a number of rural industries. The industry is characterised predominantly by small producers who are unlikely to be able, individually, to undertake R&D activities. As with other rural research, the benefits are not always saleable and not alway capable of being controlled in a manner that allows the innovator to recoup costs from all beneficiaries. Recent developments, such as the establishment of plant variety rights have overcome some of the problems inherent in agricultural research but, nonetheless, the industry retains characteristics that would warrant compulsory levies to fund research. One example is research into disease control which cannot be restricted to a particular area and requires wide application to be effective.

The case for direct government funding rests on the existence of spillover benefits outside of the grape and wine industries. While examples of these spillover benefits certainly exist, the current level of funding on a dollar for dollar basis implies that half of the benefits of research in this area accrue to the community generally.

The wine industry has quite different characteristics to the grapegrowing sector. In the past it was dominated by a large number of small fragmented producers. However, this is no longer the case. Production is now dominated by medium to large companies quite capable of funding their own research, and at the level necessary to be eligible for assistance under the 15per cent tax concession for R&D expenditure. Furthermore, wine production, by being

a relatively sophisticated processing activity, does not appear to exhibit the characteristics of a rural industry in terms of problems with internalising and appropriating the benefits of research. On these grounds, the case for a compulsory levy for the wine industry is not as strong as it is for grapegrowing, and the case for a public contribution to wine research is even less strong. On the other hand, it can be argued that the bulk of the industry still comprises a large number— in excess of 700— small firms that are similar in character to the small firms in other industries that benefit from government funding of R&D corporations.

Another relevant consideration is the Government's Innovation Statement expected later this year. This statement will address many of the issues canvassed by a recent Industry Commission report into R&D in Australia, including matters relating to the level and form of government contributions to R&D. In these circumstances, any changes to R&D arrangements recommended by the Committee for the winegrape and wine industry could be made redundant by any subsequent change in Government policy.

The Committee considers that the level of government funding for R&D in the grape and wine industries would be better assessed as part of the Commonwealth Government's consideration of R&D policy generally. In the interim, the Committee considers that the level of funding of grape and wine research should remain unchanged.

Another matter that has been the subject of some discussion in the industry is the basis for levying producers. Some consider that the levy should be changed so that it is based on the value of grape production (for grapegrowers) and purchases (for winemakers), rather than on volume. The reason for such a change is that a levy based on volume represents a greater proportion of costs for producers of lower value products than for producers of higher value products.

In principle, a levy based on value would be more equitable. However, the problem is one of administrative practicalities. Many firms are reluctant to disclose the prices received for their output, or paid for inputs, as this information is often seen as commercially sensitive. In addition, the high degree of vertical integration in the grape and wine industry means significant internal transfers occur at prices that would be difficult to identify or verify.

As a consequence, the Committee considers that a change in the levy base is impractical.

An additional matter raised in relation to the administration of R&D funding in the grape and wine industry was the proposal to merge the GWRDC with the AWBC. This is discussed in the following chapter.

6.6 150 per cent tax concession for R&D expenditure

As well as direct government funding of research through the CSIRO, the CRCV and the GWRDC, firms in the winegrape and wine industry are eligible to claim benefits under the 150 per cent tax deduction for R&D expenditure provided by Section 73B of the Income Tax Assessment Act.

The concession provides a subsidy, through the tax system, for eligible R&D expenditure.⁴ The 150 per cent concession is available where a company's annual eligible expenditure exceeds \$20 000. According to the IR&D Board, a threshold had been put in place because some minimum expenditure was considered necessary for "significant" R&D programs, and to help minimise opportunities for tax avoidance.

The industry in its joint submission said that there seems to be little evidence of corporate growers and winemakers claiming benefits under these arrangements. The industry attributed this to a number of factors, most of which relate to the small size of most grape and winemaking enterprises. Factors identified by the industry include:

- uncertainty about what expenditure qualifies;
- members not having the resources to investigate the complex legal issues involved; and
- the minimum expenditure per annum of \$20 000 required before any benefit is obtainable.

The industry made a number of proposals aimed at overcoming these problems. These were:

- funding be provided to allow the industry to investigate and provide information to members;
- lowering the threshold level to \$5 000; or
- as an alternative to reducing the R&D threshold levels, directing levy payments to a body that has the status of a registered research agency and, accordingly, the payments being eligible for R&D tax concessions. The industry referred to a similar arrangement for wheat growers where growers are entitled to Section 73B concessions on the levy payments to the wheat industry fund.

⁴ An eligible taxpayer must be a company incorporated in Australia, a public trading trust or partner in a partnership of eligible companies. Eligible expenditures include current costs (such as wages, salaries, other overheads directly related to the R&D and contracted R&D expenditure) and capital expenditure on R&D plant and equipment.

A number of participants representing smaller winemaking regions sought support for some regional specific research through the tax concession. Most asked that the threshold relating to eligible expenditure be reduced to levels varying between \$1 000 and \$3 000 per annum.

With larger wine companies growing greater quantities of grapes, the nature of grapegrowing is changing. However, production is still fragmented. As a result, few individual grapegrowers are likely to undertake R&D at a level that would qualify for the tax concession. However, a mechanism already exists to assist grapegrowers to overcome this particular problem. This is the levy and rural research corporation system already in operation in this and other rural industries which comprise mainly small producers.

Considerable public funding is provided to the industry through the CRCV and the GWRDC. Moreover, additional support is available through matching Government grants, provided that the industry is prepared to increase levy payments. In comparison with many other industries, the levy contribution by grapegrowers and winemakers is quite low. The Committee understands that there is little support for an increase in the levy for wine research. This would suggest that additional research in the wine area would not generate sufficient return to warrant investment even when, from the industries perspective, that investment cost is effectively halved. On the other hand, grape research is generally agreed to be underfunded.

The Committee does not consider that any changes to the 150 per cent tax concession for R&D expenditure are warranted specifically for the grape and wine industries.

7 THE ROLE OF THE AUSTRALIAN WINE AND BRANDY CORPORATION

The Australian Wine and Brandy Corporation (AWBC) is the Commonwealth statutory marketing authority for the Australian wine industry. The Corporation's operations fall into three broad categories:

- the control of exports through a licensing system aimed essentially at ensuring that Australian wine exports meet health and labelling standards;
- the monitoring of wine labelling in Australia to ensure that any wine sold is accurately described; and
- the promotion of grape products, principally through export promotion activities.

Although there have been changes in recent years (eg the introduction of wine labelling requirements), the core regulations and institutional arrangements applying to the wine industry were first introduced a decade or more ago. Over this period, the industry and the environment in which it operates has undergone considerable change. The industry has grown and established itself in new regions, production has come to be dominated by a few large wine companies and exports have become a major component of sales.

In light of the substantial changes that have occurred in recent years, it is timely to consider whether the present arrangements are still appropriate to the needs of the industry and the community. Perhaps more importantly, it is appropriate to look to the future and consider the form of arrangements which will most effectively steer the industry into the next century.

In evaluating the existing regulations and institutional framework, the Committee recognises that some degree of regulation is necessary, particularly given Australia's international commitments. However, regulation is not costless. It imposes costs on both the taxpayer and on the industry and, in the longer term, presents a possibly greater cost in terms of reducing the flexibility of industry to adapt to the inevitable changes that will occur in its operating environment. The failure of the wine industries in some European countries to adjust to changing circumstances is attributed, at least in part, to rigidities imposed by regulation. Thus, the Committee considers that it is appropriate to, firstly, aim for minimum regulation and, secondly, ensure that the regulations required do not unnecessarily restrict the industry's capacity to adapt, compete and innovate. Following a description on the background and current operations of the AWBC, this chapter considers whether:

- the institutional structure is appropriate given the range of responibilities of the AWBC;
- the degree of industry control of the AWBC is appropriate for either a regulatory or promotional agency;
- the powers and activities of the AWBC in relation to export and labelling controls are appropriate and meet the objectives of regulation in a cost-effective manner; and
- the regulatory and promotion functions of the AWBC and the R&D functions of the GWRDC should be combined in a single organisation.

7.1 Historical background and current operations of the AWBC

The AWBC operates under the *Australian Wine and Brandy Corporation Act* 1980 and related regulations. The AWBC replaced the Australian Wine Board in 1980 and was reconstituted as part of the general restructuring of rural industry statutory authorities in 1986. This general restructuring aimed at, firstly, setting up an arms length relationship between statutory authorities and the Government and, secondly, replacing boards comprised of representatives of specific interest groups with more professional, corporate style boards. As a result, members of boards are generally appointed on the basis of merit and skills to meet specified criteria established for each authority.

For the AWBC, the restructuring resulted in the exclusion of grapegrower representatives and the conversion of the Corporation into a body essentially representing winemakers. Amendments enacted during the first half of 1986 reduced the number of Board members from 14 to 8, and established a selection committee to nominate members of the Board, other than the Chairman and the Government member who are appointed by the Minister. The selection committee comprises a presiding member appointed by the Minister and 5 members drawn from the winemaking industry. Names of people suggested by the selection committee are subject to Ministerial approval. The Minister has the power to accept or reject the person nominated by the selection panel, but does not have the power to appoint his/her own candidate.

At that time, the Corporation's involvement in providing funds for wine research, in particular to the AWRI, was terminated. A new body, the Grape and Wine Research Council (subsequently replaced by the Grape and Wine Research and Development Corporation), was established to administer and allocate funds provided by the industry and the Commonwealth Government for viticultural and wine research. In conjunction with this change, the *Grapes Levy Act 1979* was amended to provide for the levy on grapes used in wine production to comprise two parts— a research component for the Grape and Wine Research Council, and a marketing component to fund the AWBC.

The functions of the AWBC are:

- to promote and control the export of grape products (wine, brandy, grape spirit and wine derived products);
- to encourage and promote the consumption and sale of grape products both in Australia and overseas;
- to improve the production of grape products in Australia;
- to conduct, arrange for, and assist in, research relating to the marketing of grape products; and
- to undertake any other functions in connection with grape products conferred on the Corporation by its Act or the regulations.

Core funding of the Corporation is by a compulsory levy on the volume of grapes used in wine production. Other funds are raised from user pays charges for export licences and permits, and from ad-hoc sources (principally to finance export promotion).

Voting on motions raised at the Annual General Meeting of the AWBC is on the basis of the amount of levy paid by each producer. As a result of a succession of amalgamations in the wine industry, three companies now crush over 50 per cent of Australia's winegrapes. These companies contribute 19 per cent of levy funds, with the next five largest companies contributing a further 19 per cent. As voting at Annual General Meetings of the AWBC typically involves about half of the eligible votes, the larger companies can have considerable influence on the operations and policies of the organisation.

The structure of the levy has recently been changed as a result of recommendations of the AWBC's Levy Review Committee. The principal change was to levy the owners of the wine rather than the producers of the wine. This is expected to increase the number of levy payers from some 300 to 600, as producers who have their wine made by another winemaker will now become levy payers. This change will not significantly change the amount of levy collected.

Corporation business is supported by committees which include industry and technical representatives. These committees comprise:

- the Australian Wine Export Council which has responsibility for export promotion;
- the International Trade and Technical Advisory Committee which supprts negotiations between the Government and other countries on trade and technical issues;
- the Wine Practices Committee which examines the products of the wine industry in order to identify potential abuse of laws relating to wine production (eg food standards). It operates the Compliance Monitoring Program and the Residue Monitoring Program;
- the Label Integrity Program Committee which has responsibility to develop audit and inspection programs and to report to the Board on breaches of the labelling legislation;
- the Levy Review Committee which reviews the distribution of levies by levy payers; and
- the Geographical Indications Committee, established at the end of 1993, to oversee the delineation of boundaries for Australia's winegrape producing regions.

The following sections discuss aspects of the AWBC's operations in these areas.

7.2 Export controls

Rationale for export controls

Regulation of both wine exports and exporters is seen as a way of protecting against the adverse effects of a wine 'scandal' of the type experienced by the Austrian wine industry in the mid-1980s, or of other actions by individual producers in overseas markets that could impact adversely on the industry as a whole.

The Austrian scandal involved the discovery that ethylene glycol had been added to wine to increase viscosity and sweetness. Austrian exports averaged 30.4 million litres per annum in the period from 1976 to 1980, and 42.3 million litres per annum in the period 1981 to 1985. After the discovery, there was a dramatic fall to an average of 5.8 million litres per annum in the period 1986 to 1990. Exports in 1991 and 1992 were 22.1 million litres and 17.9 million litres respectively.

At the public forums, the AWBC referred to a similar incident with Italian wine (one line supposedly containing 'poisonous' alcohol which had been added to lift the alcohol content of the wine) which resulted in a 50 per cent decline in sales of Italian wine to the US market.

The nature of international market perceptions of Australian wine are central to this problem. In common with many Australian rural based products, wine industry representatives consider that Australian wines are seen as Australian first and as a products of a particular exporter only secondly. Liquor sellers in the UK typically have 'Australian' sections in their shelves and the reporting of wine always includes prominent mention of the country of origin.

Wine is not a homogeneous product like sugar or, to a lesser extent, coal and wheat. Individual producers can differentiate their products from those of other wine companies. Indeed, local producers have invested heavily in advertising and quality control to protect and promote the value of their brands and labels. As a result, they are less vulnerable than other less highly processed agricultural products in terms of the adverse consequences of the actions of a single 'maverick' on the export market. Despite this, Australia's exports (of most foodstuffs, not just wine) are still vulnerable to a health or products standard scandal resulting from the action of a single exporter.

A second reason for the export powers administered by the AWBC is the need to comply with provisions of trading agreements entered into by the Australian Government. The most important of these is the recent agreement between Australia and the EC. This requires Government certification that exports comply with the terms of the agreement. The AWBC is the agency empowered to ensure compliance. Essentially this entails ensuring that wine exports meet the regulations governing wine exported to the EC, and the protection of European geographical names relating to all wine sold in Australia.

Export powers of the AWBC

All exporters of grape products (wine, brandy grape spirit and wine derived products) must be licensed! Regulations provide that licences may be granted by the Corporation for a period not exceeding three years. In granting licences, the following prescribed matters are taken into consideration:

¹ The definition of grape products was expanded to include wine-derived products in the December 1993 amendments to the Regulations.

- the financial standing of the applicant;
- the applicant's ability to obtain grape products from Australian suppliers;
- matters applicable to the person that relate to the promotion of the export of grape products, including matters that may affect adversely the export trade in grape products;
- any other matters relating to the promotion of the export of grape products;
- whether the Corporation has cancelled a licence held by the applicant; and
- if the applicant is an individual— whether the Corporation has cancelled a licence held by a Corporation of which the applicant was a director or a shareholder with a controlling interest.

Levy payers (ie. winemakers) applying for an initial licence are licensed for a one year period, but upon application for renewal are licensed for a further three years. In contrast, non-levy payers (that is, non-wine producers such as specialist merchants) are, in either circumstance, licensed for a one year period only.

In addition to being a licenced exporter, an export permit (an export certificate issued by the AWBC) is required for individual export shipments. The requirements associated with the issuing of an export permit are that:

- the exporter is a licensee; and
- the Corporation has approved:
 - (i) the purchaser of the product; or
 - (ii) the person to whom the product is consigned as an agent or representative of the purchaser, or the licensee, in the country to which the product is consigned; and
- the product is exported in accordance with any directions given to the licensee by the Corporation; and
- the grape product is sound and merchantable; and
- the licensee has given the Corporation, or allowed the Corporation to take, any samples of the product reasonably required by the Corporation for the purpose of determining the soundness and quality of the product.

Recent amendments to the regulations under the AWBC Act also specify that the export of a grape product is prohibited unless it complies with the requirements of the importing country, or if such standards do not apply, with the Australian Food Standard Code.

To maintain the quality of Australian wine exports, the AWBC requires that all wines intended for export be subject to organoleptic evaluation by a panel of

qualified inspectors. The samples lodged for evaluation must be labelled and accompanied by an analysis certificate, including a declaration that the wine complies with Australian food law and, as appropriate, the law of the importing country. The inspectors (a technical specialist and a commercially oriented marketing expert) assess the soundness and merchantability of the product and also check labelling.

The export procedures allow the AWBC to randomly sample consignments at the last available point before dispatch.

Regulations applying to bulk wine exports have been subject to a number of changes in recent years. These changes are intended to facilitate AWBC monitoring of the grape product once packaged (bottled) in the country of destination. In its 1990–91 Annual Report (p. 19), the AWBC said:

A key initiative in the year under review [1990-91] has been the development and implementation of procedures to require, in certain cases, shippers of bulk product to return to Australia for analysis and evaluation fully dressed samples of the final product. A list of "approved consignees" has been compiled, which includes the major state liquor monopolies. For consignees not shown on the approved list the requirement to return a sample for evaluation is invoked.

During 1992, the Corporation amended its policy to provide for the drawing of retail samples of bulk wine sold in overseas markets and, at the General Manager's discretion, for labelling information to be required at the time of approval of the sample.

In its 1993–94 Annual Report (p. 20), the AWBC said, in relation to bulk wine exports, that:

The Wine Practices Committee made further recommendations in relation to procedures aimed to minimise the potential for damage to the quality image of the Australian industry. Exporters were required to lodge certain information relating to the structure and operation of overseas bottlers of bulk wine prior to their being granted 'approved status' under the AWBC Regulations.

The issuing of export licenses and certificates, and the testing of export samples is conducted on a user pays basis. Following increases in September 1992, income from user pay fees increased significantly, from \$9867 in 1991–92 to \$357678 in 1992–93 and to \$510055 in 1993–94. In 1993–94, the provision of regulatory services cost the AWBC \$65695.

7.3 Promotion

Promotion is the second key function of the AWBC. It is responsible for generic promotion of wine in both the domestic and international markets.

AWBC promotion complements company or brand specific advertising by producers.

Rationale for compulsory promotional levies

In the rural sector, the need for compulsory levies is commonly argued on two grounds. The first is that such industries are dominated by a large number of small producers who generally do not have the financial capacity to undertake appropriate promotional activities. The second is that the essentially homogeneous nature of the product means that brand development is difficult and that generic advertising is more effective. However, it is difficult to exclude non-payers from the benefit of generic advertising (eg because (say) sugar is relatively homogeneous, any individual exporter promoting sugar would also benefit all other Australian exporters). Thus, any single exporter would generally be unwilling to promote without a contribution from the other beneficiaries. In these circumstances, there is a case for government intervention to support the introduction of a compulsory levy on all producers.

Promotional activities of the AWBC

At \$2.15 million in 1993–94, promotional expenditure is the largest single element of the AWBC's budget, accounting for 50 per cent of total operating expenses of \$4.28 million. If the \$918 000 Australian Government Officials Serving Overseas (AGO) scheme is excluded, promotion accounts for well over half (64 per cent) of the Corporation's expenditure.

The nature of promotion expenditure has changed significantly from a predominantly domestic focus during the 1970s to an export focus aimed at increasing the awareness of Australian wines in international markets. In 1993–94, no provision was made for domestic promotion in the AWBC's budget.

The effectiveness and relevance of the AWBC's involvement in export promotion, and even the very existence of the Corporation itself, came under considerable criticism in the early 1980s. Promotional spending by the then quite new large wine companies was far more than by the AWBC. These companies paid the bulk of the industry levy and were, at the time, unhappy

² The Wines for Australian Government Officials Serving Overseas (AGO) scheme provides Australian wine and brandy for government officials in overseas posts. This scheme is fully funded by the Government.

about the way the levy was spent? The conflict was sufficiently heated for an alternative promotional body to be formed— the Australian Wine Export Promotion Organisation— and for there to be calls for the AWBC to be abolished.

The Australian Wine Export Council

The Australian Wine Export Council (AWEC) was formed in February 1992, as a committee of the AWBC, to undertake generic export promotion. The AWEC is chaired by the AWBC Chairman and comprises a group of chief executives from large, medium and small exporting wineries. The AWEC operates by consensus, with each member having the power of veto.

In its first full year of operation— 1992–93 — the Council focussed on two principal objectives: first, the development of a five year global strategic marketing plan; and, second, raising the funds to implement the plan.

Priority markets were identified as the UK, the US, Sweden, mainland Europe and, in the medium to longer term, Japan. Other markets are treated on the basis of user pays, with the AWBC endeavouring to match funds provided by industry to run particular events in those markets. The Council has offices in London, San Francisco and Frankfurt. An office in Tokyo was closed in May 1993.

The original budget of \$1.2 million (of which Austrade contributed \$250 000) was expanded by an additional \$3.5 million (comprising a \$1.5 million grant from the South Australian Government, a \$1.5 million concessional loan from Austrade under the International Trade Enhancement Scheme (ITES) (since converted to a grant as part of the post-1993 budget negotiations with the Commonwealth Government) and \$500 000 from ACI (on top of the \$100 000 per annum it provides for the US program)). These funds have allowed the AWEC to double funding available for generic promotions for the next five years. Promotional expenditure for the past three years is shown in Table 7.1.

³ In 1983, the Australian Wine and Brandy Producer's Association was critical of the AWBC's overseas promotions as, at the time, exports were only 3 per cent of domestic sales.

	1992	1993	1994
	\$	\$	\$
Jnited Kingdom	477 753	639 186	884 586
Jnited States	282 740	364 774	672 997
Canada	75 255	27 128	96 061
Sweden	6 672	15 978	91 066
apan	60 313	226 858	30 827
Germany	-	-	34 246
Frade Commissioner	6 204	9 916	-
Wine Tasting Jser pays	303 285	386 996	268 779
expenditure AWEC overheads	226 381	317 016	306 752
Fotal	1 525 522	2 043 785	2 559 464

Export promotion principally takes the form of wine tastings organised in the target market. Australian producers are encouraged to attend and display samples of their products, and wine buyers and wine commentators are invited to the function.

Assistance to smaller winemakers has been provided through alternative means. For example, an 'export success' conference was held in Adelaide. This involved introducing 13 major overseas buyers to small winemakers. More recently, a consultant has been employed to advise individual wineries on government services and funding programs, and to help in identifying potential markets.

7.4 International trade relations

The International Trade and Technical Advisory Committee of the AWBC supports negotiations between the Government and other countries by providing advice on trade and technical issues. The AWBC negotiates with importing countries on behalf of the industry with regard to access and product standards. An important example has been the consultations with the EC regarding technical standards. Similar negotiations have been held with the statutory alcohol marketing agencies in Sweden, Canada and some parts of the USA. These government agency-to-agency negotiations are seen as important to the industry in freeing access to overseas markets. Discussions are also being held with representatives of the Wine Institute of New Zealand with the objective of harmonising Australian and New Zealand food regulations.

EC Agreement

Negotiations with the EC, begun in April 1988, were concluded in December 1992 with the initialling of the text of an EC/Australia Wine Agreement. The Agreement was signed in January 1994, and came into effect on 1 March 1994.

The Agreement improves access for Australian wines to key European markets by reducing the paperwork and analysis required for entry. The EC will now accept Australian winemaking practices and standards (eg the blending of wines from different regions and from different grape varieties). In return, Australia agreed to accept winemaking practices and standards for European wines exported to Australia. In addition, Australia has agreed to phase-out the use of European names to describe Australian wine products (such as Champagne, Burgundy, Bordeaux etc) which have entered into common use in the Australian wine industry. As well as eliminating the use of European names to describe Australia has agreed to protect these European names as relates to all wine sold in Australia. That is, Australia will ensure that imported wines, as well as Australian wines, do not misuse European names.

As part of the Agreement, the EC will protect the use of Australian regional names within the EC. For the protection of Australian names to be effective in the EC, it is necessary for Australia to define and protect them domestically as the EC Agreement contains a clause specifying that the contracting parties are not obliged to protect a geographical indication or traditional name that ceases to be protected in the country of origin. This process has begun with the establishment of the Geographical Indications Committee. To enable the Agreement with the EC to be enforced, the AWBC Act was amended at the end of 1993, extending its responsibilities relating to the labelling of grape products to include geographical indications and descriptions of varieties and vintages in a manner consistent with the Agreement negotiated with the EC.

Geographical indications

The Geographical Indications Committee (GIC) is a statutory committee under the AWBC established in December 1993 via an amendment to the AWBC Act. Members are appointed by the AWBC, but the Act specifies that membership must include a nominee of the winemakers' organisation (WFA) and a nominee of the winegrape growers' organisation (WGCA), together with a chairperson nominated by the Corporation. The GIC's responsibility is to identify winemaking regions (more accurately, grape producing regions) in Australia, identify the names of these regions and draw precise boundaries.

In future, if a wine is to be described as being sourced from a particular region, at least 85 per cent of the grapes used to make that wine must be sourced from that region.

A register of protected names has been set up to record the geographical indications established by the GIC. The register will also include descriptions of grape varieties from which wine may be manufactured in Australia and traditional expressions in relation to winemaking. Geographical indications, grape varieties and traditional expressions relating to Australia's trading partners will also be included in the register.

The AWBC legislation prohibits the sale, export or import of wine with a misleading description and/or presentation. In practice, all wine will have to comply with the description of regions, varieties and traditional expressions included in the register of protected names. The labelling regulations are outlined in more detail in Section 7.6.

7.5 Food standards

All food and beverages sold in Australia must comply with food standards contained in the Australian Food Standards Code as incorporated into state and territory food legislation. The Code specifies general standards on matters such as labelling and advertising, date marking, additives, vitamins and minerals, contaminants and residues. It also has standards on specific foods such as cereals and cereal products, meat, ice cream, milk, alcoholic beverages, special purpose foods, and edible fats and oils.

Standards for wine in Australia are incorporated in the various state food laws and their enforcement is the responsibility of state and territory health authorities. The standards relating to alcoholic beverages are:

- Standard P1: Beer and Beer Products.
- Standard P2: Fruit Wine, Vegetable Wine and Mead (includes cider).
- Standard P3: Spirits and Liqueurs.
- Standard P4: Wine, Sparkling Wine and Fortified Wine.
- Standard P5: Alcoholic Beverages Not Elsewhere Standardised.
- Standard P6: Wine Products (these products, which must be based on at least 70 per cent wine, include vermouth, marsala, green ginger wine and wine based cocktails).

These standards include definitions of each product, list approved additives and specify some labelling requirements. Labelling requirements relating to the blending of wine by variety, regions and vintage are no longer included in the Food Standards Code. They are the responsibility of the AWBC under the Label Integrity Program (LIP).

Standards P4 and P6 have been developed by splitting the former Standard P4 which covered all wine and wine products. The object of these recent changes is to make Australian standards compatible with the wine standards in the EC and to take account of recent technological developments in the manufacture of wine and wine products. It is the usual practice of the states and territories to adopt the recommendations of the National Food Authority (NFA).

While enforcement of compliance with the Food Standards Code is the responsibility of state and territory governments, the AWBC undertakes some monitoring within the wine industry. The Wine Practices Committee of the AWBC (established in 1989) examines the products of the wine industry in order to identify potential abuse of laws relating to wine production. It operates the Compliance Monitoring Program and the Residue Monitoring Program.

Most activities to date are focussed on analysing wine samples for chemical residues to ensure that wine sold is within Australian and international limits (eg copper and iron content and residue levels of various agricultural chemicals are checked).

7.6 Truth in labelling

The AWBC has responsibility for ensuring the accurate description of grape products produced and sold in Australia following an amendment to the

AWBC Act which became effective on 1 January 1990. The objective of the legislation is to ensure the truth of statements made on wine labels about the vintage, variety and region of origin of wine manufactured in Australia. Winemakers are required to maintain records to validate label claims, and random audits are conducted by the AWBC to establish that individual wineries are conforming with the record-keeping requirements of the legislation. The LIP Committee of the AWBC is responsible for monitoring the label integrity program. A full time LIP inspector is assisted by two part time inspectors.

The main elements of the LIP relate to the description of wine by variety, region and vintage, and the accounting procedures required for winemakers to be able to verify any claim made on their label.

Major changes to the labelling requirements were enacted in December 1993 as a result of commitments made in the EC/Australia Wine Agreement. The AWBC Regulations were amended to include new Australian blending regulations which essentially require that:

- for a wine to be described as being of a particular variety, it must consist of at least 85 per cent (by volume) of that variety;
- for a wine to be described as being sourced from any particular region, at least 85 per cent must be sourced from grapes grown in that region; and
- for a wine to be described as being of a particular vintage, at least 85 per cent of the wine must be made from grapes harvested in that vintage year.

The regulations also specify the requirements for descriptions of blends of wines by variety, region and vintage.

The Register of Protected Names, which includes geographical indications and traditional winemaking terms, both Australian and those of our trading partners, will facilitate the enforcement of accurate labelling of products sold in Australia and exported.

The AWBC's powers have been recently extended to cover imported wine as well as Australian wines being sold domestically or exported. It has been given powers to seek injunctions or to bring prosecutions against persons believed to be involved in the sale of wines which are falsely or misleadingly described or presented.

⁴ These replaced blending regulations contained in Food Standard Code P4 which had specified 80 per cent for variety and region, and 95 per cent for vintage.

7.7 Assessment and proposals for change

The AWBC has three essential functions. The first function is to act as a regulatory agency in relation to the export of Australian grape products (wine, brandy and grape spirit). The second function is to ensure the accuracy of the labelling of wine produced and marketed in Australia. The third function is to undertake and fund the promotion of Australian grape products.

For many years, the regulatory functions of the AWBC, and its predecessor the Wine Board, were quite minor — the Corporation's main activity and expenditure related to promotion. However, since the late 1980s, exports have become a major component of sales, and label integrity legislation came into effect in 1990. In December 1993, the AWBC's regulatory powers were further extended following the signing of the EC/Australia Wine Trade Agreement. In essence, what was the wine industry's promotion agency has expanded to encompass quite substantial regulatory functions.

The promotion function has also changed, with a major shift in emphasis from the domestic to export markets. The industry itself has changed dramatically with large publicly listed wine companies now accounting for well over half of the industry's production and a significantly greater share of exports. In addition, a second tier of medium to large companies has developed which are significant suppliers to both the domestic and export markets.

The Committee has received little criticism of the performance of the AWBC and the current regulatory arrangements. Only a small number of exporters were unhappy with some aspects of the administration of export controls. The majority considered that they were well administered by the AWBC. Nonetheless, substantial changes have occurred in recent years, and further significant changes have been foreshadowed by the WFWGC. Given these changes and, in particular, the evolution of the AWBC as a regulatory body, it is timely to consider whether the current institutional arrangements are appropriate, or whether alternative arrangements would more appropriately reflect the AWBC's expanded responsibilities and better serve the needs of the industry and the community.

Structure and control of the AWBC

It is generally accepted that there can be dangers in having government regulation administered by a body controlled by the industry it regulates. Regulation must not only be applied without fear or favour, it must also be clearly perceived to be so, both in Australia and overseas. The primary concern is the potential conflict between the interests of the industry and the interest of the wider community, and a potential conflict between the commercial interests of individuals on the regulatory agency and the interests of competitors being regulated. For example, in the case of those Australian industries that were afforded quota protection against imports during the 1970s and 1980s, the quotas were administered by independent bodies because of the potential conflict between the public interest and the interests of the industry. From the industry perspective, reducing quotas would have been desirable because it would have reduced import competition. However, from the community viewpoint, expanded quotas would increase competitive pressures and reduce consumer prices. In these circumstances, it would clearly have been extremely difficult for an industry body to make balanced decisions about quota levels. For these reasons, in principle, it is desirable to have regulatory functions administered by an organisation clearly at arms length from the industry, and mainly comprising members independent of the industry being regulated.

In the case of the AWBC, the distinction between the interests of the wider community and the industry is not as clear cut. Moreover, there is no suggestion that the AWBC has not effectively— and impartially— fulfilled its current regulatory functions. However, as noted above, the significance of the AWBC's regulatory role is growing and, given the likelihood of further changes in the industry over the next decade, it is timely to consider its future role.

There appear to be two issues which need to be explored. The first relates to the efficiency of having a body which is heavily influenced by industry— the AWBC — performing regulatory functions. The second relates to the potential conflict between the various roles performed by the AWBC, notably its regulatory function and its promotional function.

At present, the influence of the industry on the operations of the AWBC is considerable. Effective industry control stems from the selection committee which nominates members of the AWBC Board. This selection committee is made up of a presiding member appointed by the Minister and 5 members appointed by the WFA, the peak wine industry body.

Unlike many other statutory marketing authorities which have drawn members from outside the industry in order to satisfy the skills criteria specified by the Government for such authorities, the AWBC draws primarily on individuals with the necessary skills from within the wine industry.

Membership of the AWBC's Board presently comprises four members with current senior positions in wine companies, one member formerly with a senior position and three independent members (including the Government representative). Three of the Board members are employees of the three major wine companies. Two are employees of medium sized companies.

With some of the regulations administered by the AWBC there would appear to be relatively little scope for a divergence between the interests of the industry and the community at large. For example, there is unlikely to be any significant conflict about the accurate descriptions of grape varieties on labels: the industry needs it to promote market access and it also provides useful information for consumers. Nonetheless, there is the potential for a divergence between industry and consumer interests in other areas. For example, the December 1993 changes to the regulations extended the Corporation's powers under the label integrity program to cover imported products — with powers to initiate injunctions and prosecutions. Thus, a Corporation dominated by Australian producers who are in direct competition with importers is placed in a situation where it must make judgements about its foreign competitors. In these circumstances, it could be very difficult for the Board to act impartially, and to be seen to be acting impartially by importers.

There could also be some scope for conflict in administering the export regulations. The existing provisions permit the Board considerable discretion in determining the suitability of persons applying for export licences. There is, for example, a possibility that the provisions could be used in an anticompetitive manner (eg to restrict export numbers). This would assist incumbents, but would not be in the interests of the community generally. As discussed later, removing, reducing or specifying the regulations in a less discretionary manner would go some way towards overcoming the problem, but some potential for conflict would always remain as result of the role that individuals with a vested interest have in determining the issue of licences to exporters with whom they compete.

The other area of possible concern involves the mix of the AWBC's activityit is involved in both regulatory activities and promotional activity.

The promotion of Australian wine represents a quite different and separate function to the regulatory activities of the AWBC. Industry involvement in, and control of, promotion is desirable to ensure that it is targeted to the needs of the industry. As such it calls for different skills for Board members. However, there is the potential for promotional activities which are aimed at maximising sales and returns to the industry to be in conflict with the regulatory function.

The Chairman of the AWBC has acknowledged the potential for a conflict of interest. At the public forum (transcript, pp. 458–459), the Chairman said:

I must say that the management of the AWEC was a very deliberate part of a

structure which was set up by the previous board, in that there was a realisation, amongst some of us who were on the board at the time, that there could clearly be a conflict of interest between an organisation which was largely involved in regulatory activities, and had the ability to apply sanctions of one nature or another against exporters on the one hand and a marketing activity on the other, which of course is a very much more gung-ho type of activity ...

In part, the committee based structure of the Corporation is intended to reduce the potential for conflicts of interest to exist. However, in practice, this objective cannot be realised because there is significant overlap in membership between the AWBC, the AWEC and the other committees of the AWBC. For example, three of the AWBC's Board members are also members of the AWEC, and three additional AWBC Board members are alternatives (substitute representatives on the AWEC in the event of non-attendance of members). The principal exporters represented on the AWEC are also the principal levy payers with significant influence, through the voting system at annual general meetings, on the AWBC's actions.

These arrangements make it exceedingly difficult for Board members to conscientiously discharge their responsibilities. In effect, they are required to wear 'multiple hats'. In the extreme, they could find themselves in a position where their response to a particular issue would vary depending on the 'hat' they are wearing. This places Board members in an invidious position and is not conducive to the effective pursuit of either regulatory or promotional goals.

Following the Committee's draft report which proposed the setting up of a separate regulatory agency at arms length from industry, the AWBC (sub. 159, p. 2) said:

... the AWBC is a body which needs to be in close touch with the industry and the industry needs to posses a sense of "ownership" in the actions of the Corporation for it to be effective. This is achieved by the role of the WFA in the Selection Committee process.

The wine industry is a very complex one as it straddles both agricultural and manufacturing definitions and incorporates sophisticated technologies and marketing strategies. The industry is also a very dynamic one and these factors require the input of directors who are fully conversant with the total and immediate picture.

It is more efficient and effective to have the best representation at the Board level and this need is highlighted by the relatively small pool of suitable talent available in Australia given the tremendous pace of the industry in recent years.

The WFWGC opposed the establishment of a separate regulatory body saying (sub. 181, p. 58) that it:

... runs the risk of shifting from the current pro market regulation to anti market regulation. This constitutes a greater risk to the industry's long term growth potential than the possibility of any conflict of interest.

Assessment

The administration of regulation involves a number of conflicting objectives and a number of trade-offs between the alternative administrative arrangements.

In most cases, it considered undesirable that regulations, and the exercise of government power that this entails, be placed in the hands of those being regulated. This differs in an important way from a situation of self-regulation which typically does not involve the exercise of legislative power and where compliance is usually voluntary. Apotential for conflict of interest will always exist within an industry controlled regulatory agency. In the broadest sense, this is a conflict between the need to regulate or limit an industry's freedom to act and the legitimate objective of the industry to maximise the returns on its economic activity. More narrowly, there is the conflict that can arise where individuals in a regulatory agency are implementing regulations that can have a significant impact on their competitors both from within the domestic industry and from imports. In addition, there is always the danger that industry controlled regulation will, over time, be used to restrict competition to the detriment of consumers and the efficiency of the economy as a whole.

Arms length regulation, however, is also not without its risks. The major risk is that the regulatory process could become seriously out of touch with the needs of the industry and the community. There is also a risk of the regulatory procedure becoming excessively bureaucratic and rigid in its administration, with the associated cost that this would impose on the industry. In a rapidly changing industry, as the wine industry has been over the last decade, a government regulatory agency runs the risk of being left behind, with its 'out of date' regulations acting as a brake on innovation and industry development. Arms length regulation also carries the risk of developing a 'life of its own', expanding regulation simply for regulations sake, or to enhance the position of the regulatory agency.

The Committee considers that the principle of independent administration of government regulations is an important one. This principle applies in other areas of industry and should equally apply to the grape and wine industry. Organisations exercising government power must be both impartial and must be seen to be impartial. While there are very few complaints with the current operations of the AWBC, this needs to be seen in the context of a major export market expansion where little pressure is being exerted on the institutional framework. There is 'room for all' in the current export environment, but this may not always be the case. The current arrangements provide the potential for conflicts to appear, conflicts that will be much sharper if local suppliers are competing against each other in static, or even declining, export markets. It is desirable to establish a system which prevents these potential problems from emerging, rather than deferring action until problems eventuate. Because of these concerns, the Committee considers that a separate regulatory agency, independent of industry, should be established to be responsible for the regulatory functions performed by the AWBC.

The Committee acknowledges industry concerns about the potential for unwarranted bureaucratic interference. However, this could be addressed by an appropriately structured Board. The Board should be chaired by a person with extensive commercial experience. It should also comprise industry representatives. This should help to avoid 'red-tape' and unnecessary administrative procedures which sometimes plague Government bodies. It would also ensure that industry views are accurately represented. Subcommittees convened by the Board could also include some specialist industry representation.

The Committee recommends that a separate regulatory Authority be established for the Australian wine and brandy industry to be responsible for the regulatory functions currently undertaken by the AWBC. The Committee proposes that the Board of the regulatory Authority comprise a majority of members independent of the grape or wine industries. The Chair of the Board should have extensive commercial experience.

The Committee is very aware of the need to ensure that the proposed regulatory Authority remain sensitive to the costs that regulations can impose on industry and consumers, and of the need to ensure that an independent Authority does not seek to increase regulation for its own sake. For example, the Committee considers that the establishment of an appellation system for wine of the type existing in Europe would be a potential disaster for the Australian industry (ie it could undemine one of the Australian industry's competitive advantages— its capacity to experiment and innovate). Explicit recognition of the desire to have the minimal necessary regulation, and to fully take into account the cost of complying with the regulations should, in the Committee's view, be clearly articulated at the time the regulatory Authority is established.

The Committee recommends that the Act relating to the proposed regulatory Authority specify an underlying objective of having the minimal necessary regulation of the winegrape and wine industry in Australia.

The regulatory powers of the AWBC, and thus those of the proposed Authority, have been significantly extended since it was established in 1980. In particular, the changes made to the Act and regulations at the end of 1993 provide the Corporation with the power to 'determine any conditions' that are applicable to the use of traditional expressions and geographical indications, and the power to determine which grape varieties can be used to manufacture wine. Together with the existing powers covering blending rules relating to varieties and vintages, many of the Corporation's powers relate to grapegrowers as much as they do to winemakers. For this reason, consideration should also be given to having both grapegrower and winemaker representatives included on the Board of the new Authority. To help ensure that industry views are appropriately represented, these members could be nominated by the industry itself.

The Committee recommends that the Board of the regulatory Authority be made up of five members, three appointed by the Minister, and two on the recommendation of industry. The Committee recommends that one of the two industry nominees on the Board be nominated by the wine industry and one by grapegrowers.

To reflect the changed responsibilities of the regulatory Authority, and the inclusion of grapegrowers, the Committee suggests that a new title be considered for the Authority, such as the Australian Winegrape and Wine Regulatory Authority.

Clearly the Authority will require permanent staff. The Committee considers that the arrangements put in place for support staff should reflect the desire to maintain the independence of the regulatory Authority.

Funding of the regulatory Authority involves consideration of the reasons for the regulations and the individuals and organisations that would be the principal beneficiaries. Aspects of the regulatory Authority's activities which benefit the industry generally, such as those export control procedures which relate to the operations of particular producers, could be funded through user pays fees aimed at recovering the cost of those services. However, some of the regulatory functions performed by the Authority will benefit industry generally rather than individual producers. These activities would most appropriately be funded by a levy on wine production. To the extent that some aspects of the Authority's activities benefit the Australian community more generally, there should be a direct contribution from the Commonwealth Government. Any consideration of funding must, however, include an assessment of the cost of raising those funds, in relation to the amounts to be raised. The export licencing system administered by the AWBC costs about \$550 000 annually, while the LIP, which employs only one full time and two part time people, costs less than \$100000 per annum. The cost of introducing and administering industry-wide levies for this relatively modest amount of funds would, in the Committee's estimation, not be cost-effective.

The Committee recommends that funding for the operations of the proposed regulatory Authority be provided by government.

In addition to being an agency which implements legislation and regulation, the transfer of the existing powers of the AWBC to the regulatory Authority would provide it with the power to determine many of the regulations that it implements. The changes made at the end of 1993 highlighted this, providing the Corporation with the power to determine any conditions that are to be applicable to geographical indications, traditional expressions and to the description and presentation of wine. Other than an appeal to the Administrative Appeals Tribunal following a determination by the Corporation, there is no formal mechanism for public or even industry scrutiny of the Corporation's deliberations or of the determinations made.

The Committee recommends that a formal community consultative mechanism be established to allow consideration of any new regulation or proposed amendment to existing regulation.

This would be consistent with the arrangements for some other agencies which have regulatory responsibilities. For example, the National Food Authority has formal consultative mechanisms to ensure wide ranging input into decisions that could have a significant effect on either producers or consumers.

The establishment of the proposed regulatory Authority would involve the separation of the regulatory and promotional functions currently the responsibility of the AWBC. Two options can be considered for the administration of promotion. The first involves the establishment of a separate promotional agency, with a majority of board members drawn from industry. This agency would be funded by the existing levy arrangements currently funding the AWBC. The second option would involve the merging of the promotional and research functions into a single organisation. These options are discussed later in this chapter.

Changes to the export control powers of the AWBC and the proposed regulatory Authority

The export powers of the AWBC exist mainly for two reasons. The first reason is to ensure certain standards for Australian wine exports so as to minimise the chance of exporting a 'contaminated' product that would threaten health or Australia's wine exports. The second reason is to enable Australia to meet its international trading obligations. While these objectives are desirable, it is appropriate to consider the powers and operations of the Corporation to see if they provide the most efficient and cost-effective means of meeting these objectives.

Licensing and permit arrangements

In the Committee's view, many of the powers under the Act and the associated regulations outlined earlier (Section 7.2) and in Appendix B seem to extend well beyond what is necessary to protect Australian exports from the effects of a 'wine scandal', or to ensure the compliance of Australian wine to international standards. The major concern is that the current regulations are not precise or well defined. They are broadly specified and rely on subjective assessments. As a result, they provide the AWBC with wide discretionary powers. For example, as noted in Section 7.2, in granting export licences the Corporation must take into consideration (among other things): the financial standing of the applicant; the applicant's ability to obtain grape product; and "any other matters relating to the promotion of the export of grape products".

A major problem with such provisions is that they do not specify the 'standard' necessary to meet such criteria (eg what is an "appropriate" financial status? what is covered by "any other matters"?). Consequently, interpretation is necessarily subjective and requires considerable administrative discretion. This can create uncertainty for exporters. It mitigates against consistent decision making and creates the potential for the process to be used in a manner contrary to its intended purpose. The provisions could, for example, be used to exclude potential exporters on grounds that bear only a tenuous relationship with the underlying reason for the existence of export controls. The incentive to inappropriately apply the provisions would be greater in the event of a downturn in the export market. In the face of falling international demand, some exporters could argue (as they do in many rural industries) that competition between Australian exporters is driving down prices and reducing total Australian export revenue. In that circumstance, there could be pressure exerted on the AWBC to limit new export licences so as to protect export returns (and the position of the preexisting exporters). While this would have short term benefits for established exporters, actions which restrict competition inevitably restrict change and

innovation. It is unlikely that Australia's exports, as a whole, would benefit from the exercise of such a provision.

Under the existing provisions, there is also a distinction made between levy payers and other exporters. Levy payers (that is, winemakers), can get a three year (renewable) export licence. Non-levy payers can only get a one year (renewable) licence. It is difficult to identify the need for such a distinction. It discourages specialist traders from participating in the export market by forcing them to take a very short term and opportunistic attitude to export.

Obtaining status as a licenced exporter is only the first step in the process of gaining approval to export wine. The second step involves obtaining an export permit (or 'export certificate') from the AWBC for individual shipments. This procedure is more directly focused on the question of compliance of the wine with the relevant food standards and labelling requirements, but even here the conditions of export specified in the AWBC regulations are very broad and involve considerable discretion on the part of the Corporation. For example, the regulations prohibit exports unless: the overseas purchaser is approved by the Corporation (with no specification of the criteria for such approval); the product is exported in accordance with any directions given by the Corporation (with no indication as to the scope of such "directions"); and the product is sound and merchantable.

In its draft report, the Committee proposed that the powers of the Corporation to disallow the export of grape products be restricted to failure to comply with food standard and labelling codes (either Australian or the destination country) or if the wine is clearly spoilt. The Committee proposed that all other criteria be abolished.

Following the draft report, the WFWGC argued for the continuation of the current system of granting export licences and permits. It said (sub. 181, p. 58) that:

... the current system is intended simply to contain risks of opportunistic exporting of inferior wine by players who are not concerned at longer run implications.

The AWBC commented (sub. 159, p. 4) that the result of the Committee's draft recommendation would be:

... the loss of the current minimum standard for export samples which is the test of "sound and merchantable quality." Whilst this does possess a degree of subjectivity, it is justified on the grounds of the substantial extent of damage possible should sub standard wine reach the market.

At the draft report hearings, the AWBC (transcript, p. 1323) said:

If the wine is rejected at that evaluation [first inspection] - and that panel takes into account factors including the market to which it's destined, its price and whether in

fact the exporter has an established market, if it has been exported in the past or he has current orders waiting for it - if it's rejected at that process, then there is in fact a third level of appeal...

In relation to the need to retain the power to approve the recipient of Australian exports (particularly as relates to bulk wine), the AWBC (transcript, p. 1324) said:

... this is something that the board considers is absolutely critical to the protection of the image of the Australian wine industry.

These statements imply that the Corporation could be going beyond those actions necessary to protect the industry from damage from the export of contaminated wine or from any similar threat to public health— the sort of action that typically threatens other exporters of rural or rural based products. If this is the case, it would seem that the Corporation's discretionary export powers are being used to direct Australian wine exporters into premium wines and away from lower priced, lower quality wines. In this situation, the Corporation would be making strategic market positioning decisions on behalf of the whole wine industry. While this may be supported by many in the industry, there is no guarantee that this judgement is appropriate, or that it should be imposed on all exporters.

Any tendency to use export powers to direct Australia's wine exports could reflect the Corporation's other role of promotion. With the one body performing both regulatory and promotional functions, there is the opportunity to used the export powers to reinforce the marketing judgements made on the appropriate method of promoting Australian wine in export markets. However, there is no guarantee that the Corporation has chosen the right promotional strategy and, irrespective of whether it is correct or not in its view of the best way of promoting Australian wine exports, it is not appropriate to use export powers to enforce that view. Providing exported wine is not spoilt, and meets relevant food standards, Australian exporters should be free to exploit all possible export opportunities, including exports of lower priced or bulk wines.

In the Committee's view, the only valid reason to control wine exports is to minimise the likelihood of the export of 'contaminated' grape products which could threaten Australia's export wine market, and to ensure compliance with international obligations. The simplest means by which these objectives could be met is by focussing on the existing requirement that Australian exports of grape products comply with the standards and requirements of the destination country or with Australian food standards. Other provisions, particularly those relating to the granting of an export licence, such as regulations that permit the Corporation to take into account the financial standing of the applicant, have little relevance to these objectives and impinge on commercial judgements which are best left to the industry to decide.

The Committee recommends that the current export controls be modified to permit exports to be refused only on the grounds of:

- non-compliance with the standards of the country of export or, if such standards do not apply, with Australian food standards or:
- if the wine is clearly 'spoilt'.

Existing provisions and regulations that do not directly relate to the meeting of technical and labelling standards for wine and the meeting of international obligations should be abolished. In addition, there should be no distinction made between levy payers and other exporters (or potential exporters).

In effect, this would mean the abolition of export licences, as none of the criteria used bear any relationship with the compliance of exports to any set of product standards. Export permits would be retained solely as a means of enforcing compliance with the remaining legislation. The criteria for refusing (or withdrawing) a permit would relate solely to the failure of an exporter (or potential exporter) to meet relevant technical standards or labelling requirements, or if the wine is clearly 'spoilt'.

The Committee recommends that the changes to the export licensing and export certificate (permit) arrangements should be implemented irrespective of the future role or structure of the AWBC.

Implementation of the Committee's proposals would entail modifications to the AWBC Act and the associated regulations. In particular, those parts of the Act outlining the objectives of the Act and the functions of the Corporation (Sections 3 and 7) would need to be amended to reflect the more precise purpose underlying export controls. Corresponding changes would need to be made to Clause 8(2)(a) of the Act dealing with the export powers of the Implementation would also require the abolition of some Corporation. regulations associated with the Act which would be redundant under the Committee's proposal (ie those regulations which outline the prescribed matters that the Corporation may take into account when considering applications for an export licence which are not related to relevant technical standards or labelling requirements). This would encompass regulations under Section 5 and Section 6. Relevant parts of the AWBC Act and regulations, together with details of the clauses to be omitted or changed, are shown in Appendix B.

Other provisions relating to exports and trade

In addition to the export licensing arrangements, there are a number of other parts of the AWBC Act and associated regulations which impinge on exports and/or trade— some of which have never been used— which the Committee considers are unnecessary and/or have the potential to detract from the performance of the Corporation and/or the industry.

Power to determine export prices and quantities

Regulation 8 relating to the power to determine minimum prices and quantities of exports to particular markets allows Australia to comply with import restrictions that may exist in other countries (eg minimum prices set by the EC for imported products). Similarly, where countries have country specific quotas on imports, the power enables the AWBC to enforce these quotas. However, the wording of the regulation is open-ended and permits the power to be exercised in relation to all exports. It does not include any specification of the conditions under which it can be exercised, such as "in relation to exports to a country which require minimum prices", or, "in relation to exports to a country which require minimum prices", or, "in relation to exports to a country which require minimum prices". In these circumstances, there is a possibility that the power could be used in an inappropriate manner (eg to limit competition between exporters or to influence the price or type of wine exports).

The Committee recommends that Regulation 8 of the AWBC (Exports) Regulations be amended to clearly specify the limited conditions under which the AWBC or the proposed regulatory Authority, can set prices and/or quantities for export. The conditions should limit the use of this power to countries which impose import restrictions.

Testing of bulk wines

Recent changes to the regulations covering bulk wine exports have extended the Corporation's activities to the monitoring of the bottled product of the foreign purchaser of bulk Australian wine. Bulk wine exporters were initially required to return samples of the final product (which was, in most cases, a product over which they had no control) for analysis in Australia. Subsequently, procedures were revised to include sampling, by the AWBC, of the product in the retail export market. This is in addition to the testing of the wine before it leaves Australia. The Committee received comment that offshore buyers of bulk wine do not take kindly to interference in their marketing by what is, to them, a foreign government agency.

The testing of bulk wines largely reflects desires to ensure that the image of Australian wines is not damaged by the actions of overseas importers or distributors (eg by blending with wine from other sources which is not disclosed on the label). While this objective is understandable, the Committee has reservations about the extent to which the AWBC— or any other Australian government agency— should be seen to be directly interfering in the manner in which products are packaged, distributed or used by commercial entities in importing countries. More importantly, the effectiveness of such action is questionable. For example, a 'banned' importer could arrange to import under a different company name or arrange for another to import on its behalf.

At the draft report hearings, the AWBC and the WFWGC argued that these provisions should be retained, particularly as relates to bulk wine. The AWBC said that it is something that the Board considers is critical to the protection of the image of the Australian wine industry.

The Committee considers that, in a narrow sense, "image" in itself is not an appropriate consideration for a regulatory agency. This is a marketing decision more appropriately left to the seller of the product concerned. However, it is appropriate to be concerned that Australia's name as a source of product is not misrepresented, but that this is most appropriately and effectively pursued by negotiations between governments. To enable the regulatory agency to monitor Australian grape products bottled overseas it is, however, appropriate that the current policy of taking samples in the overseas market be retained.

The Committee recommends that the power of the AWBC (or any successor body) to approve the purchaser of grape products be abolished.

AWBC trading powers

Clause 8(2)(d) of the Act gives the Corporation the right to trade in grape products. Under the Committee's proposals, the Corporation would be restricted so that it becomes a regulatory body only. In this situation, it would clearly be inappropriate for the regulatory body to trade in grape products in competition with the industry it regulates.

The Committee recommends that the power of the AWBC (or any successor body) to trade in grape products be abolished.

Shipping of grape products

Under Section 9 of the Act, the Corporation has the power to intervene in shipping contracts for the export of grape products (ie to refuse to permit a shipping contract to be executed). The Committee considers that this is not an appropriate role for a regulatory authority.

The Committee recommends that the power of the AWBC (or any successor body) to intervene in shipping contracts for the export of grape products be abolished.

Use of Quality Assurance procedures

At present, all export shipments are required to be tested to ensure that they are technically sound and meet labelling requirements. This imposes significant costs on industry. An alternative approach would be to allow 'accredited' exporters to by-pass the testing procedures. Accreditation could be gained by firms complying with a Code developed by the industry, or it could be based on existing quality assurance standards (such as the internationally recognised ISO9000 series of standards).

The EC/Australia Wine Trade Agreement contains a provision allowing the authorised agency (the AWBC) to identify competent producers and permit them to issue their own compliance certification. The Committee supports this approach. Some steps have already been taken that could be used as a foundation for the development of a quality assurance program for the wine industry. In its 1993–94 Annual Report, the WFA (p. 49)aid:

The Code of Good Manufacturing Practice for Grape Growing and Winemaking is under preparation by a Task Force of the Committee [the Technical Committee of the WFA]. It is anticipated that the Code will provide principles of good winemaking practice, and support these principles through detailed appendices focusing on relevant sections of the Code. The Code, once compiled, will progress from the Federation to industry for consideration and utilisation. The Code is envisaged to compliment the industry moves towards Australian Standards accreditation and the embracing of Best Practices.

The significance that the industry places on the development of accreditation is reflected in the recent appointment of a quality liaison officer within the AWRI (as part of its extension services) to meet the growing number of inquiries from firms seeking accreditation to the ISO9000 series of quality standards.

At the draft report hearings, the AWBCsaid that it has considered a proposal to use an accreditation system in the past, but rejected it on the grounds that it exposed the present system to an unacceptable extent, especially in view of the relatively minor savings potential attainable. The AWBC said (transcript, p. 1329) that ISO 9000, in isolation, is not sufficient to provide the necessary safeguards.

... routine sampling drew to light that ISO9000 and the procedures that the company had in question were totally inadequate. In fact, the sampling detected the shipment of a product which was different to that which we had been advised.

The Board further said that it had not yet identified an accreditation scheme which would protect against such incidents and the consequent damage that they would do to the industry. In addition, the Board said that the cost of the audit program that would be needed at this stage is an obstacle to the introduction of an industry accreditation system.

The Committee recommends that the AWBC (or any successor body) in conjunction with the wine industry, investigate the possibility of setting up a quality assurance scheme which would allow accredited firms to ship exports without prior approval.

Label Integrity and Geographical Indications

Label integrity legislation requires wine producers to maintain records to validate label claims in respect of vintage, variety and region of origin. Random audits are carried out by the AWBC to ensure compliance.

There are essentially two reasons for the existence of these provisions in the AWBC Act. The first is to establish clear guidelines to ensure the accuracy of labelling of wine produced in Australia. The second is to ensure that Australian exports of wine comply with the labelling and description requirements of the destination country.

Some countries require Government certification that exports comply with certain standards before they can be exported. The AWBC is the agency delegated by the Australian Government to provide such certification in relation to the export of grape products. For other export destinations which do not require any official Australian Government certification of compliance, the Corporation's actions can be seen as mainly a service to exporters to assist them in complying with destination country rules.

The most significant increase in the level of regulation has resulted from the signing of the EC/Australia Wine Agreement. This has resulted in the beginning of a process of defining precise geographical boundaries for Australian wine regions (geographical indications), and the formalisation of various wine related terms (traditional expressions). Whilst Australia has agreed to these arrangements to gain access to the European (and to a lesser extent the US) market, they do not represent an unambiguous gain for Australia. For example, the marketing advantages of selling a brand from a highly regarded region could lead to investment in land within the region. In other words, there could be some undesirable investment decisions made as a result of the introduction of regional boundaries. It is also very important that this not be the forerunner to a highly regulated appellation system similar to that which applies in large parts of France where regulations extend to

include such things as specifying the number of vines, the type of harvesting, restrictions on irrigation etc.

It is necessary to have a mechanism to ensure compliance with Australia's international obligations. Given the large financial rewards that can be gained by misrepresenting wine (eg to claim that it is made from cabernet sauvignon rather than grenache grapes), it is also necessary to have the capacity to audit winemakers' products. In this context, general legislation such as the Trade Practice Act, on its own, would not be sufficient because there would be no requirement for winemakers to maintain records to validate the information contained on labels. However, the advantages which accrue to consumers as a result of the measures currently being put in place need to be weighed against the costs of the process.

In its draft report, the Committee proposed that domestic sales of wine should not have to comply with geographical indications and that the Government should seek to renegotiate international agreements to remove such requirements from exports. The Committee was concerned that the introduction of geographical indicators represented an increase in regulation that was unnecessary, and represented the risk of becoming the foundation for a system of restrictive controls on the Australian wine industry.

In response to the draft report, the industry expressed strong support for the development of geographical indicators. The industry sees a major shift in the marketing of Australian wine towards the promotion of regional wines. This is seen as part of the evolution of Australian wine sales, away from its initial push into export markets based on value for money characteristics, towards greater quality and product differentiation. The development of geographical identities for Australian wine is seen as critical to this change and to the possibility of continued export expansion, particularly in existing export markets. International agreements which Australia is a party to, both the EC/Australia wine agreement and the Agreement on Trade-Related Aspect of Intellectual Property Rights (TRIPS) under GATT, require that regional descriptions be protected in the home country for them to be protected in the export market. Thus, it appears that domestic sales will have to comply with the geographical indications if the industry is to proceed with its regional export promotion program.

One provision of the 1993 amendments to the AWBC Act— which has not been used to date — seems to go well beyond that required by the EC agreement or the needs of label integrity. It provides the AWBC with the power to determine the varieties of grapes from which wine may be manufactured in Australia. For label integrity, it would appear sufficient to simply specify grape varieties on the register of protected names to ensure the accurate representation of the variety used. However, if the wine is made from (say) a minor variety not listed in the register, or from a new variety, this should not preclude production and sale, provided that it is not misleadingly described as a listed variety. If the AWBC were to use the power to determine the varieties of grapes from which wine can be manufactured, it would run the risk that, over time, it could be locking Australia into an historic pattern of production and possibly stifling innovation because of the requirement to obtain listing of a new variety before the producer effectively alerts competitors to the existence of the new product, thereby reducing any competitive advantage from investing in a new variety. Under the present institutional arrangements, there is also a possibility for misuse of the new power if the new variety is seen to threaten commercial interests or established views (eg on quality).

One of the key advantages that Australia is constantly said to have over European wine producers is the lack of 'hidebound' rules, regulations and traditions that limit flexibility and experimentation in winemaking. The introduction and extension of such regulations are often influenced by established producers in an industry who see a threat to their market position from new and innovative entrants. While this is not the case in Australia, restrictions on varieties that can be used for making wine could provide a basis for further regulation and the beginning of the 'European disease' in the Australian wine industry.

The WFGCA argued for the retention of this power, saying that it must be retained as:

... it is required under international obligations covering, inter alia, hybrids.

The AWBC (sub. 159, p. 6) said that:

The EC/Australia wine agreement specifically precludes the export of wine produced from hybrid varieties and hence it is imperative for the AWBC to retain its authority to determine the grape variety for export. This does not prevent sales on the domestic market of wine made from hybrid varieties. The correct naming of varieties is a part of the requirements for an effective LIP and efforts need to be made to compile a register of the varieties which currently exist in Australia.

The Committee accepts that there are restrictions on the varieties, and composition of varieties, that can be used for wine exported to the EC. It also recognises the need to include varietal names on the register of protected names under the LIP. However, in the Committee's view, the power to determine the varieties used to manufacture wine in Australia go far beyond that necessary to meet export objectives, or to protect the integrity of the LIP. The requirements for export to the EC are adequately covered by the AWBC's

export permit system which relates to the type of product that can be exported and the related labelling requirements. As far as the register of protected names is concerned, this is more appropriately a question of restrictions on how wine is described on the label, rather than restrictions on what can be produced or sold. The register of protected names could include a list of approved names for grape varieties, and if any producer wishes to use one of these names to describe wine being sold, then the variety used in manufacture would have to correspond with the description in the register. However, if the producer has a variety that is not on the register, it seems excessive to have the power to prohibit the manufacture of wine from that variety. It is sufficient to prohibit the use of any varietal name until such time as it is included on the register. The wine could, nonetheless, continue to be manufactured and sold within Australia, but without any varietal name appearing on the label.

The Committee recommends that the provision for the regulatory Authority to determine the varieties of grapes from which wine can be manufactured be abolished, and replaced by conditions limiting the use of varietal descriptions to those on the register of protected names.

This would require modification of Clause 8(2)(ae) of the AWBC Act.

Promotional activities

The need for compulsory levies in the rural sector is commonly argued on the grounds that rural industries are dominated by small producers who would otherwise not be able to fund promotion, and that the homogeneous nature of the product means that promotional activity undertaken by one producer will benefit all other producers. In this situation, the producer undertaking the promotion has no incentive to take into account the benefit to others and, thus, expenditure will be less than that warranted by the benefit generated.

While there are still many small enterprises, Australian wine production, and particularly exports, are now dominated by a relatively small number of medium to large firms, some of which are publicly listed companies. Given their size, these larger companies are capable of raising funds for their promotional activities. In addition, product differentiation and brand development are well established factors in wine marketing. This makes it easier for winemakers to promote their own products and to capture the benefits of promotional activities without excessive 'free-riding' by other winemaking concerns.

In practice, much of the promotional activity undertaken by the AWBC is not strictly of a generic nature. Current export promotional activities of the AWBC predominantly involve wine tasting events where wine buyers are invited to sample and review wines from a range of Australian producers. Another major program involves bringing liquor retailers, journalists and the like to Australia and showing them around particular regions and wineries. These types of promotion are not generic promotion in the generally accepted sense of promoting anonymous Australian product. The major beneficiaries are those producers having their products and brands demonstrated to buyers. Indeed, the AWBC (sub. 29 p. 27) said:

It is important to understand exactly what AWEC does in each market. These activities are sometimes referred to as generic marketing but in essence they relate to the establishment of a promotional programme within which brand promotion can be undertaken within a positive and receptive environment. It is after all, the winemakers representing the interests of their brand sales who determine the promotional programme.

More recently there has been a move to change Australia's export market promotion to increase the emphasis on regional identification of wine. At one level this represents a move towards increased generic marketing as it would benefit all wines produced from the region being promoted. However, there is the danger that the promotion will primarily target a few 'high profile' regions and that some regions without a strong regional 'name' will rarely benefit from promotion. These regions, along with producers for the domestic market, are still levied to fund promotional activities. However, the AWBC (sub. 29, p. 37) identified benefits which accrue to other wine exporters and the community generally from its promotional activities:

The benefits of Australia's export success clearly benefit the regional Australian economy. These benefits go beyond those members of the generic marketing programs. Any wine exporter will benefit from these programs. Other industries will benefit from these programs as Australia continues to enhance it's quality image and establish itself as a reliable producer of products.

The Committee accepts that the nature of the Australian wine industry has changed significantly and that generic promotions are different to those undertaken for homogeneous products (eg sugar). It also accepts that there are benefits flowing to other exporters as a result of promotion through the increased image of Australian wine in export markets and the development of the export market itself. Indeed, one of the characteristics of a developing market is the willingness of buyers to seek greater variety, with a corresponding increase in opportunities for other exporters.

While other exporters (and potential exporters) will be the immediate beneficiaries, it is claimed that the growth of the export market has also benefited those who produce solely for the domestic market. For example, many in the industry contend that the increased profile of Australian wine as a result of its success in export markets strengthens its position on the domestic market, to the benefit of all local suppliers. In these circumstances, it is appropriate that the levy be paid by all producers, including those that do not currently export.

The Committee does not propose any changes be made to the levy arrangements to fund the promotion of grape products. However, given changes being made in the style of promotion being undertaken, it would be appropriate to review the levy arrangements in three years time.

Merging of the GWRDC and the AWBC

In addition to the continuation of the current arrangements relating to the Board of the AWBC and its functions, the AWBC and the WFWGC argued for the amalgamation of the GWRDC with the AWBC, with all regulatory, promotion and R&D functions contained within the one 'super corporation'.

The joint submission by the industry (sub. 30, p211) said that the specific rationale for the integration of the AWBC and the GWRDC is based on:

1. Integrated strategy

The current arrangements introduce an artificial separation of the grape growing and wine producing segments of the industry. Maintenance and further development of the industry depend on a strong linear relationship from vineyard to marketplace. Amalgamation will ensure that research imperatives take into account the full range of activities undertaken by the industry from "the soil to the shelf", and consequently allocate the resources supporting the research effort accordingly, so that returns on research investment are maximised. 2 Representation

An amalgamation of the Corporations would provide the opportunity for grapegrowers to be better represented on a Board with control of the research agenda across the whole industry. This serves to ensure a higher level of commitment by a broader sector of the industry to this important activity.

3 Efficiency

Despite the high level of management of the two existing Corporations which pursue two different roles to the industry, it is considered inevitable that a small degree of duplication would exist. Merging the two Corporations will offset some of the inefficiencies of running two separate organisations.

4 Economy

The maintenance of two separate Boards is not making best use of the industry's key resource people or finances. It has been estimated that a saving of \$60,000 could be achieved through the merger, while freeing up several individual's time to pursue other industry objectives.

The joint submission (sub. 30, p.212) said that, for accountability reasons, the R&D function would have to be quarantined from the export promotion and regulatory functions.

It is envisaged that when the "Super-Corporation" is formed, there will be a need to ensure that the "Research and Development", "Marketing", and "Regulatory & Statutory Activity" functional areas are "quarantined" in terms of separate management and funding accountability, yet integrated in terms of representation and direction to provide the best industry outcomes.

The GWRDC said that the alteration of institutional arrangements is of lesser importance than the establishment of improved communication, objectives, strategies and performance indicators to guide efficient, effective R&D and meet industry's development needs. The GWRDC (sub. 31, p19) also said that it was necessary to ensure:

- quarantining of R&D funds from promotional or regulatory funds
- that a priority profile was maintained for R&D in any new arrangements
- that the portfolio selection and balance between program areas, and between shorter term strategic and longer term R&D be based on independent non sectoral assessment against industry needs and priorities.

The proposal for amalgamation put forward by the peak grapegrower and winemaker bodies was not uniformly supported by industry participants. For example, the King Valley Grape Growers' Association (KVGA) (sub. 7, p. 7) said that they "view with some dismay the efforts of the AWBC to take control of the GWRDC." The Association commented that:

There have been complaints about the research priorities of the GWRDC, and the KVGA also has concerns in this regard. However, it would be more professional if

the issues were addressed openly, and priorities established through a process which has regard for costs and potential for economic gain, and which is both transparent and which accommodates the various interests in a rational manner.

Additionally, the KVGA (sub. 7, p. 8) said:

It is difficult to see how any significant cost reductions could be achieved. It might be possible to reduce administrative costs by having less Board members, but we believe this would be most undesirable as it would put the industry R&D in fewer hands.

The GWRDC said that an independent research corporation is the optimal approach, and that this is recognised as such by independent reviews. The GWRDC stressed the need for accountability, particularly given the extent of public contribution of funds for research, and the need for contestability in the placing of research projects. In the Corporation's view, this is best achieved by an independent research corporation. On the question of integration and coordination with industry, the GWRDC said that this could be best addressed by developing a broadly supported industry plan, within which R&D arrangements were designed and operated.

In response to the draft report, the AWBC (sub. 159, pl) reaffirmed its support for the amalgamation of the functions of regulation, promotion and R&D in the one organisation. It said that the enhanced communication between representatives of the industry and those responsible for directing R&D resources would be of significant benefit to R&D, and result in more effective outcomes.

Assessment

The GWRDC has been set up, along with a large number of other rural research corporations, as a separate organisation capable of making independent assessments of the priorities for research, and open contestable assessments on the disbursement of funds. The introduction of arms length decision making and contestable research projects inevitably creates some tensions within the research 'industry'. Researchers are expected to compete on the basis of costs and effectiveness for access to research funds. However, this is a desirable change as it ensures that greater incentives exist for researchers to ensure that research is undertaken efficiently and in a way that is relevant to both the needs of the industry and the publicly available priorities of the research corporation.

The amalgamation of the AWBC and the GWRDC may result in some savings in administrative costs and time, although this would be reduced by the need to 'quarantine' the various functions of the proposed merged organisation. The more significant gain would be in the coordination of research and promotional activities, and the development of a more integrated policy focus. This integration would not overcome potential conflicts of interest between regulatory and promotion functions. However, the Committee has recommended the creation of a separate regulatory Authority at arms length from industry to undertake the regulatory functions of the AWBC. If this proposal were implemented, then much of the conflict of responsibilities and objectives within the industry's proposed merged organisation would be resolved.

The Committee recommends that a single organisation be established to be responsible for the promotional activities currently being undertaken by the AWBC and the disbursement of research and development funds currently undertaken by the GWRDC.

The new organisation would comprise a Board responsible for policy and setting broad priorities. Two sub-committees, each headed by an executive director, would report directly to the Board. One sub-committee would be responsible for the promotional activity and the other would be responsible for R&D.

As Government levying authority underlies both activities, and the R&D function involves a direct Government contribution, the Committee considers that Government representation on the Board and on the R&D sub-committee is essential. Members of the R&D sub-committee would be appointed by the Board and would include people with skills in both the grape and wine industries, as well as people with a knowledge of research and development. The promotion sub-committee would be made up of industry, or industry nominated, members with skills in the area of wine marketing.

As with the current GWRDC, the Board would comprise a chairperson appointed by the Minister, 4 to 6 directors nominated by a selection committee, a government member and two executive directors (one responsible for promotion and one for R&D) appointed by the Board. The selection committee would comprise a chair nominated by the Minister and members representing grapegrower and winemaker organisations.

The Committee considers that separate funding arrangements should be maintained for the promotion and R&D activities. The Committee proposes that the levy arrangements which currently fund the AWBC be transferred to the promotion/R&D organisation to fund promotional activities, and that the existing levy arrangements funding the GWRDC remain to fund R&D activities. The separation of the wine account and the grape account for the disbursement of R&D funding should continue.

This approach of placing the R&D function and the promotion function within the one organisation is, to some degree, an experiment and would involve some risks. For example, there could be a tendency to conduct less 'public good' research and more of the type of research that benefits individual firms. On the other hand, if the proposed approach works as envisaged, it would make R&D more responsive to the broad needs of the winegrape and wine industry. In view of the experimental nature of the proposed coordination of functions, the Committee believes that a review of it operations would be appropriate after three years.

The Committee recommends that the performance of the amalgamated organisation be reviewed three years after its commencement of operations.

8 IRRIGATION AND WATER ISSUES

8.1 Introduction

Water availability and quality is a major concern of many winegrape growing regions in Australia. Around 63 per cent of winegrapes (including multipurpose grapes grown for use in wine production) are sourced from the irrigated areas in New South Wales, Victoria and South Australia. Viticulture in all other areas is, to varying extents, reliant on some form of irrigation.

As outlined in Chapter 1, the industry aims to increase annual wine production by some 70 per cent over the period to 2010. It is estimated that this will entail the establishment of around 35000 hectares of additional vineyards at a cost in excess of \$1.2 billion. In almost all cases, future wineyard development is contingent upon the availability of water for additional irrigation. Indeed, the WFGCA estimate that, after allowing for improvements in the efficiency of water use, about 90 000 ML of additional water will be required. This represents an increase of around 40 per cent on water usage in 1993–94. However, t appears that the scope for simply increasing allocations of water from current supplies is, in some irrigation areas, not feasible. For instance, the SAFF (sub.45, p. 16) remarked that:

Water quality and water availability impose significant constraints on the ability of the industry in South Australia to consolidate existing production and to expand, despite the availability of land suited to viticultural production.

Similarly, the Victorian Department of Conservation and Natural Resources (sub. 66, pp. 2–3) reported that:

The opportunities for expanded irrigation based on additional water allocations are, however, limited ...

... in southern areas the high level of current resource allocation and the increasing competition for that resource with environmental needs will prevent any allocations of new water ...

The constraints applying to water use vary between regions. Some regions are faced with allocations that account for all available water. Future development of the industry in these regions will require an overall increase in water supply capacity (or a reduction in water wastage), the diversion of water presently used for other purposes, or the injection of water presently allocated to other districts. For other regions water availability and quality are not presently of concern, but could become more problematic as time goes by. In the MIA, future development hinges on the effective accommodation of tile drainage problems and the facilitation of water transfers from alternative agricultural uses, notably pasture and rice, to viticulture. In the Victorian and New South Wales Sunraysia districts, problems with soil and river salinity constrain development. Some areas reliant on groundwater sources for vineyard irrigation are finding that acquifer depletion (the exhaustion of groundwater supplies) is increasingly restricting further irrigation development.

Overriding these concerns is the growing recognition that water is a finite resource, possibly approaching the limits of its sustainable exploitation in Australia. Indeed, in some areas— New South Wales in particular— some participants consider that present allocations of water exceed levels which are supportable in the longer term. The sustainable future development of all industries dependent upon water, including winegrape growing, requires that policies be implemented to accommodate this ultimate supply constraint and to ensure that available water is used for its most productive purposes.

This chapter examines options for reform of the water industry, with a specific emphasis on those issues relating to viticulture. Given that much offie water for additional grape plantings inevitably will come from other existing users, particular focus is placed on the use of tradeable water entitlement (TWE) systems and the potential such arrangements have to assist the development and expansion of the wine industry. Participant's concerns relating to the environmental, social and economic consequences of TWEs alsoare considered.

Although not canvassed in this report, recent studies have pointed to the need for far more extensive reforms to Australia's water supply industry (particularly with regard to the tariff structure and the level of charges) Governments have generally accepted the need for reform. Indeed, industry wide reforms are proceeding, with the Council of Australian Governments (1994, p. 3) endorsing a:

... strategic framework for the efficient and sustainable reform of the Australian water industry.

The reforms under way will help improve the efficiency of water supply and benefit both water users— including grapegrowers— and the community generally.

8.2 Allocating rights to water use

Rights to water use are a crucial concern of many participants. For example, the Wine and Brandy Producers' Association of South Australia (sub. 50, p. 15) submitted that:

... access to water is critical to development.

Similarly, the South Australian Government (sub41, p. 5) remarked that:

There is the potential for vineyard expansion in the Riverland but water availability is currently acting as a constraint to new developments.

Traditionally, the right to use water was linked to the ownership of land. Ownership of land adjacent to rivers or other irrigation sources generally was accompanied by the right to a particular volume of waterIn some areas, these traditional arrangements continue to apply. However, while they provided advantages during the development phase of the water industry— notably ensuring those with access to water paid for this access whether they used their allocation or not — their relevance to present circumstances an**d**heir potential to hamper irrigation development increasingl**y** re being questioned.

Allocating water rights to particular parcels of land potentially limits the adjustment capacity of agricultural industries, making it difficult for water resources to flow from less productive to more productive activities. For instance, Coffey (1991, p.3) suggested that:

... linking water and land makes it difficult to reallocate between irrigation enterprises or reallocate to other beneficial uses. These constraints result in the economically inefficient use of a resource which is approaching the limit of its availability.

Opinion suggest that a 'freeing up' of the link between land and water is required in order to satisfy individual preference for water requirements while increasing water use efficiency and productivity.

Similarly, the Nyah to the South Australian Border Community Salinity Group (1992, p. 61) favoured a move away from land based water entitlements to a tradeable water entitlement market:

Breaking the link between land and water will allow water to move, under market forces, to land where its productivity is higher. This will enable an overall improvement in the efficiency of water use in Victoria.

Most jurisdictions have now recognised these concerns and moved away from land based water allocations to systems in which the rights to access available water supplies are separate from land ownership. Under these arrangements, water can be transferred, to varying extents, between different agricultural users and, in some cases, to alternative industrial or recreational uses (see Appendix C).

Why have a market for water?

Where conditions of scarcity exist, options for determining allocations between competing uses range from bureaucratic distribution of access rights to the creation of an environment in which a market process can determine the most efficient allocation.

Experience in other countries suggests that a market operation can deliver an outcome in which the values of alternative uses of water resources are taken into account (although issues relating to the specification of water 'rights' and the treatment of environmental and social concerns need to be addressed). On the other hand, bureaucratic distribution of access rights suffers from the potentially ad hoc manner in which available supplies must necessarily be allocated. For example, in the past, such rights frequently were allocated on the basis of first-come-first-served. Under this arrangement, it is unlikely that water will flow to its most productive uses. Arbitrary distribution mechanisms also are likely to be relatively inflexible over time. This reduces the ability of the system to adjust to changes in demand for irrigation water. Recognition of these concerns has driven the observed change in most jurisdictions towards a market based system of transferable water entitlements.

A free functioning market for water allows users to purchase additional water or sell unused portions of their allocation depending upon their situation. In these circumstances, buyers who value water highly are able to bid water away from less productive activities. The converse applies for users who have water surplus to their requirements.

The direct income benefits from the transfer of water entitlements are significant. For example, in the seven years following the introduction of limited water trading in New South Wales (198384 to 1990–91), rural incomes were estimated to have increased by \$42.5 million as a result of water flowing to higher value-added uses (Sturgess and Wright 1993). Sturgess and Wright postulated that the benefits from a system unconstrained by geographic limitations on transfers and other impediments to trade, though remaining subject to technological and environmental considerations, could be greater still.

As shown in Table 8.1, irrigation in Australia is used in a number of different agricultural and horticultural activities, with grapevines being a significant, though far from dominant, crop type. In 1992–93, land used for growing grapes (including grapes for drying and for fresh consumption) accounted for only 2 per cent of irrigated agricultural land in Australia.

Crop type	New South Wales	Victoria	South Australia	Australia
Grape vines	7 436	14 058	20 584	43 418
Citrus fruit trees	12 550	4 727	7 485	28 613
Other fruit trees	11 623	14 381	5 377	45 848
Nut trees and berries	7 003	2 249	2 089	24 462
Vegetables	14 968	20 103	11 086	95 674
Pasture	537 218	523 898	85 092	1 289 583
Cereal and crops nec	372 471	32 095	9 904	555 858
Cultivated turf	1 692	188	107	4 4 1 4
Nurseries and flowers	1 757	3 917	592	10 115
Total	966 718	615 616	142 316	2 097 985
includes pasture given the assump		reported irrigat vn for seed outs	ed pasture area may be o ide of South Australia is	s irrigated

Table 8.1: Irrigated agriculture in Australia, 19992

Given the varying gross returns per megalitre of water used attributed to different crop types — estimated to range between \$60/ML for some rice crops to over \$1200/ML for some dried vine fruits— and the land area and water volume presently used for irrigation purposes, the scope for more extensive water transfers from low to high value water users appears to be significant.1

In addition to the measurable income effects, a secondary market for water creates the price signals needed to guide future investment decisions- not only for the providers of necessary irrigation infrastructure, but also for irrigators contemplating further plantings or changes in cropping mix. For example, where water is underpriced, artificially inflated levels of demand may encourage the development of new infrastructure (or the refurbishment of existing infrastructure), even though such investment may not be economically justified. Likewise, incorrect pricing of water may induce

¹ This is not to suggest that all irrigated land occupied by crops with a low gross return per megalitre be replaced by viticulture. Not all soil types are suited to grapegrowing. In other cases, the gross return per megalitre may not provide an accurate indication of the overall profitability or viability (ie the net returns realised taking into account all input costs of activities on irrigated land).

irrigators to invest in crops or irrigation technologies they would not choose if faced with the 'true' social opportunity costfor water.

Transferability of water entitlements increases the production choices available to irrigators, allowing them to incorporate changes in technology and changes in the prices of inputs and outputs more easily. In this sense, transferability assists farm adjustment by disaggregating land and water rights into separate negotiable assets— farmers don't have to sell land to realise the value of their water allocations. This capability can soften the costs of necessary adjustment and assist in the redevelopment of agricultural resources to more productive uses. In this context, ABARE (1991, p20) reported that:

If there is a reduced need for irrigation, part of the quota can be sold and the capital transferred into other farm investment. ... In short, some of the changes that previously required long term planning can, with transferability, be easily incorporated into short term planning.

A water market also offers an efficient mechanism for dealing with distributional issues arising from water transfers. Simply stated, those who sell their water entitlements will do so only if the returns from the sale make them at least as well off as they were previously. Likewise, the voluntary nature of water entitlement purchase means the same presumption can be applied to water buyers. However, this 'win-win' outcome needs to be viewed in the context of potential third-party or environmental costs. These concerns are discussed later.

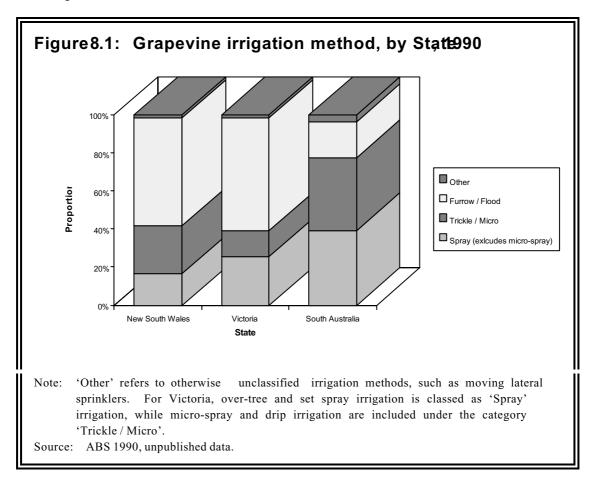
By attaching a market price to water, a TWE system discourages water wastage and rewards irrigators installing efficient irrigation systems (eg replacing inefficient transfer mechanisms such as open channels or adopting more stringent water use behaviour). This incentive helps to reduce unnecessary drainage and run-off water returning to rivers and other water-courses, in turn reducing the impact of irrigation on salinity and other environmental concerns.

The Committee understands that, in some areas, irrigation efficiency (the proportion of water applied through irrigation actually used by the crop) ranges between 40-80 per cent. For example, the River Murray Water Resources Committee (1994,p. 3-20) reported that:

Much of the water allocated for irrigation could be used more efficiently in terms of crop water use. Irrigation applications efficiencies ... vary widely from 50 per cent to 80 per cent.

In many cases, low irrigation efficiencies can be attributed to the use of outmoded irrigation systems or techniques. For instance, in the MIAupwards of 90 per cent of the area under vines is serviced by flood or furrow irrigation, with only a small proportionserviced by trickle and drip irrigation. For South Australia, a significant shift in irrigation practices has resulted in the majority of vineyards operating on pressurised systems (using overhead sprinklers or micro-irrigation systems) However, of the remaining flood and furrow irrigation in that state, almost all is used to service vineyards. Figure 8.1 summarises the various irrigation methods employed by grapegrowers in New South Wales, Victoria and South Australia?

Where irrigation efficiencies are low, excess drainage run-off can increase nutrient contamination of rivers and contribute to salinity by increasing groundwater accessions. As discussed later, these environmental consequences are not without costs.



At the draft report hearing, Graetz Irrigation stated that efficiencies exceeding 90 per cent are now achievable from properly designed drip irrigation systems. Modern systems not only conserve scarce water resources, but also

² Given the age of the data and recent trends towards the use of trickle and drip irrigation, the data in Figure 8.1 will almost certainly overstate the use of flood and furrow irrigation.

reduce land degradation and save on fertiliser application. However, both Graetz and the Irrigation Association of Australia stressed that, while changes in water pricing arrangements and investment allowances provide incentives for growers to adopt modern irrigation technologies, there is also a need to improve understanding of the capacity of different irrigation systems and of installation and operational options to optimise their efficiency.

Transmission losses— primarily seepage and evaporation from open channel distribution systems— also are significant. The Victorian Department of Conservation and Natural Resources estimates that up to 90 per cent of the water diverted to some irrigation systems from the River Murray is lost in this manner (see Box8.1). Obviously, a large proportion of these losses are either natural or simply too costly to prevent. However, the Department (sub6, p. 3) considered that further expansion of winegrape growing could be facilitated through:

.... more efficient utilisation of the currently available resource, both through more efficient on-farm use and reduced loss within the delivery infrastructure.

In the MIA, almost all water distribution is via gravity fed open channels. However, evaporative and seepage losses are estimated to be lower than in Victoria — the difference being attributed to the clay soils that exist in much of the region.

Creating the environment for effective market solutions

Markets cannot provide solutions in all circumstances. In the case of water, and indeed all resources, an effective market requires:

- property rights which are completely and exclusively allocated (that is, holders of property rights are guaranteed exclusive use of a portion of the resource and non-property right holders can be effectively excluded);
- transferability the capacity to physically transfer the resource from users who place a low value on its use to those who value the resource more highly; and
- divisibility the ability to trade the resource in small, divisible bundles which can be easily combined into larger more efficient allocations.

Box 8.1: Initiatives to reduce transmission losses

The Victorian Department of Conservation and Natural Resources estimates that up to 90 per cent of water transported through some open channel delivery systems is lost to evaporation and seepage. To help reduce these losses, Murray Sunraysia Water (formerly part of the Rural Water Corporation) encourages local water supply authorities to upgrade aging infrastructure, principally involving a shift from open channels to closed pipe delivery systems.

Of particular interest is the privatisation approach promoted by Murray Sunraysia Water. In the Carwarp region, the local progress association formed its own private water supply authority, buying the irrigation water infrastructure previously owned by Murray Sunraysia Water. The private supply authority is undertaking a program of upgrading the region's open channels to a piped system, with the consequent water savings (around 1 200ML) auctioned by Murray Sunraysia Water. The private authority considers that savings in terms of operating and maintenance costs will be sufficient to cover the costs of purchasing the supply system from Murray Sunraysia Water and upgrading the infrastructure.

Murray Sunraysia Water is also investigating the possibility of a private company funding infrastructure refurbishment in return for access to the water previously lost to seepage and evaporation.

For private diverters, mechanisms exist to allow irrigators to realise the benefits of reduced transmission losses by selling (or using themselves) any water realised through infrastructure improvements.

The specification of property rights is crucial to the effective operation of a water market. In most irrigation areas, 'ownership' of water entitlements is already specified. However, in some areas, rights to access water are either not specified in terms of volume ¢g where water rates comprise a flat fee regardless of usage) or would not otherwise be considered to be a separate legal asset. Box 8.2 outlines some characteristics of an effective property rights regime.

Where the right to access water is attached to land ownership, it is likely that the value of this right, over time, will have been capitalised into the value of the land. An equitable distribution would therefore take into account the extent to which existing water users alreadyhave 'paid' for their water rights. The South Australian Government noted that, despite licences only being issued annually, there is a clear expectation that they will be renewed without alteration — to the point where some financial institutions apparently regard water allocations as secure assets.

Box 8.2: What are property rights?

Property rights are legally defined and enforceable rights which relate to the ownership and select use of certain resources or commodities. The specification of property rights is a crucial prerequisite for efficient resource use under a market system.

For water, given that the resource itself is vested in the state, property rights relate to the ownership of the right to *use* water resources in a specific fashion. To this end, a property right over water should specify the volume of water available for use (including the security of supply), the range of permissible uses and the tenure of the permitted use.

Defining the security of supply need not involve the calculation of the exact probability that the entire nominal entitlement will be delivered. For instance, a water right could specify access to a *proportion* of available water (after all higher order uses, like environmental flows, are satisfied). Alternatively, users could be given rights to a set volume of water, with the proviso that this quantity will be adjusted downwards in times of low flow or drought in order to maintain a given level of environmental flows.

The tenure of the right also is important. Basically, a right may be a perpetuity (a permanent right) or it may be a form of lease (eg a 99 year lease permitting the use of water resources over this period). For some purposes, the differences between permanent rights and shorter term leases is minimal. However, as discussed later, the distinction becomes important where investment decisions outlive the tenure of available leases.

A fundamental element of any property rights regime is not just the rights to the income earning potential of the asset in question, but the ability to transfer or dispose of that asset, along with the current owners ' rights and responsibilities. For water, this necessarily entails that trade in water titles is permitted irrespective of land ownership. If transferability is restricted or prohibited, the flexibility and efficiency of resource use will be diminished. A property rights system also should detail other conditions under which transfers are permitted. This should include, for example, any environmental restrictions on transfers.

However, simply ratifying or 'grandfathering' pre-existing 'rights' is not without a down side. Given that the transfer of any resource has costs—whether these are the physical costs of transfer or additional government imposts like transfer stamp duties— settling on an allocation reflecting current usage patterns may perpetuate inefficiencies if the costs of transfer discourage potentially beneficial trades.

Where current levels of resource exploitation exceed that thought to be sustainable — or desirable from the community's perspective — grandfathering may be seen as an example of governments justifying over-exploitation of water resources. However, as discussed later, an effective property rights system should permit governments to specify (and purchase, if necessary) required volumes of water for environmental purposes, thereby guaranteeing such flows are maintained.

Grandfathering of existing water rights should not be viewed as evidence of governments 'giving away a public resource'. As alluded to above, many holders of existing licences have paid significant sumsto previous land owners for the right to use water resources and the prospect of largescale windfall gains to current irrigators from ratification of existing rights appears limited.

Where water rights are not already (indirectly or directly) specified, distribution of water rights amongst competing users would best be achieved through an auction. For example, where the available quantity of water is increased through capacity augmentation of dams (or existing supplies are not fully allocated), additional rights should be sold to the highest bidder.

In some areas, the quantity of water available frequently is less than the total of all allocated water rights. This can reflect periods of drought or overallocation by water authorities. In either case, some or all users will have to forgo access to a proportion of their nominal water entitlement.

For a water market to be effective, rights to a particular volume of water should detail the likelihood of the full nominal entitlement being available for use (see Box 8.2). For example, in New South Walesthe Department of Water Resources operates a two-tiered water security system in which allocations are defined as either high or normal security (see Appendix). Such a system provides water users with additional flexibility and certainty, while still accommodating natural fluctuations in water supply.

In some areas, transfer of water entitlements is permissible only on a short term basis (usually annually). Such arrangements are designed to allow irrigators and other users to 'topup' their requirements from yearto year, without significantly disturbing the overall pattern of regional water use.

While some short term trades offer irrigators benefits in terms of flexibility, prohibitions on permanent transfers of water entitlements have the potential to restrict irrigation development. For example, where the water is available only via short term leases, projects requiring access to water over the longer term may be discouraged. On this, Sturgess and Wright (1993, pl.1) remarked:

... if the permitted tenure of water 'leases' is too short, tradeability in water rights may not in itself result in a more efficient allocation of water. If the tenure is too short, higher-value water users may decline to take on additional water, since the capital outlay involved in doing so may need to be recouped over a period longer than that allowed by the transfer.

Short term transfers may be appropriate for crops which are replanted each season (eg rice and peas). However, vineyard investments are recouped over tens of years. Consequently, vineyard development is unlikely to proceed where the security of water supply is contingent on the capacity of the short term water market to deliver required volumes.

Transfers may be restricted where water resources are locked into specific geographic regions. To a degree such restrictions may reflect unavoidable physical or technological limitations on water transfers of between valleys not linked by a common watercourse). However, in many regions additional spatial restrictions are imposed upon the transfer of water. For instance, in New South Wales, water transfers from some irrigation areas are constrained by zonal boundaries which map out limits beyond which transfers are not permitted (see AppendixC). Often such restrictions arebased on concerns over the economic viability of particular regions in the face of a sustained outflow of water resources. Regional economic viability issues are discussion later in this chapter.

On a larger scale, there are restrictions on water transfers between states despite the existence of common watercourses which could act as supply conduits. South Australia, in particular, increasingly is recognising the development constraints that geographic (both inter and intrastate) transfer restrictions impose on its agricultural and horticultural industries— and the wine industry specifically. These sentiments were reflected in a press release from the Premier of South Australia (Brown 1994).

There are significant opportunities to improve the economics of primary production through utilising water to produce higher value outputs.

... a more flexible system of water allocation is urgently need to cope with added demands, ... [allowing, for example], ... water rights transfers to transcend State borders.

The Committee understands that other state governments and the Murray Darling Basin Commission(MDBC) are actively pursuing the possibility of interstate trade in water allocations.

The efficiency and effectiveness of a water entitlement market also may be compromised by excessive transactions costs imposed on water transfers. Some administrative charges, designed to cover the costs of registering water transfers and keeping track of water owners and users, are necessary to preserve the integrity of the market. However, charges in excess of required administrative levies will reduce the volume of transfers and discourage the efficient movement of water resources.

Similar implications may arise where transfers are subject to 'in-kind' charges. For example, a number of jurisdictions apply reduction factors to transfer volumes — in some cases reducing the actual volume of water transferred by 70 per cent. Frequently, such reductions are premised on concerns of over-allocation from water sources and are aimed at reducing or eliminating the extent of this over-allocation. However, these objectives would be more effectively and efficiently achieved through transparent public purchases of allocations necessary to sustain environmental objectives(see later discussion).

For any market to function efficiently and effectively, governments must provide a stable and predictable regime of enforcing legally binding transfers, and maintain a consistent set of rules governing transfers and availability of water allocations. For example, water authorities need to ensure that increases in the quantity of available water allocations are made only with commensurate expansions in supply capacity (given that resources are fully allocated initially). Without such allowances, the value of existing rights may decline and the incentives for water transfermay be reduced

If the market mechanism is to operate efficiently, there must also be sufficient information disseminated to potential participants to inform them of the benefits of participating in the market and of operating 'rules', and to enable them to make informed buying and selling decisions. In this context, the South Australian Government commented (transcript, pl366) that:

... the state government has through a cabinet ruling allowed our department to release information — names and addresses and water allocations and use information — to the general market. Previously ... the water transfer market was

blind; the sellers were running around and by pure chance would run into someone who was wanting to buy water. Now that we have this information available a potential purchaser of water can look down the list and see who has a large allocation, or any allocation that is unused, and approach that person, either personally or through a broker.

Separating water entitlements and land ownership is an important prerequisite for trade in water. Specification of property rights over water allocations should also be a high priority for state governments. Such rights should detail the quantity of water available, security of supply, tenure of permitted access and conditions under which transfers are allowed. Governments should aim to minimise transactions costs and other restrictions imposed on water transfers. Initiatives to facilitate interstate movement of water allocations should be accelerated.

The Committee recognises that progress in specifying property rights varies between jurisdictions. However, the specification of property rights is an essential pre-requisite to trade in water. Consequently, the Committee agrees with the Council of Australian Governments (1995, p14) that:

While the challenges to putting in place property right arrangements are not underestimated, it is considered that high priority should be given by government to achieving this.

To this end, the Committee supports finalisation of a property rights system (and associated initiatives required to permit trade in water) within the timetable established by the Council.

In formulating property rights, a cooperative approach involving the states and the Commonwealth is most likely to maximise the potential benefits of water transfers. For example, a uniform approach to the style of water rights and conditions of transfer would assist in the development of a comprehensive interstate water market. However, delays in the implementation of a national water transfer scheme should not inhibit individual states introducing more liberalised and comprehensive water markets.

Enhancing the efficiency of a water market

To be fully effective there are a number of potential environmental problems that an efficient TWEs system must address. If these concerns are not addressed, transfers could impose costs on third parties not directly involved in the transfer process. For example, Coffey (1991, p3) suggested that:

... while TWE should increase economic efficiency and productivity it is possible that TWE will also produce external costs (eg environmental degradation, river salinity, and land salinisation) which will not accrue to the parties involved in the transactions. Therefore these costs will not be reflected in the market value of water.

Transferability of water entitlements also raises concerns regarding the continued viability of regional centres faced with the loss of irrigation capacity due to water being transferred out of the local area.

River salinity

River salinity is a major problem for many irrigation areas in Australia. Although salinity occurs naturally, large scale irrigation increases river salinity by increasing flows of saline drainage or groundwater into river systems. Coal mines, electricity generation plants and land clearing are other significant causes of artificially high river salinity.

At times of low flow, salinity in some Australian rivers exceeds levels recommended for human consumption and frequently is above those levels shown to be detrimental for horticultural use (see Box 8.3). The use of saline irrigation water reduces the capacity of grape vines to take up the nutrients in the soil and subsequently impacts upon grape yields. River salinity also may impose costs upon industrial and urban water users.

Box 8.3: Measuring river salinity

The standard measurement unit for river salinity is the EC (electroconductivity) unit. The relationship between the EC unit and the quantity of salt in the water is not strictly proportional. However, for salt loads below 4000mg/L, a relationship of 0.6mg/L per EC can be used as an approximation.

Drinking water should not exceed 830EC (approximately 500mg of salt per litre). For water above 370EC, studies have shown that each 100EC increase in water salinity will decrease aggregate horticultural yields by about 1 per cent. The effects of levels below 370EC have not been quantified.

Salinity in most rivers increases as the water flows downstream, reaching a maximum where the river flows into the ocean. Taking into account fluctuations arising from seasonal variations in irrigation activity and river flows (as well as 'slugs' of saline water moving downstream), salinity levels in the Murray are estimated to range between 40EC in the headwaters, around 580EC at Morgan and approximately 800EC where the river meets the ocean. Salinity in the Hunter River also is highly variable, with estimates of between 350 to 400EC for water in the Glenbawn Dam to levels of over 1000EC at Greta.

The impact of irrigation on salinity varies widely. It depends upon the efficiency of the irrigation technique employed, the underlying hydrogeological characteristics of the area and the extent to which the irrigator has installed effective drainage or other abatement mechanisms. At best, additional irrigation would not change current levels of salinity, but in some areas each additional 1000ML of water applied through irrigation has the potential to increase river salinity by up to 0.9EC.

River salinity in Australia is trending upwards, indicating that the costs from salinity, or necessary salinity abatement, will similarly increase. ABARE (1991) reported that the annual agricultural costs of river salinity are approximately \$37 million, with additional urban losses of around \$65 million. While neither estimate accounts for the costs of avoiding salt emissions — in itself likely to be significant— they suggest that the benefits from reducing river salinity are likely to be substantial. Without action to reduce salinity, the MDBC estimated that the annual agricultural costs of river salinity would increase to \$95 million by 2015.

The use of TWEs could raise absolute levels of salinity and/or change the existing pattern of river salinity. For example, the Australian Conservation Foundation (sub.205, p. 1) pointed out that trade would increase water use and, hence, salinity problems:

In the Murray Darling, <u>all</u> of the current trade in water is in 'sleepers' (or unused entitlements). In most cases, therefore, water trade results in more water being used, not less ...

Similarly, transfers of water allocations from areas where irrigation has little impact on salinity to areas where the impact is relatively highwould increase the absolute level of river salinity.

Conversely, transferability of water allocations offers scope for reductions in overall levels of salinity and beneficial changes in the pattern of river salinity. However, in the absence of any mechanism to encourage buyers and sellers to take into account the external effects of water transfers, this effect would be unpredictable.

State governments have adopted different methods of dealing with the salinity impacts of TWEs. Victoria has identified high salinity impact zones and low salinity impact zones (reflecting the impact on river salinity of additional irrigation), with transfers encouraged from high to low impact areas and prohibited from low to high impact zones. In New South Wales and South Australia, geographic restrictions may be imposed by water authorities on water transfers likely to cause significant increases in saline flows to a river (see Appendix C).

Some organisations have suggested that governments subsidise salinity reduction measures as a method of countering this growing problem. For example, the Nyah to the South Australian Border Community Salinity Group called for subsidies of between \$550 and \$1400 per hectare for irrigators diverting drainage water away from the River Murray. While recognising the external benefits such a subsidy could yield, subsidising salinity reduction measures potentially could induce increased irrigation investment in high salinity impact areas (relative to the level that would prevail in the face of no subsidies). These opposing incentives must be weighed when considering the value of salinity reduction subsidies.

A number of participants suggested that the costs of addressing salinity problems should be borne by those likely to benefit, including the wider community. To the extent that such benefits would be enjoyed by irrigators, such a system appears similar to the market based mechanisms outlined below. However, beneficiary-funded salinity reduction does not provide adequate incentives for those responsible for the salinity (either irrigators or others) to modify their behaviour to accord with community wishes. Furthermore, it would be difficult to identify indirect beneficiaries and to access the extent of associated benefits.

Alternatively, salinity levels could be controlled through the imposition of market based mechanisms such as a salinity tax or tradeable salt discharge quota system. Box 8.4 outlines two salinity reduction schemes that operate based upon the concept of tradeablerights to contribute to river salinity

Market based systems are used widely overseas to cope with pollution emissions and similar environmental concerns. ABARE (1991, p28) stated that salinity taxes stood out as the measure most easily implemented and most likely to achieved the desired results:

Salinity permits also have the potential to be efficient, though the initial allocation of permits may be complicated. Subsidies are likely to have undesired long term effects. The use of standards would require a large amount of new information gathering if economic inefficiency were to be avoided.

However, ABARE warned that the effectiveness of any market mechanism introduced to deal with river salinity would be diminished without allowance for the transferability of water entitlements.

In its report into the water resources and waste water disposal sector, the Industry Commission (1992) considered that tradeable discharge permits and salinity taxes offered scope for environmental objectives to be met with minimum costs to irrigators and the economy.

Irrigation charges, appropriately structured, have the potential to efficiently account for environmental costs arising from irrigation activity. In this sense, they permit salinity increasing irrigation to proceed only where the costs imposed upon other users are outweighed by the benefits of increased irrigation activity. However, practical difficulties in the measurement of irrigation-sourced salinity impacts means that cost-effective monitoring of an individual irrigator's contribution to river salinity is unlikely to be a realistic or cost-effective option. Moreover, extrapolating economic costs from salinity levels or increases also may be problematic.

Governments need to trade off the benefits from more efficient resource use decisions against the simplicity and (potential) relative cost advantage of alternative regulatory systems. For example, the Victorian system of spatial restrictions based on high and low salinity impact zones is able to prevent a large proportion of salinity increasing water transfers, although with a consequent reduction in efficiency of water allocation distribution.

Nevertheless, there is scope to incorporate within current pricing signals some indication of the external costs salinity increasing activity imposes on others. In this sense, a tax can be levied on th*input* to salinity increases, specifically, the water used for irrigation. For example, all Victorian irrigators– except those in the Nangiloc-Colignan region– presently pay a 50c/ML salinity levy to account for salinity effects of irrigation. Similarly, buyers of 'new' water (from Dartmouth Dam) at the recent Swan Hill water auctions were required to contribute to the capital and operating costs of salinity abatement works (as directed by Victoria's involvement with the MDBC's salinity and drainage strategy).

Improvements in salinity monitoring technology would offer scope to differentiate such levies to take into account the varying impacts between different irrigation locations and among irrigators employing different irrigation and drainage technologies.

Where practicable, irrigation charges should be structured to account for the external costs imposed by irrigation-sourced salinity increases. Where such charges are not feasible, or adequate differentiation of charges is not possible, restrictions on water transfers between recognised 'low' and 'high' salinity impact areas should be considered.

State governments should assess the costs of salinity and the likely impact of irrigation activity on salinity levels. From this information, charges and transfer restrictions should be formulated to encourage reduced environmental

degradation and the movement of water resources to areas in which salinity impacts are lower. Importantly, charges should apply to all irrigators, not only those purchasing water allocations from existing users or new water sources.

Box 8.4: Tradeable discharge permits to reduce salinity

The MDBC salinity and drainage strategy incorporates a form of salinity trade between New South Wales, Victoria and South Australia. Each state contributes to salinity reduction works to reduce the level of salinity at Morgan (the source of Adelaide's water). To date, \$27 million of joint salt-interception schemes have been completed, resulting in a median salinity decrease of 80EC at Morgan. In return, New South Wales and Victoria each received 15EC 'credits' which can be used to offset salinity increasing developments within their boundaries. South Australia did not receive an explicit EC credit for its participation, but benefited indirectly through the overall net reduction in river salinity.

Trade in EC credits is permissible, with a state able to transfer its responsibilities under any joint salt interception scheme , in return proportionally forgoing the number of EC credits it earns (and subsequently diminishing its ability to undertake works which increase river salinity). States also have the option of contributing to additional salinity reduction projects to earn more EC credits.

States can 'spend' EC credits as they wish, with the only criterion being the salinity impact at Morgan. The strategy ignores potential changes in the distribution of salinity impacts outside of Morgan. For instance, New South Wales may shift the point at which saline water enters the Murray to below where water is drawn for a particular irrigation project. By reducing the salinity of water available for this project (though not the median salinity level at Morgan), there may be some benefit to the project and the state overall, although not in the form of EC credits.

The New South Wales EPA is to introduce a system whereby coal companies can trade permits allowing them to discharge saline water into the Hunter River. The EPA will set a maximum allowable salt load limiting the collective discharges of salt by Hunter coal mines. A permit will enable a mine to discharge a quantity of salt equal to a set *proportion* of this allowable salt load. If a reduction in overall salinity levels is required, the EPA will reduce the allowable salt load, with all coal companies affected proportionately. T he EPA hopes to establish a 'price' for river salinity increases, thereby encouraging coal companies to take into account the costs of their actions and adjust their behaviour accordingly (eg the potential sale of surplus 'salt credits' would provide a commercial incentive for coal companies to reduce the amount of saline water they discharge).

While the mechanics of salt discharge from easily identified 'point' sources like coal mines lends itself to such a scheme , it is more difficult to incorporate other sources of salinity — notably irrigation activities — into the scheme.

Irrigation system costs

Third party effects of water transfers may arise where irrigators operate within the same water distribution system and share the fixed costs associated with this infrastructure. These concerns are prominent amongst irrigators in government irrigation districts in which fixed costs are spread between all users. In some cases, the movement of water out of a district may result in remaining users being forced to bear a larger share of the total operating costs of the infrastructure (Delforce, Pigram and Musgrave 1990, p60).

Significant loss of water from a region can have a direct economic effect on the irrigation farm firms that continue to operate in the area. The fixed costs of supply and drainage infrastructure per firm will increase as these costs will be borne by fewer firms. Remaining firms will be disadvantaged if the cost increases are passed on in full or in part, while society will suffer if governments subsidise all or part of the cost increases.

To counter these concerns, some states restrict water transfers to those users operating within the same water delivery system. In South Australia, restrictions of this nature were relaxed recently (see Appendix C).

However, restrictions of this nature ignore parallels with other forms of economic activity, and the solutions devised for these situations. For example, few would suggest that lessees at a commercial shopping centre be restricted from leaving simply because the remaining establishments may be required to increase their contributions towards fixed costs such as lighting, security and cleaning (assuming no alternative vendor can be found). In such situations, it is the price of the infrastructure (the shopping centre) that adjusts to accommodate any changes— for instance, through reduced rents to attract a new vendor.

The important distinction for irrigation systems is the separation of the infrastructure charge from the price of the water itself. Effectively, the delivery system should operate as a separate infrastructure service entity which provides water transfer services to local irrigators (ie transporting*heir* water from source to farm gate). As such, operators of the delivery system should not be able to restrict the out-transfer of water allocations, whether through physical limitations on transfers or through the levying of 'exit charges' or similar ondeparting irrigators

Irrigation infrastructure services should be provided by a separate service provider. Such entities should not be permitted to obstruct transfers of water entitlements.

A similar outcome can be effectively attained by vesting ownership of the local supply system with the irrigators it services. This 'community ownership' approach provides benefits in that it internalises the costs potentially imposed by one user leaving the system.

Environmental flows and system viability

Permitting the transfer of water allocations allows irrigators to sell their water entitlements to users further up or downstream. Transfers of water allocations to upstream users may reduce flow levels to some downstream localities. Particular problems may emerge if environmental flows through certain parts of the river are not explicitly specified and allocated.

Minimum levels of flow are required to meet ecological requirements and maintain stream flows and river navigability. Seasonal flooding requirements and dispersion of effluent loads also may require additional environmental allocations. Where environmental flows are not specified, stream flow and the water requirements of riverine ecosystems frequently are indirectly reliant upon water allocations remaining with downstream users.

The extent to which governments have explicitly allocated water for environmental objectives is varied. For the River Murray, 18000ML of water is allocated for environmental purposes. However, in some rivers, notably the Darling river system, no such flows have been allocated.

In New South Wales, a recent initiative has been the establishment of ECAs to provide water for environmental requirements (eg the Gwydir wetlands have been allocated an interim ECA of 20000ML, while the Lachlan Valley ECA has been set at 100000ML).

However, the effectiveness of such measures has been questioned in the face of continued over-allocation of water resources. For instance, McCosker (1994) criticised the New South Wales approach to ECAs, questioning the worth of 20 000ML of environmental flows in the face of an 8000ML overallocation of water resources from the Gwydir River. Moreover, ECAs remain essentially a mechanism for the shortterm relief of environmental problems. However, the Committee understands that recent changes to the ECA system means that environmental flows are now set aside from regulated river flows, before determination of other annual allocations (see Appendix C).

Where water resources in specific river systems are over-allocated, it is imperative that the commercial consumption of water is reduced to allow for increased water for environmental and recreational flows. It is clear that, to facilitate this end, water entitlements currently allocated to irrigators will need to be repurchased and allocated to specific environmental objectives. The SAFF (sub. 45, attachment, p.11) concurred:

... any streams considered to be over-allocated should be a priority for the repurchase of allocations, to establish environmental flows.

The Expert Group on Asset Valuation Methods and Cost Recovery for the Australian Water Industry considered that it is a matter for governments to determine the manner and arrangements under which water is obtained for environmental purposes. To this end, the Expert Group suggest that the costs of such reforms be borne by the beneficiaries, except where wider public benefits exist, in which case it would be appropriate for governments to fund any necessary water entitlement repurchase. The Expert Group also suggested that the option should remain for individuals or other organisations to separately fund any additional 'environmental protection' above that deemed necessary to sustain the river (COAG 1995).

The Committee generally agrees with these recommendations from the Expert Group. However, to the extent that governments are responsible for the present levels of over-allocation, publicly funded re-purchase of water entitlements and subsequent allocation of these entitlements to specific environmental objectives appears appropriate.

Governments, in conjunction with relevant water authorities and multijurisdictional bodies such as the Murray Darling Basin Commission, should identify the environmental requirements of river systems and quantify the minimum flow levels necessary to meet these objectives. Where existing environmental flows are insufficient, governments should repurchase necessary water entitlements.

The Committee recognises that this objective will not be met cheaply. Indeed, given an indicative price of \$440/ML for River Murray water (the average price for water entitlements traded at the Swan Hill water auction), the current 'cost' of the 180000ML identified as environmental flows is approximately \$79.2 million. However, by explicitly identifying and costing environmental objectives in this manner, the community is able to make informed trade-offs between competing water uses.

Additionally, once adequate environmental flows have been established, governments could exercise the option of leasing (on a short term, possibly annual, basis) any water surplus to environmental requirements as a result of continued downstream allocations to private irrigators. This would provide additional funding for the purchase of any additional entitlements required for

the maintenance of future environmental flows. The flexibility this entails is essential for community acceptance. For instance, changes in the value the community places on environmental amenities could be accommodated by additional purchases of water entitlements for environmental purposes

A related problem is the extent to which river systems can accommodate large scale movements in water allocations. In some cases, physical limitations exist. For example, certain sections, or chokes, in the Murray are unable to carry more than a set volume of water per day. Similarly, in New South Wales, certain sections of the NamoiRiver are constrained by weirs with limited through capacity and numerous streams which cannot accommodate additional water flow. Water rights and transfer arrangements need to be structured to account for such physical restrictions.

Secondary income effects and regional implications

In regions where irrigation activity is a significant contributor to the local economy, some participants were concerned that the transfer of water to another region would reduce demand for irrigation support services, leading to a decline in the local population and the capacity of the area to maintain existing services. Indeed, the Council of Australian Governments Working Group on water resources policy (1994, p7) noted that:

... local government concerns over the impact of water trading on the current pattern of regional economic activity has led to ... opposition in some areas.

Local government opposition is, in many cases, premised on concerns over reductions in the rateable base available to them. For instance, although the separation of water rights from land holdings does not have any effect on the underlying aggregate value of rural land, it could change the base value upon which council rates are levied. This reduction, in turn, could affect local government's capacity to provide services to shire residents.

The Committee understands the concerns of participants and recognises that transfers of water resources could potentially involve distributional and regional consequences. However, it is important to note that simple observations of water resources transferring out of a particular region are not prima facie evidence of regional decline. Change is a pervasive feature of all industries and regions, and water transfers may simply be a consequence of a shift towards 'drier' farming in the region, possibly through the use of more water efficient crops or cropping methods. Indeed, the increased flexibility afforded rural industries by a tradeable water entitlements market may increase the aggregate valueof a council's rural rate base.

Similarly, outward transfers of water may reflect a change in the industrial structure of the region away from agricultural based industries to alternative activities. The adjustment process in this scenario may actually be enhanced by TWE, as separate water rights provide farmers with an asset able to be realised without selling their land. For example, the Murray Valley Region submission (sub. 137, p. 5) suggested that:

The regional development that has been ongoing, has been significantly due to the fact that water allocations were able to be purchased and relocated on the Victorian side of the river. [The Committee's] recommendations will enhance further development in the inland regions to more efficient water use, particularly with wine grapes.

For these reasons, it is overly simplistic to presume that permanent water transfers will lead to large scale regional decline. More importantly, to the extent that any potential regional decline is outweighed by benefits to the wider community and the national/state economy, such costs should not be used as justification for constraining necessary structural adjustment.

8.3 Areas for reform

The wine industry has an advantage in that, compared to many other crops commonly grown in areas suitable for viticulture, grapes are comparatively water efficient. Combined with the relatively high value of grapes themselves, vineyards provide potentially the highest dollar return per megalitre of water applied of all the irrigated area crops.

Provided water rights are transferable, the high levels of return per megalitre of water should allow vineyard operators to bid water away from less productive broad acre uses and expand the level of Australia's grape production. Grapegrowers therefore should be able to benefit greatly from an expansion of the market for water. More importantly, the community overall will benefit from scarce water resources being used for more productive purposes.

Some of the changes required to develop efficient water markets are already underway. For instance, Southcorp Wines (sub. 59, p10) submitted:

State Governments have reformed water allocation rights, so that the market is effectively redistributing water licences to their most efficient use. Transfer of riparian licences is almost totally deregulated so that the more efficient users of water, such as viticulturalists, have purchased licences from broad acre graziers ...

Similarly, the Department of Primary Industries and Energy referred the Committee to the progress all jurisdictions have made towards the implementation of water industry reforms, as proposed by the Council of Australian Governments Working Group on Water Resource Policy. The direction of these reforms is broadly in line with the recommendations of the Committee.

However, the Committee considers that a number of avenues exist for further reform, some with the potential to assist the development of the wine industry in particular. For example, despite the recent changes, all state governments retain some form of spatial restrictions over water trading. Scope exists for further liberalisation of barriers that presently prohibit the transfer of water between geographic regions— and particularly those impediments to water transfers between states. Likewise, limitations on water trading through the imposition of transfer taxes (whether monetary or in terms of reductions in transfer volumes) and unnecessary administrative charges should be avoided. Such charges could discourage potentially beneficial trades and reduce market depth and liquidity.

The Committee recognises that, in many cases, existing restrictions were implemented to account for environmental or other third party considerations. However, recognition needs to be given to alternative ways in which these external effects can be accounted for. To this end, market based mechanisms like salinity charges and active government involvement in the water market to establish environmental flows would more efficiently address many of the irrigation-sourced environmental problems faced by the industry and the community more generally.

Where barriers to trade between regions and states are to be removed or reduced, it is important to ensure that market distortions do not arise from remaining differences between water charging policies. Where such differences remain, the potential exists for persistent, inefficient patterns of water consumption. This is not to suggest that any environmental charges should be applied at a uniform level— such charges should reflect the differential environmental effects of water use among activities and regions.

9 OTHER IMPEDIMENTS

In addition to concerns about the availability and supply of water, participants identified a number of other factors which they considered could reduce competitiveness and impede development. This chapter considers the more significant of these impediments, namely:

- packaging costs;
- labour and training;
- grape supply arrangements; and
- state government regulations.

9.1 Packaging costs

In submissions and in verbal comments to the Committee, considerable concern was expressed about the competitiveness of the packaging industry. The majority of complaints were in relation to glass wine bottles, but there was also some mention of paperboard packaging. Complaints centred on price, with many winemakers arguing that Australian packaging prices are uncompetitive with those overseas. There was also some comment that the service provided by packaging companies is substandard. From the perspective of many winemakers, high prices and poor service extend from a lack of competition in the provision of packaging. There is only one bottle manufacturer (ACI Glass Packaging), and two firms— Visyboard and Amcor — dominate carton packaging.

Winepackaging

Participants views

Participants claimed that wine bottle prices in Australia are internationally uncompetitive and that small volume wine producers are forced to pay prices substantially higher than those paid by larger volume wine producers. Also, during industry visits a number of winemakers commented that the quality of service provided by the manufacturer (eg the degree of consultation with the industry and delivery arrangements) was below standard. The Victorian Wine Industry Association (sub. 114, p. 22) stated that:

... the service to smaller buyers is less than adequate for small winemakers.

Southcorp Wines Pty Ltd (sub. 59, p. 13) stated that:

Depending on specification and quantity, glass packaging is up to 30 per cent more expensive in Australia than in Europe.

The Riverina Wine Industry and Interest Organisations (sub. 47, p8) also identified the high cost of packaging as a concern:

High cost of packaging especially that of glass (in the case of bottled wines, packaging costs more than twice as much as that of the grapes content) creates a comparative disadvantage and is generally attributed to the monopoly in glass manufacture.

The Australian Winemakers' Forum (sub33, p. 16) commented that:

... small winemakers are unable to receive bulk purchase discounts on packaging materials because of their relatively small volume purchases.

ACI made a written submission to the Inquiry addressing some concerns raised by other participants. However, the company indicated that it wishes all of the submission to be considered confidential.

Production of wine bottles in Australia

ACI is the sole producer of wine bottles in Australia. It has production plants in Adelaide, Brisbane, Hobart, Melbourne, Perth and Sydney. Up until 1991, New South Wales was serviced by two wine bottle manufacturers, the other being a joint venture between Glass Containers Pty Ltd and SCI Operations Pty Ltd. In 1991, ACI acquired the Smorgon's operation which, at that point, had 20 per cent of the Australian glass containers market.

The production of wine bottles is a relatively capital intensive process with significant scale economies. Large furnaces are employed to colour and mould the glass into desired shapes. Although a furnace can be used for producing a range of different bottle types— including those for use by other industries which use glass packaging— one furnace can produce only one bottle type at a time. To change the bottle type, the furnace must be shutdown while moulds and colours are changed. This can be a lengthy process with some colour changes taking up to seven days to complete. Consequently, shutdowns reduce the bottle throughput of a furnace and increase the capital cost per bottle.

With a large throughput, it is possible to minimise furnace shutdowns and to increase plant utilisation. The capacity for this to occur in Australia is to some extent limited by the size of Australian demand which is small compared with that in some overseas countries. Specialisation is also impaired by the geographically dispersed nature of the Australian wine bottle market which forces production facilities to be located close to markets to minimise the high cost of transporting wine bottles. This has resulted in one relatively smallscale production plant servicing the market in each state. If markets were less dispersed, fewer plants of larger scale could be used, reducing the cost of production.

It is argued that the wide range of bottles demanded by the Australian wine industry (this currently totals 170 different types of bottles) further raises bottle production costs above those overseas. A large range of bottle types results in smaller production runs and contributes to a higher number of shutdowns. If cost savings from longer production runs were passed on to users, wine producers would be able to buy at a lower price if there was some rationalisation in the number of bottle types demanded.

However, from the perspective of winemakers, the shape and quality of bottles is important. Many small volume wine producers differentiate their product on the domestic market by using different bottle types to those used by the large volume producers. For example, the Australian Winemakers' Forum (sub. 33, p. 16) stated:

... many small winemakers use unique packaging materials to differentiate their product from those 'commercial' brands on the market.

Market power

The demand and supply conditions outlined above largely explain the current situation in Australia where bottles are supplied by a sole manufacturer, mainly from plants located close to major wine producing regions. In these circumstances, competitive pressures are low and there is the potential for some misuse of market power.

In some areas of bottle manufacture, market power is tempered by the availability of substitutes. For example, soft drinks can be packaged in plastic, aluminium, steel, paperboard or glass. Similarly, beer can be sold in aluminium, steel or glass containers. Consequently, in these areas other types of packaging can be substituted for glass if bottle prices become unacceptably high. In contrast, there is only limited scope for substituting the packaging of most wine products. Premium wines are now, and traditionally have been, packaged in bottles to aid the aging process and because there is an aesthetic value in packaging wine in a glass bottle.

The lack of direct and indirect competition faced by ACI reduces the pressure on the company to price efficiently and to respond quickly to users' needs. It also means that there is limited incentive for the company to share with users any cost savings (eg savings which could be generated by a rationalisation in the number of bottle types).

Factors limiting market power

Despite ACI's market position, a number of factors limit ACI's capacity to increase price.

First, wine bottles can be imported. Importing wine bottles is expensive because of a costly freight element and it can be logistically difficult to obtain a consistent supply. At present, imports are very small. However, should ACI's prices rise above import parity (ie the total cost of procuring supply from off-shore sources), imported bottles would become a viable alternative to domestic supply. Consequently, import parity generally sets a ceiling on the prices ACI can charge.

Second, exporters of wine products have the option of bottling offshore. Although there are some offsetting factors (eg loss of quality control, higher costs for local bottles associated with smaller domestic purchases and the cost of bulk shipping containers), offshore bottling avoids the large freight costs associated with importing wine bottles and allows exporters to benefit from lower bottle (and bottling) costs. Offshore bottling is already occurring, although the volumes remain small.

Third, the rate at which ACI can increase its prices is regulated by the Prices Surveillance Authority (PSA). While it has not been effective in encouraging competition in the industry, to some extent it has imposed a 'cap' on prices. In the event that ACI wishes to raise its prices, an application must be made to the PSA. The PSA assesses the claim based on a 'basket' of costs. The basket includes raw materials, labour, gas, electricity and depreciation. If ACI's costs have increased by a similar amount to an increase in this basket of costs, the price rise is generally granted. However, the WFWGC reports that industry representatives have found regulation by the PSA to be inadequate in that it does not encourage:

- ACI to necessarily become internationally competitive, but merely maintains existing profit margins; and
- scale economies from wine industry growth to be passed on through lower prices.

Fourth, the threat of entry into the wine bottle market if ACI were to earn excess profits could also constrain ACI's capacity to increase price. The TPC (1991, p. 29) found that the technology existed to build a glass manufacturing plant of a smaller scale than those operated by ACI. These plants would not be as cost efficient as ACI's larger plants and the smaller scale would limit the volume of production and the variety of shapes and colours that could be produced. However, should ACI's prices become too high, a small scale glass bottle manufacturing plant specifically dedicated to the production of wine

bottles would become an increasingly viable alternative, especially if technological changes favour smaller scale production as has been the case in some other industries (eg the development of steel mini mills). If this were to occur, one possibility would be for a large wine company— or perhaps a consortium of wine companies— to establish a bottle plant.

One factor which possibly could reduce the likelihood of imports or of the establishment of a new bottle manufacturer relates to ACI's existing overseas affiliations. In principle, even informal agreements between ACI and large overseas manufacturers could increase the difficulties a new entrant would face in acquiring necessary equipment and technology. They could also add to the difficulties in obtaining supply faced by potential importers of bottles into Australia.

Packing cartons

Paperboard packing cartons are extensively used by the wine industry to protect their product during distribution. While participants recognise that competition in the carton industry is greater than it is for bottles, there is still concern over price. The WFWGC (sub30, p. 136) stated that:

... the prices paid for cartons are high ... evidence available within the industry shows that this still represents a cost above international levels.

Production of cartons

There are two major producers of cartons— Amcor (trading as Containers Packaging) and Visyboard. The carton industry, like the glass industry, has recently undergone some rationalisation with the exit of a major producer. Smorgons was again the exiting company, dividing the sale of its plants between Amcor and Visyboard.

The supply characteristics of the carton industry are somewhat similar to that of the glass industry. The production of packing cartons is capital intensive and has associated scale economies. However, the size and dispersion of the Australian market limits the scale at which local plants can be operated. Australian plants cannot match the scale of those overseas which service much larger markets (eg USA). Also, due to their bulk, transports costs are relatively high. Because of the costs of distributing finished products to geographically dispersed markets, plants are generally located close to market centres.

Potential for abusing market power

The potential for the misuse of market power is less for paper packaging then it is for bottles. There are, for example, two major producers and some smaller producers. Thus, there is some scope for users to negotiate on price and conditions of supply. Another factor is the potential for substitution. Although virtually all wine cases are currently made from paperboard (for reasons relating to protection from breakage as well as price factors), the industry is not 'locked into' cardboard packaging to the same extent that it is committed to glass bottles. Thus, with changing technologies, there is a possibility of substitute packaging (ie plastic packaging) replacing the traditional paperboard container if prices and or other conditions of supply were to deteriorate in future years.

Conclusion

Glass bottles and paper packing are most efficiently produced in large volumes by sophisticated capital intensive plants. This factor, coupled with the relatively small size of demand by the wine industry and its wide geographical dispersion, have contributed to the present circumstances where local supply is provided by one bottle manufacturer and by a small number of carton suppliers. As a result, the competitive pressures applying to packaging suppliers is relatively weak. However, some factors limit the capacity of existing producers to exploit their market position. These include the possibility of imports and of new entrants and, in the case of glass bottles, monitoring by the PSA.

At the draft report hearings, the WFWGC stated that bottle prices represented a major impediment to future export growth. It suggested (sub181, p. 52) that the Government establish "international benchmark prices for glass containers as the reference point from which world parity prices can be pursued."

The Committee does not consider that it would be practical or desirable to follow this course of action. In the first place, there would be considerable problems in identifying relevant benchmark prices. Prices vary between manufacturers depending upon factors such as purchase volumes and supply conditions (eg form of payment and shipping arrangements). Additional differences arise because of variations in bottle design and quality. Furthermore, once a set of suitable benchmark prices are established, it would be difficult to argue that these should provide the basis of a price cap to apply to locally produced bottles without some adjustment for 'local circumstances'. What should, or should not, be taken into account would be a matter of conjecture, but arguably it could involve adjustments to take account of product mix, differences in input prices and differences in technologies required to operate at maximum efficiency in the Australian market. In essence, the information requirements would be extremely demanding and, to the extent that this would involve a degree of subjectivity, there would be ongoing debate. In the Committee's view, this approach would be far more costly and no more effective than the existing monitoring procedures performed by the PSA.

Technological changes could increase competitive pressures at some later time. In the meantime, the industry's best options for obtaining more competitive packaging may revolve around negotiation with suppliers. In the case of smaller firms, this might be most efficiently achieved by forming regional 'buying cooperatives' to gain larger volumes and, in the case of bottles, to consider the scope for rationalisation of bottle types. Alternatively, following amendments to the Trade Practices Act, the industry could apply to become authorised to collectively negotiate for the supply of bottles.

The competitiveness and efficiency of the glass and packing carton industries, along with other packaging industries, are presently being examined in an inquiry undertaken by the Industry Commission.

9.2 Labour and training issues

According to 1991 Population Census data, the winemaking and viticultural industries employ around 10000 permanent workers (including self-employed).¹ Of these, some 4400 work principally in viticulture and about 5 600 in winemaking. Approximately 50 per cent of grape workers and 25 per cent of workers in the medium to small wineries are self employed.

In addition to those permanently employed, significant casual labour is used for seasonal tasks such as harvesting, pruning, bottling and packing. As a result, wine employment may double during vintage, and grape employment may increase five to ten fold during harvest.

The Australian Council of Viticulture forecasts employment demand in the grapegrowing sector will increase by almost 50 per cent over the next five years. Most of the expected increase will be for skilled labour. In contrast, major winemakers do not anticipate a significantly larger workforce in the next five years. For example, Southcorp (sub. 59, p. 12) stated that:

¹ Includes employment in all viticultural activities (ie including grapes grown for drying and fresh consumption).

The industry's job numbers are expected to remain static. Any increase will be modest and occur primarily in privately owned vineyards and wineries.

Industrial relations issues

Workers in the grapegrowing and winemaking industry are represented by the Australian Liquor, Hospitality and Miscellaneous Workers Union or the Australian Workers Union – Federation of Industrial Manufacturing and Engineering Employees.

The Wine and Spirit Industry (South Australia) Award is the most significant award covering the wine industry. About 70 per cent of the national wine industry workforce is employed by six major companies under this award in South Australia, and in other states under enterprise agreements which replicate the grades and structures of the South Australian award. In addition, there are other state awards and a Federal award (the Wine Industry Consolidated Award 1982) covering the wine industry.

There has been little award restructuring in the wine industry. While discussions are being held on restructuring the New South Wales and Victorian awards, only the South Australian award has been restructured. In addition, there are considerable disparities between jurisdictions. For example, the South Australian award provides salary increments for skill competencies (for depth of skills but not for breadth), whereas the Federal and Victorian awards offer increments based on length of service rather than on skill. The WFWGC (sub.30, p. 144) suggested that a lack of uniformity in awards poses problems for the industry:

A current impediment to the industry is the diversity of awards which apply throughout the country. The industry needs the relevant unions to cooperate to enable uniformity between states in award rates given that the training is Australia wide.

Participants who commented on labour issues considered that the recent introduction of enterprise bargaining had improved productivity in the wine industry by facilitating greater flexibility in the use of labour. They also considered that other workplace reforms such as: the introduction of new organisational structures with more flexible management and work practices (eg Penfolds); improved workplace communication strategies (eg BRL Hardy); and the introduction of quality assurance schemes (eg Petaluma)– had led to higher productivity in recent years. Southcorp (sub59, p. 11) noted:

There is no real constraint on the productive use of labour in the Australian grape and wine industry. Current awards and enterprise

bargaining agreements have helped to increase labour flexibility and productivity. Of yet greater benefit has been the consultative mechanism, the harmonising of relationships and progress towards selfmanaging teams, which have contributed in large measure to flexibility and productivity gains.

Similarly, the WFWGC (transcript, p. 385) commented:

... there has been a fair degree of flexibility in terms of the utilisation of labour, particularly in the winery situation. The recruitment of labour is not subject to any particular constraints and generally the award-type arrangements have been fairly freely negotiated and have been fairly compatible with the operational requirements of wineries in the industry.

Availability of labour

A shortage of labour, mainly skilled labour (eg qualified viticulturists), was reported as a problem by many participants. In South Australia, the Government and the WBPA stated that lack of skilled labour is as much an impediment to industry growth as is lack of access to water. The Robinvale Wine Grape Growers Association referred to the skills shortage as "endemic" and considered that it needed addressing urgently.

Unskilled labour

Although there was reported to be the occasional shortage in some regions, participants generally considered that there were few problems in attracting unskilled or casual labour. Unskilled labour is used extensively in many vineyards, especially during harvest, and is commonly used by wineries, mainly during vintage. However, a number commented on the limited capacity of unskilled persons employed to undertake a range of outdoor, agricultural jobs. For example, the Pemberton Wine Industry Association (transcript, p. 281) commented:

You might get 20 people apply for the job and absolutely none of them know anything about it, so you are doing the training yourself and there's a huge need in our area for some type of training, even on a very basic level.

To help reduce unemployment, the Government has established programs to increase the skill levels of the unemployed. However, from its perspective, the wine industry has not found these efforts very effective. Southcorp (sub. 59, p. 12) noted:

Unfortunately, ... more recent Federal policies, as enunciated in the White Paper (Working Nation), [are] directed to the long term unemployed and entry level training. Such initiatives are rarely appropriate for the wine industry.

For some participants, the cost of unskilled labour was more of an issue than was its availability. The concern largely reflects the high labour content in vineyard operations. For example, the South Australian Government (transcript, p. 336) said of pruning and harvesting:

Those two activities in terms of labour in a fully labour-intensive vineyard operation, take up often something of the order of 70 per cent of total budget for production of vines.

A number of participants claimed that the cost of employing unskilled labour is unnecessarily inflated by government regulations, particularly the administrative demands associated with providing superannuation. This is of particular concern in relation to casual labour. Participants commented that the administrative tasks required to discharge employers' superannuation responsibilities can be quite costly, and it is not unusual for casual workers to 'disappear' without trace soon after the 'paperwork' has been prepared. To reduced such difficulties, the WIAWA considered that the threshold for the superannuation guarantee levy should be raised from \$450 to \$1000.

The high cost of labour and problems of availability in some regional locations has accelerated the growth and widespread acceptance of mechanical harvesting and pruning in the Australian industry. The CSIRO said that approximately 80 per cent of Australia's total winegrape crop is now mechanically harvested. The number of machines has increased from 1 in 1972 to 76 in 1976, with around 300 now in operation throughout Australia. According to the CSIRO, approximately 60 per cent of grape plantings are now pruned by mechanical hedging or minimal pruning. One winemaker–Yalumba — told the Committee that labour costs in viticulture are now only one-third per unit of output of what they were 15 years ago. These changes, together with industry rationalisation and the increased sophistication of both grapegrowing and winemaking, has increased the need for skilled personnel.

Skilled labour

Skill needs differ considerably within the industry. The larger wine companies tend to employ a high proportion of viticulture and oenology graduates. Small wine companies and vineyards (which are often integrated operations) tend to have more TAFE trained employees and more multi-skilled personnel.

At the tertiary level, Charles Sturt University (Wagga) and the University of Adelaide (Adelaide and Roseworthy) provide courses in oenology, viticulture and wine marketing. TAFE colleges also provide a range of courses relevant to the industry's needs. Some winemaking companies— mainly the larger ones— place considerable emphasis on in-house training.

Overall, the training provided locally has contributed positively to the competitive edge that the Australian industry has developed over its overseas competitors. For example, the AWRI (transcript, p. 677) told the Committee that:

... the difference that Australia has going for it compared with a lot of other countries is the rate and extent at which we adopt technology and innovate and modify, and that comes back to people and it comes back to the very good education system we have had in this country.

CSIRO (sub. 9, p. 2) referred to "world class viticultural and oenological education" offered primarily through Roseworthy College, and at Wagga Wagga.

Despite this apparent advantage, a significant proportion of industry representatives commented on difficulties in attracting skilled labour. This encompasses people with specialist industry skills, particularly in viticulture, as well as managerial skills (including marketing). The problem appears to be most acute in small enterprises, especially those located in remote areas. The Vignerons' Association of the Grampians and Pyrenees Regions (transcript, p. 86) stated:

There aren't that many [graduates] around. Who wants to go to university for 4 years to get a degree and then go to live out back of Woop Woop ?

Many participants pointed to a need for improving teaching facilities. The WFWGC (transcript, p.385; sub. 30, p. 144) summed up its views in the following terms:

... the real issue that is left in the labour area is the one of skills availability ...

The main labour impediments to development can be summarised as the low skill levels of labour; a scarcity of skills in management of wine companies and vineyards; ...

Many of the concerns expressed to the Committee reflected the need to recruit additional skilled labour necessary to accommodate expansion plans. In this context, participants pointed to the need for suitably qualified viticulturists and other skilled labour needed as new plantings come on stream. For instance, the Murray Valley Region (sub18, p. 11) noted:

New vineyard developers are all concerned about the expanding need for more trained people to manage and operate their new investment.

There were also some concerns voiced about difficulties involved in obtaining the skilled personnel required to maintain and upgrade existing operations. Southcorp, for example, stated that there is an urgent need for the retraining of experienced employees in a range of areas (eg laboratory technology, cellar operations and distribution tasks). According to participants, the widespread shortage of skilled labour is exacerbated by a shortage of training facilities, particularly vocational training provided by TAFE colleges, rather than tertiary training provided by the universities. A viticultural labour survey undertaken by the education sub-committee of the Australian Council of Viticulture showed some 40 per cent of projected demand over the next five years will be for TAFE or higher education. The survey revealed a need for around 2200 TAFE graduates, 200 persons with Associate Diplomas of Viticulture and 200 persons with Degrees in viticulture or oenology. The WBPA (sub50, p. 23) noted that:

It is a major concern that there will not be sufficient off-the-job training providers to address this problem.

Vocational training facilities

The shortage of training resources appears to be impacting most heavily on vineyards. The South Australian Government (sub41, p. 92) stated that on the one hand:

In South Australia it is believed that there are adequate training arrangements for labour in this industry in the area of oenology.

On the other hand, it contrasted this with viticulture where:

... there is a shortage of vineyard managers and trained labour. There is a long waiting list for entry to TAFE courses ... [TAFE is] unable to meet the demand for places.

It appears that the larger firms are not as badly affected by shortages in vocational training resources as are small firms and vineyards. Increases in the major wine companies employment are expected to be of a relatively modest size, and some of the large companies have in-house training facilities to help meet their skilled labour requirements. Larger companies are also better placed to support their staff wishing to undertake external studies.

Most participants supported the TAFE system as a means of providing basic courses for both vineyard and winery labour. It was widely acknowledged to be capable of providing a wide range of basic skills such as welding, setting up spray equipment, carrying out basic maintenance on farm plant and rural automotive mechanical skills. However, many agreed with the South Australian Government's view that the TAFE system cannot cope with the industry's demand for training. Many contend that the underlying problem is a shortage of trainers rather than a shortage of physical infrastructure. The WBPA (transcript, p.423) was concerned that:

... having put enormous time and effort into establishing structures and frameworks the industry is having difficulty accessing providers for the level of

training it requires for existing employees. Where are the training providers for the new employees going to come from?

Participants claimed that the TAFE system is operating at full capacity and has long waiting lists for courses relevant to the industry. Within the entire South Australian TAFE system there are said to be only two viticulture lecturers, two cellar lecturers and one bottling-packaging lecturer. Participants claimed that there are no lecturers for issues relating to laboratories, cellar door sales or warehousing and distribution.

Although TAFEs with wine industry courses are beginning to install videoconferencing, concerns were still expressed about the lack of access to training facilities in some of the more remote regions in which the industry is located. For example, Yarra Yering (transcript, p. 60) stated that it had two workers enrol in the external course at Wagga, but:

... for both of them the demands were too great for a married man with a family to be able to handle and both of them gave it up within a year.

A recent initiative by the Commonwealth Government under its Training Reform Agenda (TRA) had been welcomed by the wine industry. The TRA provided funds to assist industry to identify areas where skills needed improvement and to develop competency based training through TAFE and in-house courses. In March 1994, companies and unions formed the Wine Industry National Training Advisory Council (WINETAC) to take advantage of the assistance available under the TRA and to take "direct ownership and control of its own training agenda." WINETAC developed a multi-stream, multi-level classification system based on competency standards. A curriculum has been developed for these streams, and the South Australian Award provides for employers to pay for technical training This training involves on-the-job training with log book records certified by one of over a hundred qualified assessors, and off-the-job training of up to 500 hours from a TAFE instructor or equivalent.

Government assistance has also been received to pilot the introduction of the Australian Vocational Certificate. Over 130 trainees are undertaking an 18 month traineeship over the next three years.

This training is recognised by the Australian National Training Authority (ANTA) and is classified under the Australian Standards Framework (ASF) levels 1 and 2 of the certificate in food processing. Some of the larger firms undertake this training in-house. The TAFE system is the major provider for other firms.

While vocational education and training had rapidly gained momentum, it represents a significant "change of culture for the industry." Participants

noted that the wine industry has only been a declared vocation for less than 18 months. WBPA stated that, while the industry had set up tertiary training decades ago, it was only "during the last few years" that it had begun to recognise the value of vocational training. A number of participants pointed to a reluctance to fully support the use of industry resources in this fashion. According to some, many in the industry do not have the resources or financial capacity to contribute to a 'cooperative' training scheme. Some appear to have more deeply seated concerns relating to support for training generally — in particular, a concern that trainees may not remain with their firm.

Participants acknowledged that the industry is not yet supplying sufficient resources to move vocational training from "its pilot stage to a self-sustaining and integrated national framework." This is not to say that industry has not made a substantial and growing contribution. A review commissioned by the ANTA (Reynolds and Warren 1995), estimated that industry had contributed almost a million dollars in cash and in kind to vocational training courses. However, WFWGC (sub. 181, p. 11) considers that the work is still needed in consolidating the framework, maintaining standards and quality control over assessment practices and working towards articulation between vocational education and training and higher education. According to WFWGC, this "will require increased commitment by Government and the wine industry to training programs".

A number of participants criticised the Commonwealth Government's decision to withdraw financial support of ASF 1 and 2 course material. The South Australian Farmers' Federation (SAFF) (sub. 45, p. 14) said that, at a time when industry is just adapting to and becoming familiar with the TRA, such change:

... before there has been an opportunity to assess its effectiveness ... is premature. The existing system needs to have the opportunity to work. Changes at this stage will only confuse and alienate industry further.

Southcorp (sub. 59, p. 12) concurred:

It seems very short-sighted to steer an industry down a particular training path but withdraw financial support before journey's end.

The WBPA said that the key to success, which will see vocational education and training continue to rapidly advance in the wine industry, is to maintain the capacity of a national coordinator. Funding for this position has been available over the past 2 years through the Australian Vocational Training System pilot project, which ends on 30 June 1995. The WBPA (transcript, p. 1401) said: rather than ceasing all funding at the end of the pilot stage, a staged withdrawal over a 3-year period could achieve a sustained education and training outcome. The industry believes that a national coordination position can be self-funding within a 3-year period after the conclusion of thepilot.

Private provision of accredited training has been allowed from 1995, but WBPA stated (transcript, p. 1405):

It's not happening, and the checks that occur now and again, as with the budget last night, bring a level of uncertainty to it, and it's not enough then to overcome the inertia that I have referred to in the system.

ANTA's review of the WINETAC model (Reynolds and Warren 1995) considered that lessons learned in the pilot could be useful for fast-tracking the development of standards, curriculum, learning materials and assessment in other vocations. Participants consider that these positive externalities justify further funding for the WINETAC model for the next three years. Alternatively, they believe sufficient funds could be generated if the Department of Employment, Education and Training licensed WINETAC to sell its learning resource materials to wine industries in other countries.

Disappointment about the cut in funding under the TRA is part of a wider concern among participants who believe that a major factor in the shortage of TAFE training facilities has been the withdrawal of Commonwealth Government funding. According to participants, Commonwealth Government funding has been redirected to programs aimed at providing skills for the long-term unemployed. In this context, the SAFF (sub. 45, p.14) noted that the Federal Government is now:

... providing subsidies to employ unskilled and long term unemployed people. It is also providing funds for training them. As a social issue, this is commendable but at the same time the TAFE system is having its funding cut again.

Tertiary training facilities

The wine industry was, according to the WBPA, the 'driving force' behind the establishment of the Roseworthy and Charles Sturt University viticulture and oenology courses. Virtually all in the industry acknowledge the contribution made by these institutions. For example, A&G Engineering (sub6, p. 6) noted:

... the successes of the modern Australian wine industry is due primarily to the efforts of the two teaching institutions. Their response has been imaginative, energetic and highly effective.

Roseworthy— now part of Adelaide University— offers four year degrees in Applied Science (wine) and Agricultural Science (viticulture or oenology), and an Associate Diploma of Wine Marketing. Roseworthy also has the only wine marketing tertiary course in the world. It draws students from around the world. Charles Sturt offers 3-year degrees in wine science or viticulture. Both campuses also offer graduate diplomas, but find that most people prefer to do the full degree, even if they already have another degree.

The wine industry is also developing links between the universities and TAFEs and wine research institutions such as the AWRI. In this context, the AWRI (transcript, p. 686) noted that at the University of Adelaide:

... students now have access into all the research community on the campus. [Most AWRI] senior staff are teaching into the University of Adelaide wine science course. At the present moment the institute's senior staff are supervising over 20 PhD candidates.

Some participants commented that, while technical skills have been essential in facilitating the expansion of the industry, the industry now needs to place increased emphasis on business skills (eg marketing and business economics). According to the VWIA (transcript, p. 10), business skills are needed because, in order to be profitable, the wine industry requires:

... a complex understanding of the economics of production and most winemakers and viticulturists are not highly skilled economists in that respect.

Business skills are not emphasised in current wine and viticulture degrees. Adelaide University only includes two units on the basic principles of running a business in the new 4-year degree, and the Charles Sturt three-year degrees do not address marketing at all.

It is possible that, at least in some areas, the shortfall in university trained graduates will be reduced in coming years. The viticultural labour demand survey — which was criticised by some participants as being overly optimistic — forecast demand for some 200 graduates over the next five years There are more than that number currently enrolled in degree courses at the moment. However, almost half of those enrolled are intending to set up their own vineyards or wineries, and some Australian graduates are employed in European wineries.

Conclusions

In the labour and training area, the major problem appears to be shortages of suitably qualified training staff in TAFEs. Some participants consider that disparities in awards between jurisdictions also have the potential to impede development.

Problems with TAFE training are not unique to the winegrape and wine industries. For example, EPAC (1993, p. 86) considered:

Australia's education systems have typically catered for those young people with high academic skills very well, but have sometimes ignored the needs of others in the community.

Similarly, a 1992 report (Sweet 1992) found that, in comparison with the OECD average, Australia gives low priority to non-university vocational education.

The present shortages could, in part, be addressed by increasing the level of government funding. However, given the many competing demands for government funds (for increases in TAFE and education funding generally, as well as funding unrelated to training and education), there would be some uncertainty about the success of pursuing this approach. An alternative which would produce a more certain outcome would involve the provision of more privately provided training. As there appear to be both national and private benefits associated with a better educated workforce, both government and industry should contribute. Governments could extend funding, for a limited period, of the current pilot stage of the vocational training scheme (for example, fund the position of coordinator suggested by the SAFF). Industry could also contribute to the funding of relevant TAFE courses and make available greater numbers of skilled industry personnel to teach at TAFE colleges and/or increase in-house training expenditure to complement that currently available from TAFE colleges.

The Committee recommends that the industry consider cooperative actions to increase its contribution to vocational training and that the Commonwealth Government consider extending funding for the position of national coordinator for a further three years. This extension of funding would be to ensure that the vocational training agenda developed by WINETAC is well established. Thereafter, industry should fund the coordinator position.

Over the last decade, awards have been restructured in many industries with commensurate improvements in industry performance. In the wine industry, however, only the Wine and Spirit Industry (South Australia) Award has been restructured and there remain considerable disparities between awards in different jurisdictions.

For larger companies this should not present significant problems as they can seek to change employment conditions through the enterprise bargaining process. Indeed, the larger wine companies have dealt with restrictive or disparate award provisions by using enterprise bargaining to extend the terms of the restructured South Australian award to their operations in other states. For these companies, the imposition of a uniform award throughout Australia could restrict their flexibility to negotiate outcomes which best suit their style of operation. However, the capacity of small firms to negotiate enterprise agreements is limited. In these circumstances, it is not clear to what extent, if any, these firms are disadvantaged by the present differences in awards between jurisdictions.

9.3 Grape supply arrangements

The majority of grapes used in winemaking in Australia are purchased from independent grapegrowers under a variety of contractual arrangements. Supplies from independent grapegrowers are most significant in the nonpremium market, with winemakers' self-sufficiency being greatest for grape varieties grown for premium wine production.

The importance of contracts has changed as the industry has evolved over the last two decades. Within winemaking, the rationalisation of wine companies has resulted in the formation of some large and commercially powerful organisations, with considerable economic bargaining power in relations with independent grapegrowers. At the same time, with the growth of the cask market in Australia and the supply to the wine industry of grapes previously destined for the dried vine fruits market, a greater number of independent grapegrowers are now involved in the industry.

To the extent that much of this new supply has been of multi-purpose grapes for which alternative markets existed, growers could be somewhat relaxed about the power of the wine companies and the nature of the contracts being offered. However, this is changing. Increased import competition has reduced the dried vine fruit market. For example, with the reductions in tariffs, imported dried grapes are now some 30 per cent cheaper than local grapes of similar quality. This has seen demand for local dried grapes in the Murray Valley Region decline from over 90 kilotonnes a year in the early 1990s to under half that amount now. In addition, there has been a continued shift in production to wine-specific grape varieties which, while offering a greater return to growers, makes them considerably more dependant on winemakers. As a consequence, independent grapegrowers are becoming increasingly concerned about the contracts they supply under.

The importance of contracts for winemakers is also changing. The growth of the export market, with its much greater demand for price stability and reliability of supply, has resulted in winemakers reviewing their grape supply situation. At the same time, the growth of the export market has required the industry to look to developing a significantly increased supply of grapes. For some winemakers, this means investing in their own vineyards, but for most it means a review of their contractual arrangements with grapegrowers aimed at encouraging the expansion of supply.

Current circumstances

According to the Winegrape Growers' Council of Australia, approximately half of all traded fruit, that is grapes that are not grown by winemakers, are sold subject to contract. Whilst this involves a formal contract, rather than a gentleman's agreement, few contracts stipulate the exact price to be paid. Instead, a range of other options for determining price are specified. These include:

- annual negotiations with no specification as to what determines price;
- annual negotiations within a certain price range, such as plus or minus 10 per cent of the previous years price;
- a base price plus an inflator such as the CPI;
- a 'fair and reasonable' price; or
- an average of prices paid in the region.

The existing contracts, while providing some assurance of a market for a grower's product, have little role in stabilising volatile prices.

The variety of contractual arrangements that exist within the industry, in relation to both price and quality, reflect the different characteristics of the companies, and the different wines being produced. Firms range from large public companies to small family owned wineries, while wines range from low priced, high volume product, to low volume wines targeted at narrow market segments. The level of self-sufficiency of grape supply also varies immensely within the industry. The SAFFsaid that the use of contracts is not confined to particular winemakers, although the majority of formal contracts relate to the larger winemakers, with the very small wineries tending to rely on verbal contracts and trust in established suppliers.

At the premium end of the market, grape quality is critical to the quality of the wine being produced. Because of problems in identifying and measuring the key grape characteristics that determine grape quality, and thus including them in any contract, wine companies have relied mainly on producing their own grapes or on establishing long term relations with individual growers based essentially on trust and on the grower's past performance in supplying a quality product. Any written contract is, in may respects, secondary in importance to the relationship based on trust. Contracts for premium winemakers typically include a guarantee to take the grapes produced, and most contain incentives and penalties relating to grape quality. Some specify minium prices.

At the non-premium end of the market, incentives for quality are less relevant, and less likely to be included in the contract. Nonetheless, contracts are important in this segment of the market with major supplies coming from independent grapegrowers. Contracts are essentially for quantity supplied, with some penalties for poor sugar content, damaged fruit and contamination of the shipment. Prices are generally determined by the 'market' or by prevailing 'spot' prices. With these arrangements, there always has been the chance of the winery not accepting grapes, or accepting them only at a much lower price, using various penalty clauses in the contracts. The WGMB (sub. 46, p. 4) summed up the independent grapegrowers position as follows:

Independent winegrape growers are suppliers in the last resort. They operate at the highest risk segment of the market. Also, true winegrape growers do not have alternative outlets for fruit as do dual purpose growers.

As in any industry, there are a variety of operators with different views and approaches to contractual obligations. Inevitably any inquiry into an industry will hear disproportionately from those who are dissatisfied by contracts or who feel that they have been badly treated in some way. In this inquiry, concerns about contracts appeared to be widespread in the areas dominated by independent growers supplying non-premium grape varieties to the volume end of the wine market.

One of the problems with contracts between growers and wineries is that their legal status is unclear. The SAFF (sub. 45, p9) said that the best legal advice it had was that the typical contract in use was "unenforceable by either party". Indeed, Southcorp (transcript, p.741) stated at the public forums that:

... the historical grape contracts - it was like the Clayton's contract - the contract you had when you really didn't have a contract, and that obviously isn't good for predictable outcomes in terms of costs.

The Committee was also told that it was unheard of for a contract dispute to go as far as a law suit. Indeed, rather than legally binding contractual obligations, grower and winery alike said that "before 1985 no one would put their cards on the table" and "both sides wanted the annual haggle over prices".

Similarly, the recently released South Australian Government report (Meyers 1994, p. ii) on the Australian wine industry stated that:

... many growers view supply contracts as no more than a statement of intent, resulting in ... some growers holding out for the highest bid in times of short supply.

As noted above, many contracts stipulate that the price should be the "weighted average market price" prevailing when the grapes are delivered. However, the WFWGC noted that this could be "an almost circular argument"

— when there are only three or four wineries in an area, each can influence this average simply by including its own prices The King Valley Grapegrowers' Association (sub. 7, p. 10) commented that:

This has usually resulted in the dominant company in each area setting the price in times of surplus, although all companies compete with each other when there is a shortage. This practice exaggerates the industry boom/bust cycles .

Growers are also concerned that, even where contracts do stipulate firm prices, it can be much easier for wineries to get out of contracts than for growers to do so. Wineries are usually aware that contracts are not legally enforceable, but many small growers are not (or feel morally bound to their contracts anyway). A number of smaller growers expressed fear over the common contract condition that they would be liable for a winery's lost profits if they chose not to fulfil supply conditions². In this regard, the SAFF (sub. 45 p. 10) said that growers needed to be:

... aware of the mechanism for proper negotiation instead of the current situation where little or no negotiation takes place or where wineries bluff growers into accepting prices.

Part of the reason why contracts are difficult to enforce is that currently there is no practical way to measure the quality of wine flavourants in grapes. Growers and winemakers both told the Committee that often the issue of quality was either avoided or poorly handled, and that there was a serious need for contracts to contain clearly stipulated and consistent quality parameters.

Past problems and uncertainties over contractual arrangements appear to be having an effect on the industry's current expansion prospects in the face of rising export demand. Growers have expressed reluctance to expand plantings at the rate called for by the wine industry. This reluctance can, in part, be attributed to a lack of trust in the wineries. The WFWGC (sub. 30, p. 127) noted in its submission that this mistrust is partly based on historical problems with contracts:

Some regrettable experiences in past vintages have led growers, rightfully or wrongfully, to suspect forecasts, promises and even contracts themselves ...

A related problem is that, even where growers are prepared to extend their vineyards, bankers are sometimes reluctant to lend them the money because of past experiences and current contract problems. Southcorp noted (sub. 59, p. 15):

² Some contracts stipulate similar rights for the grower if the winery does not fulfil its obligations.

The financial sector recalls all too vividly the rorts of the Growth Industries 'Viticulture 2000' projects which saw millions of investors' dollars wasted. Consequently, despite the apparent buoyancy of the industry, financiers continue to view grape production as high risk.

Where growers are trusted, participants said that bankers can still be reluctant to lend on the strength of contracts that are unenforceable and/or stipulate only uncertain prices.

Possible solutions

Although these problems with contracts have been around for many years, growers and winemakers alike now consider that conditions are appropriate for change. Growers are aiming to reduce confusion and uncertainty through the setting up of a model contract. Winemakers are introducing new contracts designed to give growers incentives to increase both the size and quality of their grape crops, and to ensure a supply of input at a time when further expansion of the export market is expected.

Growers note that the recent grape supply shortages have "brought about new levels of cooperation between growers and wineries". Also, the resulting increased grape prices have allowed growers to have some funds available to address these issues.

The SAFF mentioned at the public forums and hearings that growers are well on the way to developing a mode *pro forma* contract that can be used industry wide (with appropriate allowance for regional variations).

Many growers attach considerable importance to perceived fairness and participants told the Committee a common problem was that smaller growers feel that they 'have been got at' by the wineries. Having a universal, or model, contract would mean this was no longer the case, because growers would know that they had a similar contract to other growers. Growers consider that both winemakers and growers would benefit because the proposed contracts would be legally binding and make future prices and terms and conditions more certain for all parties.

In practice, the widespread use of a standard contract is unlikely in the industry because of the variety of production across both grapegrowers and winemakers. The SAFF has recognised this and sees the contract being developed as a 'model contract' rather than a 'standard contract' to be used throughout the industry. For example, the model contract contains "half a dozen" pricing options for the parties to choose from. Perhaps the greatest gain from the existence of a model contract will be the increase in knowledge and confidence it will give to growers in their negotiations with winemakers. With a model contract in hand, they will have a benchmark against which they

can assess the conditions suggested by the winemaker and be more confident in arguing for alternative conditions.

Drafting costs would also be much reduced with a model contract, and it would no longer be only wineries that could afford to draw up contracts—which the WFWGC (transcript, p. 345) said has caused some problems in the past:

The existing contracts, like their predecessors, are frequently inequitable towards growers in that they are drafted by winemakers and seek to protect the commercial interests of winemakers that commission the drafting of the contract. They understandably shift as much of the discretion to the buyers as possible, given this fact.

The development of a model contract is well underway, with a draft already available for discussion with winemakers. The SAFF expects that the model contract will be available for the 1996 vintage. Growers have asked that state governments assist by standardising the varying state legislations and controls that affect contracts relating to grapes grown in one state but processed in another.

In contrast to growers, winemakers consider that some supply problems can be efficiently dealt with by modifying existing contracts, but that some problems require other solutions. Winemakers also see the need to continue with a variety of contracts rather than the single contract favoured by many independent growers.

As noted above, there is a tendency for wineries to themselves grow a high proportion of their premium grape needs. In part, this is because contracts cannot provide the necessary control over fruit quality because, at present, there is no reliable way of measuring the wine flavourants in grapes before they are processed.

For medium-quality grapes, where quality is important but not vital, some winemakers are seeking to develop closer working relationships with selected independent growers. They are developing contracts with greater emphasis on good grape quality, and committing to the purchase of a growers' entire crop. In these circumstances, there is an incentive for wineries to provide viticultural and management advice to maintain and improve quality.

Wineries' renewed interest in improving contracts is also a response to the need to assure quantity of supply at times of increasing demand. Southcorp, for example, said that its need for increased supply was so pressing that it developed new forms of contracts that are not just legally binding, but offer guaranteed returns on investment. These contracts are aimed at what wineries consider are 'professional' growers— large scale, technically proficient and

diversified, and 'likely to be cost-effective down the road'. Southcorp (transcript, p. 742) said that it was able to attract such growers to the new contracts by showing them that:

... we were able to convince the bankers and bring them into the party too.

Southcorp (transcript, p.726) said that it was able to attract bankers by showing them that for up to ten years (ie at least as long as it would take to pay back any loans) the contracts would give growers assured payments:

... not so much directed towards price per ton, but sensible returns on their investment.

For example, a number of contracts now in use offer to purchase grapes at the higher of either market rates or a guaranteed minimum price

Growers and bankers have responded favourably to such initiatives. The King Valley Grapegrowers' Association (transcript, p44) noted that with such contracts it was possible to form "very meaningful relationships in a strictly business sense with companies". A number of growers told the Committee that "a long term contract is very useful to take to your bank manager" and Southcorp (sub.59, p. 15) commented that with:

... the genuine attempts to make such contracts 'bankable', financier attitudes towards the more professional growers have softened noticeably and funds are beginning to flow.

The WFWGC noted that there has probably been more long term contracts signed in the last two years than in the entire history of the wine industry, and said that the present supply shortage could have been avoided if such contracts had been in force five years earlierIn this context, Southcorp stated that a different type of contract wasn't an easy concept to sell to many growers. For example, some growers told the Committee that they felt that wine companies would walk away from even this type of contract when their desired number of new plantings had been established.

For high volumes of low quality grapes, winemakers frequently use contracts that offer to purchase a grower's entire crop at the forecast market demand (subject to some minimum quality standards). For flexibility, winemakers also use spot contracts to purchase additional grapes at harvest time. The WFWGC told the Committee that many small growers prefer to operate on the spot market rather than to have contracts. The inherent risk of this approach is generally covered by spot prices being higher on average than contract prices, and by the practice of hedging risk by growing several different crop types.

Information needed for better contracts.

Participants said that, as the average term of contracts increases, there is a need for increased quantity and quality of information. For example, the WFWGC (transcript, p.383) said that toenable contracts to be more certain as to price:

... there is a consensus that viticultural data needs to be better and obtained more rapidly ... there are inconsistencies between collections which need to be ironed out.

Because the larger wine firms generally have contracts with many growers and in many regions, they tend to have better information — and stronger bargaining power — than individual growers. In the past, wine firms have sought to reinforce this strength by threatening not to renew dealings with growers who divulge the conditions of their contracts to other growers However, such practices have contributed to grower mistrust which, as noted above, has made them reluctant to commit to the new plantings wineries need to supply exports. The problem of information has been recognised by the industry. Since 1991, wineries and growers in the irrigated areas of South Australia, Victoria and New South Wales have been meeting each year in November for the Tri-State Outlook Conferences to discuss forecast demand and supply for the upcoming harvest.

The industry is also now undertaking research to develop a practical means to test grapes in the field for the quality of wine flavours they will produce. The AWRI told the Committee that the necessary research should not be too difficult as most wine flavourants have a glucose molecule attached to them, and glucose is "the most widely measured compound in medical and plant history". The AWRI expects that, within three to five years, simple and efficient tests will enable quality parameters to be regularly used in contract payments.

Summary

The need for winemakers to reduce sudden and dramatic variations in the price and to safeguard the quality of winegrapes, coupled with the declining demand for locally produced grapes for drying, have provided incentives for the development of improved forms of contracts. Aided by the development of closer business relationships between winemakers and grapegrowers generally, progress has been made toward developing a model contract. While this should be useful, particularly in increasing the knowledge and understanding of the many smaller independent growers, a standard contract should not be mandatory as some suggest. It must be recognised that the industry is diverse, and the product varies considerably in quality and target

market. There will always be some in the industry who have difficulty in accessing and using information who may favour standard contracts. At the same time, there will always be some who prefer to operate on a spot market, taking both the risks and benefits of that activity. For them, a standard contract would be of little relevance, particularly one that emphasises a long term relationship. The development of closer and more cooperative relationships between grapegrowers and winemakers, including work on improving contractual arrangements, is nevertheless an significant step forward for the industry and reflects the increasingly 'business like' approach to grapegrowing and winemaking necessary to sustain competitiveness in the export market.

9.4 State regulations

Regulations in the MIA

In the MIA, the WGMB, which was established in 1933, is charged with ensuring "placement of the total crop at ... prices acceptable to growers." To this end, the Board has the capacity to compulsorily acquire the crop from growers (that is, under New South Wales legislation, ownership of the grape crop in the MIA is vested in the Board) and act as a single seller of grapes from the region.

The Board rarely takes physical control of the product. In effect, it uses vesting as a power to negotiate minimum prices and conditions for grapes grown in the region. Once this has been concluded, growers are free to deliver their crop. It also helps to ensure that growers are paid in accordance with agreed selling conditions.

The Board's view is that its powers have effectively increased the return to grapegrowers in the MIA by increasing their bargaining power. The Board (WGMB 1993, p. 8) contends that, in the absence of its presence, winemakers would have been "able to achieve lower prices for fruit", there would have been "little new planting activity" and growers would have been "slower to adapt plantings to winemakers' changing needs because of the weaker market signals". The Board (WGMB 1992, p. 2) considers that the MIA is :

... in a unique position over other regions in having a resource in the Board which is capable of developing ... programs which will see the Riverina become the single most important wine grape growing area of the Australian wine industry.

In practice, the Board's power to influence grape prices is limited by the ability of larger winemakers to ship in out-of-area fruit or juice. However, because of the geographical isolation of the MIA, the Board could increase returns on supplies to local wineries— by essentially selling grapes at the cost of the alternative 'imported' product (which would include a margin to cover transport costs). Any excess in local production would be 'exported' at lower prices determined by more direct competition from other grapegrowing regions. Even this small degree of market power would be limited by the need for the local wineries to compete in the Australian and export wine markets against wineries from other regions with access to grapes at prevailing market prices. In this competitive market situation, it is difficult to see how the WGMB could have any appreciable success in increasing returns to grape growers.

Any ability of the Board to increase grower returns on a local scale needs to be weighed against costs to the MIA associated with its activities. The region has been largely bypassed by the rationalisation of wine companies that has occurred over the last two decades. The WGMB said that the MIA is characterised by family companies with very little involvement of the big four winemakers. This situation is not solely, or even primarily, the result of the operations of the Board. Restrictions in land ownership in the MIA have also limited the ability of wine companies to invest in the region. However, the existence of centralised price negotiations and the vesting of the crop in a statutory authority reduces the incentive for wineries to vertically integrate or have more direct dealings with growers. As a consequence, the region is often treated as a supplier of last resort by external wineries.

The dominant position of the WGMB in negotiations with wineries over prices and contracts prevents the development of long term contracts between growers and wineries, reducing the price signals seen by growers and reducing the incentive to differentiate product on the basis of quality. Elsewhere, the development of longer term contracts between growers and wineries is an increasing feature of the industry driven, to a large extent, by the need to ensure the availability and growth of supplies of premium grapes for the export market. At the draft report hearings, the WGMB said that, as of next year, contracts will be allowed, and that growers wishing to enter into any sort of contract can apply to the Board to revest the crop to the grower to enable the contract to go ahead.

An additional problem presented by the existence of a marketing authority is that it opens up the trade in grapes to greater political pressures, such as maintaining the viability of local wineries, which may not be in the best interest of growers generally. For example, the CIE (1990, p. 124) reported that, prior to 1982, the crop had been re-vested to growers, but after San Bernadino Wines got into difficulty the Board did not revest the crop, leading to a situation where:

... the stocks were disposed of beyond the control of the board and the board was faced with a substantial loss. ... When San Bernadino got into difficulty again in 1989 the board was fortunate enough to have an insurance policy which indemnified it for 90 per cent of the loss

However, the Board (WGMB 1992, p. 5) noted that, from 1991, insurance was "not a practical option" and saw fit to remind wineries that the Boards' charter "does not mean that individual wineries will continue to exist."

The Board's current vesting powers expire at the end of 1995, at which time the New South Wales Government will review the Board's powers and operations. The Board has indicated that it will seek an extension of its vesting powers.

The Committee considers that, while attempting to countervail producers' powers may be a desirable aim for growers, using statutory powers to set prices is not the best way to do this. Indeed, with the 'opting out' that is to be allowed through individual contracts between growers and wineries, it is debatable whether vesting and centralised price negotiations would continue to serve any useful function for the majority of growers. Increasing competitive pressures, together with the removal of restrictions on land ownership, will encourage growers to become larger and more efficient, gradually eroding any need for the 'protection' of a statutory marketing agency.

The Committee considers that the WGMB's vesting powers should not be renewed when they lapse at the end of 1995

An additional influence on the development of the industry in the MIA is regulations on land ownership and farm size. Companies are not allowed to own farm land in the MIA, and individuals are restricted in the area of land they can own. Individuals can own one block and families are allowed to own two. The size of blocks varies, but the average is around 40 acres. The WGMB reports that this size is too small to maintain an efficient scale of operations.

Some growers have increased the size of their vineyards by using nominees to acquire adjacent land. The Murrumbidgee Irrigation Areas & Districts Management Board (MIADMB) said that, as an example, Wynnvale Wines had built up substantial holdings using nominees, and many family companies own large holdings. In its view, the regulations only limit the "uninformed". The MIADMB said, however, that a simple consistent system similar to all of Australia is preferred.

While these examples imply that there are ways to 'get around' the regulations, they almost certainly impose additional costs. On the other hand, the Committee has been unable to identify any offsetting benefits.

In 1989, The New South Wales Government decided to remove land restrictions in the MIA, but has yet to act on this decision. Legislation was introduced into the New South Wales Parliament towards the end of 1994 but was not voted upon before business ceased for the 1995 election.

Cranswick Smith, a major exporter of wines from the Riverina, expressed some concern about the potential disruption to supply for local wineries if both vesting and ownership restrictions were removed at the same time. It suggested that vesting should be removed first to give local wineries the opportunity to develop contracts with individual growers to ensure some stability of supply before the removal of ownership restrictions allowed large wine companies operating elsewhere to buy land in the MIA. Cranswick Smith referred to a situation where, in anticipation of the removal of ownership restrictions (that did not subsequently occur), a major Victorian winery sought to purchase the property of one of its major suppliers. Because of the WGMB's powers, Cranswick Smith, unlike wineries elsewhere in Australia, had been unable to 'protect' its grape supplies by entering into contractual arrangements.

The decision of the WGMB to allow individual contracts as of next year, could go a long way towards enabling local wineries to develop the necessary contractual arrangements with their suppliers. Presumably, local wineries are now free to begin negotiating such contracts in anticipation of their coming into effect in 1996. Changes to ownership regulations are still delayed. In effect, the sequencing of change is occurring along the lines suggested by Cranswick Smith, even if only by default.

The Committee considers that the New South Wales Government should act on its in-principal decision to remove land ownership restrictions existing in the MIA as soon as possible.

The Tasmanian Appellation System

The appellation system, administered by the Tasmanian Liquor Licensing Commission, aims to encourage the production and sale of wines with 100 per cent Tasmanian grapes. Wines that meet this criterion are able to display the Tasmanian appellation symbol.

The appellation system was introduced in 1986, following approaches by the local industry concerned about wine from outside Tasmania being brought into the state and passed off as Tasmanian. The Tasmanian system was

introduced prior to the setting up of the Australia-wide LIP administered by the AWBC.

At the time of its introduction, the local industry believed that, for an appellation system to be effective, it needed to be supported and controlled by Government as other voluntary industry administered schemes had met with only varying degrees of success. Initially, the regulations required mandatory submission of wines for appellation, but this was not continued and involvement in the Tasmanian appellation system is voluntary.

At the draft report hearings, the Tasmanian Government stressed the voluntary nature of the scheme and said that no informal pressure is placed on Tasmanian wineries to comply with the appellation system. Both the Government and the Tasmanian wine industry currently see the appellation system as an important marketing tool for the local industry, and a way of clearly distinguishing Tasmanian wines in the eyes of the consumer.

In its draft report, the Committee expressed concern that the appellation system was restricting the flexibility of the Tasmanian industry, particularly in relation to the blending of wines from different regions— something that is seen as one of the strengths of the Australian industry. At the same time, there was some concern that the scheme could be operating as a disguised subsidy to Tasmanian production in competition with other Australian wines. In addition, the Committee questioned the need for a separate Tasmanian scheme, with separate and parallel auditing procedures, now that the Australia-wide LIP is in place. While the LIP allows wine to be described as of Tasmanian origin if blended with up to 15 per cent of out-of-state wine, the LIP also requires that, if a wine is labelled as being of 100 per cent Tasmanian origin, this must be an accurate description. Prosecution can occur under the LIP if a wine is not accurately labelled.

At the draft report hearings, the Tasmanian Government said that, as the local industry was still small, the cost to the government of administering the appellation system was reasonably insignificant, involving the equivalent of only one full-time person. It indicated that, when the industry gets bigger, it would be expected to pay for the cost of administering the scheme.

The Committee considers that most of the benefits attributed to the Tasmanian appellation system could be realised at lower cost under the LIP. This would allow the current auditing system to be abandoned in favour of relying on the LIP to ensure truth in labelling. However, if it is decided to continue the appellation system, the Committee recommends that the Tasmanian Government consider abolishing the present government legislated scheme in favour of a voluntary scheme operated and funded by the industry itself.

State liquor licensing

The Committee received comments that the form of liquor licensing which operates in a number of jurisdictions hinders the development of wine sales, particularly in competition with the hotel and brewing industry.

For example, the Australian Liquor Stores Association (ALSA) (transcript, p. 1230) said that Tasmania and Queensland are not "in sync" with the rest of the states in Australia, and that there should be a level playing field for hotels and liquor stores. It said (transcript, p1229) that, in Queensland, you need to hold a hotel licence in order to have a liquor store, and that:

... the only people who can operate the so-called detached licences in Queensland are hotel operators.

The Queensland Government said that the wine industry was not disadvantaged as the new Wine Industry Act permits licensees to sell their own product, both at the wine growing and/or producing premises, and at other locations. These outlets do not need a separate licence, and are not subject to licence fees. If they wish to sell other wines, they can supplement their Wine Industry Act licence with a Limited Licence under the Liquor Act, and sell any Australian wine, subject to a scale of licence fees ranging from nil for their own product, 2per cent for other Queensland wines and 10 per cent for other Australian wines. The Queensland Government said that this method of trade has been available to Queensland winemakers since 1974.

The legislation is, however, limited in scope. In particular, it applies only to producers of Queensland wine and to the sale of wine only. Consequently, it does not cover specialist liquor wholesalers and retailers who, in most other jurisdictions, would normally operate retail liquor outlets selling a range of wines, beers and spirits. In addition, it does not permit producers of Queensland wine to sell alcoholic products other than wine.

The Tasmanian wine industry criticised the dominance of alcohol retailing by the brewing industry and the policies of the Licensing Board of Tasmania which are perceived as restricting new entrants to the benefit of the existing distributors. The Vineyards Association of Tasmania (sub60, p. 16) said:

The current legislation, the Liquor and Accommodation Act 1990, permits the Licensing Board to regulate the sale of liquor in a form that best aids Tasmania and the orderly development of the hospitality industry in this State. Their current interpretation of the Act has favoured the established liquor industry, particularly hotels.

The ALSA (transcript, p.1229) said that:

Essentially the legislation in Tasmania does not allow for liquor stores.....essentially the only place in Tasmania where you can buy, say, a singe

bottle of wine or a six-pack of beer is from a hotel. If you elect to buy it from the very small number of wholesale licences which operate as liquor stores, you have to buy 9 litres.

The Tasmanian Government said that the 9 litre limit did not apply to Tasmanian wines. While this would appear to benefit local wines, the restriction on volumes of other wines, and all other alcoholic beverages, limits the overall market of independent bottleshops, reducing their viability and making it more difficult for the wine industry to establish a separate marketing role from the hotels which traditionally focus on beer sales.

In response to the draft report, the Tasmanian Government (transcript, p&12) said that:

... the 9-litre limit has been the Holy Grail of the Australian Hotels Association. Their effective lobbying to the government has probably meant that it has stayed there in place. They believe, I think, that the removal of the 9-litre limit widens the scope for the government to do all sorts of other things with the sale of liquor.

The Tasmanian Government said that there is a feeling within the traditional hotel industry that, because they have a liquor licence, they deserve some protection. However, the Tasmanian Government also said that a recent appraisal of the Act has proposed the phased removal of the 9 litre minimum sale limit for off-licence premises. The Tasmanian Government has not indicated its intentions in relations to this proposal.

The Committee considers that the Tasmanian Government should amend its liquor marketing regulations with the objective of removing differential treatment of the sale of wine not produced in Tasmania.

The Committee considers that State and Territory Governments should review their liquor licensing regulations with the objective of removing or modifying provisions which act to protect the position of established suppliers and which inhibit competition between wholesalers and retailers of wine and other alcoholic beverages.

10 EXTERNAL EFFECTS OF ALCOHOL CONSUMPTION

10.1 Introduction

The terms of reference require the Committee to consider the appropriate form and level of taxation on the winegrape and wine industries.

One justification for taxation of a product relates to the costs that its use may impose on others in the community, in addition to those costs borne by consumers.¹ In this context, many contended that excessive consumption of alcohol is associated with significant external costs, over and above private costs borne by drinkers themselves. (See Box 10.1 for an explanation of these terms). More recently, a number of studies have identified benefits (both private and external) stemming from moderate levels of alcohol consumption.

Most attention has focussed on health costs— both for drinkers that suffer from alcohol-related complaints and for innocent third parties that are injured (or otherwise suffer) as a result of the actions of alcohol affected individuals. However, as discussed later in this chapter, a range of other external costs are also associated with alcohol consumption (eg costs borne by industry because of illness and reduced worker productivity, some infrastructure costs (eg higher policing costs) and certain road accident costs).

The effect of health and lifestyle considerations on the future demand for wine and other alcoholic drinks provides another reason for examining the effects of alcohol consumption. As noted previously, the level of alcohol consumption is generally declining in Australia.<u>In part, this decline</u> is likely to reflect a greater awareness of the physical and social consequences (particularly drink driving) of excessive consumption which has resulted from government information programs and from changing consumer preferences.

¹ Taxation is not the only way in which these costs can be addressed. Alternative measures include government regulations (eg regulation prohibiting or limiting the sale or advertisement of a product) and information programs. These measures are discussed in Section 10.4.

Box 10.1: Private and External costs

The economic costs that may be associated with the consumption and/or production of goods and services can be categorised as 'private' costs or 'external' costs.

Private costs (which are sometimes referred to as 'internal costs') are those costs which are borne by the producer/consumer of the product in question. In the case of alcohol consumption, the affects of a hangover or damage to a drinker's vehicle attributable to his/her actions which driving under the influence of alcohol are generally regarded as primarily private costs.

External costs (which are sometimes also termed 'spillover' costs) are those costs which are imposed on the broader community as a result of the production/consumption of particular goods. The loss of life and pain and suffering endured by victims of road accidents caused by drunk drivers are typically regarded as external costs associated with alcohol consumption.

In considering the external effects of alcohol consumption, this chapter canvasses a number of important matters, in particular:

- What are the major private and external effects associated with alcohol consumption?
- How significant are the external costs and benefits?
- What levels of consumption are associated with external<u>costs</u> and benefits?
- To what extent, if any, do the costs and benefits of wine consumption differ from those associated with the consumption of other forms of alcohol?

Although many areas are not as yet adequately addressed, there is a vast amount of literature examining the effects of alcohol consumption. While some has been contributed by organisations of international repute, other publications are by organisations and individuals about which little is known. Often the studies provide insufficient information to assess the rigour of the analytical framework or the veracity of the data (eg some results are based on survey data collected from relatively few individuals and may not be meaningful). A feature of the existing literature is the conflicting opinions which exist on most issues crucial to determining the effects of alcohol consumption. Indeed, in this inquiry participants representing the wine industry and health and drug abuse agencies cited extensively from the literature to support diametrically opposing views in many key areas. In this chapter, the Committee has attempted to reflect the range of views presented to the inquiry by participants and those contained in some of the better known studies into the consequences of alcohol use. Given the range of information available, the discussion is necessarily selective in the choice of the studies on which it draws— it is simply not feasible to cite all studies noted by participants or any more than a minute fraction of the substantial literature that addresses the issues discussed in this chapter. In some instances, the Committee has drawn conclusions from the available information. However, in many cases the existing research is inconclusive.

10.2 Effects on health of alcohol consumption

While there is general agreement that excessive consumption of alcohol represents a serious health problem, there is considerable uncertainty about the extent of the problem, the costs that are imposed on the community generally and the costs associated with consuming different types of alcoholic beverages.

The incidence of alcohol-related mortality and morbidity

The negative physical and social consequences resulting from the consumption of alcohol are broad ranging. The Australian Medical Association (AMA) (sub.37, p.1) stated that excessive consumption of alcohol leads:

... to an unacceptably high level of sickness and social disruption. It causes serious disease of the nervous system, heart, liver and other organs and contributes to many common medical problems, serious accidents of all types, family breakdowns, unemployment and alcohol-related offences.

The precise incidence of alcohol-related problems is however, difficult to gauge. First, there are significant data problems. For example, there is little reliable data on the drinking habits of hospital patients dmitted for alcohol-related diseases or on the effects of alcohol use on worker productivity. Further, in those instances where data are kept, they are rarely recorded consistently. Second, the linkage between cause and effect is not always certain. The Tasman Institute (1991, pp. 9–10) pointed out that alcohol abuse may be a symptom of other causes, such as job insecurity and stress. In other words, it is difficult to know whether alcohol abuse is a cause of (say) suicide or whether other factors contributing to suicide also lead to alcohol abuse.

According to the Commonwealth Department of Human Services and Health (1995, p. v), alcohol is second only to tobacco as themajor cause of drug-

related mortality in Australia. In 1992, there were an estimated 3660 Australian deaths due to alcohol. In comparison, it is estimated that active smoking killed nearly 19000 Australians in 1992. However, because smoking mainly effects older age groups, the average years of life lost per death is higher for alcohol than it is for smoking (15.2 years compared with 4.7 years). In 1992, it is estimated that alcohol caused the loss of 5\$450 person-years of life before 70. The corresponding figure for cigarette smoking was around 88 000 person-years.

Deaths attributable to misuse of alcohol represented about 16 per cent of all drug-related deaths and about three per cent of all deaths in 1992. Data published by the Department of Human Services and Health (1995, p259) show that the major conditions contributing to alcohol caused mortality in 1992 were liver cirrhosis (19.7 per cent of all deaths), strokes (19.4 per cent), road injuries (14.2 per cent) and fall injuries (8.9 per cent). In that year, it is estimated that 30 per cent of road traffic fatalities were due to alcohol (Department of Human Services and Health 1994, p8).

According to the Health Department of Western Australia (sub. 162, p.), mortality (and morbidity) from alcohol has been higher among the aboriginal population than the non-aboriginal population. The Department also noted that alcohol consumption is frequently much higher in remote areas than in urban areas. For example, it stated that, in 1992–93, consumption of pure alcohol in Perth was 9.83 litres per head compared with 19.76 litres per head in the Kimberley region.

Among young people (15–34 year age group), the majority of drug-caused deaths are due to alcohol. The most common cause of alcohol-related deaths among young people is road injuries, accounting for 53 per cent of all alcohol-related deaths in this age group (Holman and Armstrong 1987, p. 29). Although there are difficulties in separating cause and effect, suicide was the other leading cause of alcohol-related death among young people, resulting in 21 per cent of deaths.

There is currently no national collection of hospital morbidity data in Australia. However, the Department of Human Services and Health (1995, p. vii) estimates that, for males, alcohol was responsible for 6.1 per cent of all hospital bed days in 1992. For females, alcohol was estimated to account for 3.1 per cent of hospital bed days. The corresponding figure for both sexes-4.4 per cent — is about 10 per cent lower than the hospital bed-days attributable to cigarette smoking. The Department also reports that, in 1992, misuse of alcohol was responsible for over 70000 hospital episodes. This represented 2.5 per cent of all hospital episodes.

Who bears the costs of alcohol induced mortality and morbidity?

Alcohol-related morbidity and mortality can impose large costs on users and the rest of the community.

Some of the costs associated with alcohol abuse are mainly borne by individual consumers. For example, it is the alcohol consumer that suffers most of the effects of a hangover (although family, fellow workers and employers could also be affected). In principle, privately borne costs should be accounted for in users' decision to drink, provided drinkers are sufficiently informed of the effects of alcohol consumption and are capable of making rational decisions. However, Richardson and Crowley (1991, p6) argue that individuals are not rational when decisions to drink are made:

... after drinking commences it impairs the capacity to make the sort of calculation assumed here. More importantly it is highly unlikely that individuals could make an accurate assessment of the internal cost. ... this would require an objective assessment of the probability of alcohol induced death, disability, sickness and property loss — factors about which there is some objective evidence available to specialists in the area but which is not widely known to the public. In the absence of this information there would be no mechanism for internalising these costs in the decision to drink.

Excessive alcohol consumption can also generate external costs. An external cost is created when the actions of the drinker imposes costs on other members of the community. As noted in the following section, the claisfication of costs is not straight-forward and there is some debate in the literature about which costs should be considered asprivate (internal) costs and which are external costs. However, external costs are generally considered to include *some* of the costs associated with: the costs of alcohol induced traffic accidents; the increased costs of law enforcement and litigation; the costs to society of the loss of life (eg through lost productivity and the suffering imposed on relatives and friends) the costs to industry (eg through alcohol induced absenteeism and higher accident rates); and the pain and distress suffered by victims of alcohol induced assaults and by the relatives of people who die of alcohol-related illness.

Many consequences of alcohol abuse result in both internal and external costs. For instance, in the short term, a hangover can impose external costs if it temporarily lowers an individual's productivity at work. However, if an individual's work performance is continually diminished by the effects of repeated hangovers, then<u>some of the</u> external costs can become internalised through reduced promotion opportunities, reduced pay or even dismissal. Similarly, road accident costs and health care costs would generally have both an internal and an external component (see later discussion).

The possibility that an individual is unaware of the consequences of his/her drinking may raise the external costs associated with alcohol use above what they otherwise would have been. For example, a drinker who is unaware of his/her capacity to drink may be more likely to drink and drive as he/she is unaware their blood alcohol content exceeds safe limits.

Health and the level of consumption

The costs associated with alcohol use depend on many factors including the amount and frequency with which alcohol is consumed and the demographic profile (eg gender and race) of the drinker.

The significant proportion of alcohol-related problems, particularly among young people, are caused by binge drinking. Binge drinking occurs when alcohol is consumed to a point of intoxication over a short period of time. An episode of binge drinking is normally succeeded by a period of abstinence from alcohol. While bingeing is associated with a recovery period during abstinence, according to the National Health and Medical Research Council (1992, p. 12) it also leads to relatively higher levels of blood alcohol during a drinking episode and a higher probability of acute intoxication.

Continual heavy drinking (ie over nine standard drinks a day for men and over five a day for women) represents the other major form of alcohol abuse. Alcohol dependence is associated with long term health problems such as liver cirrhosis and cancer?

There is increasing medical evidence suggesting that not all alcohol consumption is bad. A number of researchers have found that moderate consumption of alcohol can reduce the risk of cardiovascular mortality, the biggest cause of death in Australia. (As discussed later, some studies have reported higher health benefits for wine consumption than for other forms of alcohol.) Medical research identifies a 'U' or 'J' shaped relationship between alcohol intake and cardiovascular mortality (Klatsky et al 1990a; Rimm et al 1991; Razay et al 1992; DeLabry et al 1992). The U shape refers to the fact that both non-drinkers and heavy drinkers show a higher risk of cardiovascular mortality than moderate drinkers.

The risk of cardiovascular mortality has been estimated to be between 45 and 80 per cent lower for a moderate consumer of alcohol than for either an abstainer or an abuser (Klatsky et al 1990b). This relationship appears to hold

² A standard drink is defined as 8 to 10 grams (10 to 12.5 millilitres) of alcohol.

across all smoking categories (Rimm et al 1991) and for both sexes (Razay et al 1992). Control for diet strengthened the association (Rimm et al 199^F).

Alcohol is claimed to reduce cardiovascular mortality in three ways. First, in the long term it raises the level of high density lipoprotein (HDL)— an agent which clears away the plaque which blocks arteries. Second, it acts as an anticoagulant reducing the formation of blood clots. This is a relatively short term effect. Third, some alcoholic beverages contain anti-oxidants which prevent low density lipoproteins (LDL) from oxidising and eventually blocking arteries.⁴

Moderate alcohol consumption also has been found to have a number of psychological benefits. In a review of existing literature, Baum-Baicker (1985) found evidence to suggest that low to moderate amounts of alcohol:

- is effective in reducing stress;
- increases overall affectionate expression, happiness, and pleasant and carefree feelings;
- improves certain types of cognitive performance; and
- has been effective in the treatment of geropsychiatric problems.

In addition, Baum-Baicker reported that heavy drinkers and abstainers have higher rates of clinical depression than regular moderate drinkers.

Medical opinion argues that moderate consumption amounts to 40 grams (50 millilitres) of pure alcohol a day for men and 20 grams (25 millilitres) a day for women (Moore et al 1986; Klatsky et al 1990a). Fifty millilitres of pure alcohol amounts to around four pots of full strength beer, four standard glasses of wine or four measures of spirits. The National Health and Medical Research Council (NHMRC) has adopted these consumption levels as a standard. It recommends that individuals not consume above these levels.

³ Some contend that the U shape reflects the inclusion of a significant proportion of individuals already suffering alcohol-related diseases in the abstainers group. In other words, it is alleged that abstainers include individuals who stopped drinking in response to emerging alcohol-related problems (Shaper et al 1988). However, Klatsky, Armstrong and Friedman (1990) and Rimm et al (1991) rule out this explanation for the observed beneficial effects of moderate alcohol consumption.

⁴ The main function of LDLs is to transport cholesterol from the liver through the body, while HDLs transport it away from organs and tissues to the liver for conversion to bile acids and excretion. LDLs increase the accessibility of fatty molecules to the inner layers of the artery walls. The formation of plaques— containing cholesterol and other lipoid material in the inner layers of the walls of medium size and large arteries— is a risk factor for coronary heart disease.

However, the medical profession maintains that moderate consumption may not necessarily benefit everyone, and that those who currently abstain should not begin drinking as a health measure. In particular, it advises pregnant women and those showing a genetic predisposition to alcohol dependence to abstain from alcohol intake. In this context, the National Centre for Research into Prevention of Drug Abuse (NCRPDA) (sub. 145, p3) stated that:

... such benefits [lower risk of cardiovascular disease] are experienced over a fairly narrow age range and apply, in any case, only to populations at risk of heart disease.

The World Health Organisation (WHO) argues that there are better ways of reducing the risk of cardiovascular disease than drinking in moderation (eg by not smoking, reducing the intake of fats and engaging in physical activity). In addition, it claims that the maximum alcohol levels recommended by the medical profession are not reliable because they do not take into account body weight, individual vulnerabilities, gender or time between drinks.

Consumption patterns

ABS data show that the average per capita daily consumption of pure alcohol in Australia is below the level which the NHMRC considers to be 'moderate' (ie four standard drinks). However, these data provide no indication of the average intake of alcohol by drinkers or of consumption patterns of wine drinkers relative to consumers of other alcoholic beverages. There is also no reliable data about the effect of drinking alcohol in different concentrations (eg the impact of low alcohol beer versus high alcohol beer). Studies on drinking habits generally have relied on information provided by individuals about themselves or their close relatives and friends, and not from direct measurement. The data are thus liable to bias. For example, many consumers of alcohol, particularly those that consume large quantities, are prone to (deliberately or inadvertently) underestimate the amount they have consumed.

The Alcohol Project Management Group (APMG) found that 76 per cent of adults surveyed had consumed alcohol at least once over a two week period. Of those surveyed, 18 per cent consumed alcohol once over the period, 12 per cent consumed it twice and 16 per cent claim to have consumed alcohol on eight to 14 days. The remaining 30 per cent of alcohol consumers had drunk alcohol on three to seven days of the two week period. On the last drinking

⁵ The APMG was set up under the National Campaign Against Drug Abuse Media Steering Committee to oversee the development of relevant and appropriate media programs.

⁶ The 1993 National Drug Strategy Survey found that 10 per cent of alcohol consumers drank alcohol every day of the week.

occasion, 84 per cent were reported to have consumed four or less standard drinks, 10 per cent had five to six drinks and six per cent had seven or more drinks.

APMG also surveyed the drinking habits of 16, 17 and 18 year olds. They found that just over one-third (36 per cent) had drunk alcohol on only one day of the preceding two week period and two-thirds (62 per cent) had drunk on no more than two occasions. The overall average number of standard drinks consumed by drinkers in this age group on the last occasion was 4.9. Thirty-four per cent of drinkers had 2 standard drinks or less on the last occasion, 19 per cent had 3–4 drinks, 13 per cent had 5–6 drinks and 24 per cent had seven or more.

In submissions to the draft report hearings, the NCPDA and the Western Australian Health Department pointed out that statistics about the number of individuals that exceed safe drinking limits and average consumption levels disguise the *volume* of alcohol consumed in a harmful way. These participants referred to research undertaken on their behalf which suggests that 47 per cent of all alcohol consumed is hazardous or harmful.

The APMG survey found that wine was the most popular drink amongst adults with 52 per cent drinking it on the last occasion. Thirty-nine per cent of men and 65 per cent of women drank wine on the last occasion. Wine was the preferred drink of those in the 35–44 year age group, and amongst those from professional and clerical backgrounds.

Twenty-one per cent of adults ranked full strength beer as their preferred alcoholic beverage. Thirty-nine per cent of men surveyed preferred to drink beer. In contrast, only four per cent of women surveyed drank beer. Beer was the preferred drink of the under 35s and the over 55s.

Nineteen per cent of women and 15 per cent of men surveyed preferred mixed spirits.

According to the APMG study, full strength beer is likely to be the preferred drink of teenagers, with 35 per cent consuming it on the last drinking occasion. Twenty seven per cent drank mixed spirits on the last occasion, 17 per cent drank wine, 14 per cent drank wine coolers, 12 per cent drank spirits on their own and 7 per cent drank low alcohol bee[§].

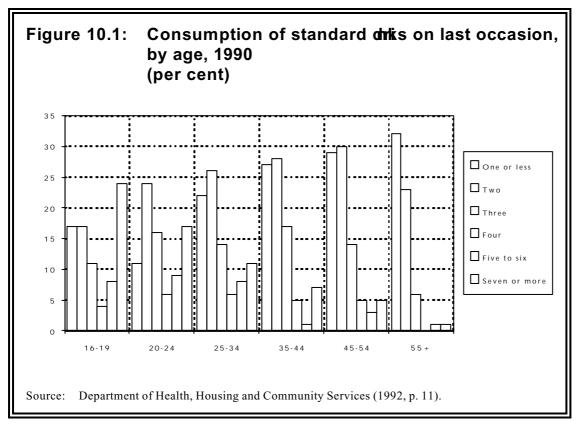
⁷ The study related 'hazardous' and 'harmful' to the NHMRC guidelines. For men, the first four drinks on any day were categorised as 'low risk', the next two 'hazardous' and all others 'harmful'. For women, the first two drinks were 'low risk', the next two 'hazardous' and additional drinks were categorised as 'harmful'.

⁸ These percentages do not add to one hundred as some participants reported drinking more than one type of alcoholic beverage on the last occasion.

A study by the Department of Health, Housing and Community Services (1992) reported little variation across age groups in the average daily intake of alcoholic beverages, although there was a significant decline in the intake of the over 75 year olds? Its results conflict with those of APMG's in that full strength beer was the most preferred drink in all age groups. However, the study confirmed APMG's finding that young adults (16–24 year olds) were most likely to binge drink (see Figure 10.1). Young adults were found to drink less often than those in older age groups, but to drink more heavily when they did drink. The study reported that nearly 25 per cent consumed seven or more standard drinks on the last occasion that they drank alcohol. This approximates APMG's figure.

According to the Department of Human Services and Health, binge drinking is not uncommon with children aged 12 and under. It stated (sub. 202, p4) that:

Approximately one third of secondary school students in New South Wales and Victoria who are drinkers have participated in binge drinking. Over 17per cent of these students were aged twelve years or less.



⁹ Based on the Australian Bureau of Statistics' National Health Survey: Summary of Results Australia, 1989–90.

The Department of Human Services and Health (sub. 202, p3) stated that NHMRC survey data show that occasional heavy or very heavy binges are not limited to a small minority. Seventy per cent of men and 5% er cent of women reported having five or more drinks at least once in the last year. One-third of males and one in eight females reported having had five or more drinks on at least one occasion in the past two weeks.

The proportion in each age group consuming alcohol above National Heart and Medical Research Council guidelines declines with age. The tendency of young people (16–24 year olds) to binge drink makes them the most obvious contraveners of the guidelines. Twenty nine per cent of respondents in this age group consumed over four drinks on the last drinking occasion. By contrast, only two per cent of over 55 year olds consumed over four standard drinks on their last drinking occasion.

Is wine different?

If the absolute volume of alcohol consumed is any guide, Australian consumption patterns would imply that beer is the major cause of alcohol-related problems. However, alcohol-related problems can arise when any form of alcohol is abused. It is therefore necessary to know what the abusers of alcohol are drinking. In this context, participants representing health and drug abuse agencies and the beer and spirits industries essentially claimed that, in terms of abuse, "alcohol is alcohol" and it is not possible to claim that wine is subject to less abuse than other forms of alcohol. For example, the NCRPDA (sub. 89, p. 7) claimed that:

... on average, the majority of wine consumers drink in moderation, but there is a substantial minority who drink at levels which, if maintained over time, are deemed harmful to health ... Furthermore, when wine is consumed along with other alcoholic beverages, which on the basis of these findings is more usual than consuming wine alone, almost half of the total consumption exceeds NHMRC guidelines [four standard drinks a day for men and two for women].

In contrast, participants representing the wine industry stated that there are strong grounds for accepting that wine is subject to less abuse because it is drunk under different circumstances and by individuals who are less likely to abuse alcohol.

The WFWGC cited research (Lin et al 1976 and Sedman et al 1976) showing that physiological effects, such as brain and liver tissue damage, are related to blood alcohol concentration, and that food significantly diminishes the blood alcohol concentration. It stated (sub. 181, p27) that:

Approximately 77% of the population consumes bottled wine with food (50% of cask wine consumers) while, in comparison, only 11 and 7% of the population consumes beer or spirits, respectively, with food.

Similarly, AWRI (sub. 72, p. 7) argued on the same grounds that wine is not necessarily as harmful as other alcoholic beverages:

Beer and spirits are generally consumed in the absence of food, that is, either pre or post dinner. The cardioprotective effect of wine may also be partly explained by its usual consumption with meals ...

Norrie (sub. 79, p.1) made a similar claim:

Wine is also consumed differently from beer and spirits - at the table with a meal so it is consumed more slowly, absorbed more slowly and one gets the benefits of the nutritional value of the food consumed as well.

A number of points need to be made about these claims. First, beer and spirits are also consumed with food (eg counter lunches at pubs and barbecue meals). Second, at times, all forms of alcohol are consumed without food. Third, the fact that wine may normally be consumed with food does not prevent wine (or other forms of alcohol) from being abused. In this context, the Western Australian Department of Health (sub. 162, p8) stated:

Even if wine is consumed in different settings, and in particular with food, it is frequently as an addition to consumption of alcohol in other forms in more recreational contexts, and as such it simply adds to the enhancement of risk for long-term and short-term harmful consequences. Why should the whisky or beer drunk before a meal or at work before coming home be considered any more culpable for harm than the wine consumed at a subsequent meal? The findings of the AGB McNair poll on consumption with food are really irrelevant.

The AWRI (sub. 72, pp.6–7) argued that wine, in particular red wine; s more cardioprotective than other forms of alcoholic beverages because of wine's high concentration of phenols. Research indicates that phenols, particularly flavonoids, behave as anti-oxidants preventing LDL from depositing on vessel walls.

As red wine has a significantly higher concentration of these cardioprotective polyphenolic compounds, it is, therefore, possible that red wine is significantly more cardioprotective than white wine which, in turn, is more cardioprotective than beer and spirits.

However, much of the medical research documented in the literature is conflicting. Some studies find wine more cardioprotective. For example, Klatsky and Armstrong (1993) found that those who drank wine had a lower rate of cardiovascular mortality than those who drank liquors. Further, they found that white wine drinkers had a slightly lower cardiovascular mortality rate than red wine drinkers. Stamper et al (1988) also found wine to be marginally more cardioprotective than other forms of alcoholic beverages.

In contrast to these studies, Yano, Rhoads and Kagan (1977) reported a lower risk of cardiovascular mortality among beer drinkers. Rimm et al (1991) found beer, wine and spirits all had the same inverse relationship with cardiovascular mortality, although the relationship was more pronounced for spirits.

Most participants representing medical and drug abuse bodies were reluctant to endorse studies which suggest that the beneficial effects associated with drinking moderate quantities of alcohol are greater for wine than for other alcoholic beverages. However, the AMA (sub. 193, p2), in referring to one study recently reported in the British Medical Journal, stated:

... the study found that, while there is evidence of a health benefit from a moderate intake of wine, no such benefit is derived from the intake of beer and spirits. It would therefore seem sensible to encourage moderate wine consumption by means of lower taxation relative to other alcoholic drinks.

In responding to the draft report, the WFWGC (sub. 181, p24) stated that:

... there are at least 25 references available which conclude that wine is the most cardioprotective beverage compared to beer and spirits.

The WFWGC cited a number of studies which had found wine to have a higher cardioprotective affect than other alcohols, including Criqui and Riagel (1994) which, according to the WFGGA (sub. 181, p24) analysed data from 21 countries between 1965 and 1988 and found that:

... wine was consistently and significantly inversely related to cardiovascular disease while beer and spirits were only weakly correlated.

The WFWGC stated that red wine, because it contains a higher concentration of phenolic compounds, has a greater protective affect than white wine. It stated that red wine also contains the flavonoid resveratrol which acts as an antioxident and inhibits platelet aggregation.

The WFWGC (sub. 181, p.27) also stated that data collected by the ABS (1994) shows that consumers of wine are less likely to abuse alcohol than are consumers of other alcoholic beverages:

The percentage of the population greater than 18 years of age that consumes wine in excess of these [recommended drinking] limits is only approximately 24% and 19% of male and females, respectively, while the percentage for full strength beer is 57% and 42% of males and females, respectively and for spirits is 31% and 21% for males and females, respectively.

A number of other participants considered these data not to be meaningful. For example, the NCRPDA (sub. 145, p2) criticised the findings because the data: ... excludes from its estimation wine consumption which is associated with the consumption of other alcoholic beverages. Not surprisingly, so superficial an analysis leads to the conclusion that wine is rarely drunk in excess or associated with harm.

According to the WFWGC, wine can also be distinguished from other alcoholic beverages in terms of the characteristics of those individuals that drink wine. It claimed (sub. 181, p31) that:

More employed, full time and part time, persons consume wine (27.9 and 35.5%, respectively) than unemployed persons (11.2%); more beer and spirits are consumed by unemployed persons (17.5%). Indeed, of the employed, wine is most consumed by professionals whereas beer is more consumed by tradespersons. The most preferred alternative beverage for wine consumers is soft drink followed by water or mineral water, while for beer consumers [the most preferred alternative beverage] is soft drink followed by wine and spirits.

The Federal Office of Road Safety submitted the results of a 1994 study undertaken by the Monash University Accident Research Centre into the types of alcohol beverages consumed by drivers apprehended at random breath testing stations and those involved in fatal or serious road crashes that had returned a positive (but not necessarily illegal) reading. The study found that drivers that had been drinking beer were generally over-represented (relative to the proportion that beer contributes to total alcohol consumption) and that drivers that had been consuming wine were under-represented. In the case of males, disaggregating the data by sex reinforced this finding. However, in the case of females, it was found that a relatively high proportion had been drinking wine (eg 47 per cent of females involved in crashes had consumed wine).

10.3 The costs of alcohol abuse

The total cost stemming from excessive alcohol consumption and the classification of costs between internal costs of consumption and external costs is contentious. Cook (1984, p.63) argued that a large percentage of the cost of alcohol use was borne by the drinker:

For example, the economic cost of lost productivity is calculated on the basis of data that reflect the reduction in earnings resulting from chronic alcohol abuse. The primary 'losers' in this case are obviously the drinkers and not society at large.

Cook (1984, pp.63–64) also suggested that:

... a large percentage of the economic cost of injury and death resulting from highway and other accidents [could be excluded] because the drunken drivers themselves or people who voluntarily elect to ride with them, constitute a high percentage of the victims.

In contrast to this view, others argue that the level of external costs are frequently understated. For example, in relation to the drunken driver example cited above by Cook, the Western Australian Department of Health (sub. 162, p.4) stated:

The assertion that the death of a drunk driver is largely an internal cost ... effectively values the economic loss to the family, the emotional deprivation and career truncation of children, the loss of future expectation, and the costs of funerals and estate management to the relatives at zero. It also ignores the substantial public costs of coronial inquiry, and police work, and the sunk cost of employers and the State in the training of the individual.

Even more extraordinary is the postulate that the death of a consenting passenger is an internal cost.

Three recent studies have attempted to measure the aggregate cost of alcohol abuse in Australia. None of the studies attempted to distinguish between different types of alcohol.

The first study— by economists Collins and Lapsley— was commissioned by the (then) Department of Community Services and Health in 1990. The study established a methodology for estimating all the economic costs (private and external) of alcohol abuse in Australia and applied the model to the most recent year (1988) for which all relevant data were available.

A second study was completed by the Tasman Institute in 1991. This reviewed the Collins and Lapsley study and pointed out that the external costs associated with alcohol abuse are substantially less than the total cost figure estimated by Collins and Lapsley. The Tasman Institute used the Collins and Lapsley data to estimate external costs. The third study was completed by Richardson and Crowley in 1991. This established an alternative approach to the evaluation of the cost of alcohol consumption.

Collins and Lapsley classified the economic costs of alcohol abuse as tangible and intangible. Tangible costs were considered to be costs capable of being estimated (such as hospital costs). In principle, any reduction in these costs is likely to save resources (which could be employed in other productive uses). Intangible costs are costs, such as pain and suffering, which when reduced will not yield resources for consumption or investment purposes.

The Collins and Lapsley study assumed that 30 per cent of all alcohol consumption was abuse, although no justification was given for this assumption. Based on this figure, it estimated the total economic costs in 1988 of all past and current alcohol abuse. For that year, the study estimated total costs to be \$6.027 billion. This is equivalent to an average cost of over \$40 per litre of (pure) alcohol consumption (based on consumption in that year). A disaggregation of the Collins and Lapsley estimate is given in Table 10.1.

In estimating the cost of alcohol abus it is necessary to account for the possible benefits induced by alcohol consumption. The cost of male and female mortality estimated by Collins and Lapsley was heavily dependent on the incidence of alcohol-induced mortality estimated by Holman and Armstrong (1990). Holman and Armstrong estimated alcohol-induced mortality as 'net deaths', which was defined as the number of deaths caused by alcohol less the number of deaths prevented by the use of alcohol. Consequently, by using Holman and Armstrong's metality estimates, Collins and Lapsley implicitly allowed for the benefits that alcohol consumption can induce.

	ates of the economic costs is and Lapsley, 1988	of alconol	apuse
		\$m	\$m
Road accidents			
	Legal and court proceedings	14.0	
	Insurance administration	26.2	
	Accident investigation	9.8	
	Losses to others	2.9	
	Vehicle damage	138.5	
	Traffic delay	20.8	
Total road accident costs			212.2
Production costs ^a			
	Male morbidity	138.0	
	Female morbidity	90.9	
	Male mortality	1433.8	
	Female mortality	386.7	
	Total production costs	2049.4	
less consumption benefits	production coolo		
r r r r r r r r r r r r r r r r r r r	Male mortality	781.1	
	Female mortality	467.1	
	Total consumption benefits	1248.2	
Total net production costs	· · · · · · · · · · · · · · · · · · ·		801.2
Health care			
	Net medical services	139.9	
	Net hospital bed days	388.2	
	Net nursing home bed days	52.9	
Total health care costs			581.0
Ambulance service			s.n.a.
Welfare			s.n.a.
Alcohol consumption Intangible costs			1651.0
-	Consumption of the deceased	1248.0	
	Value of loss of life to the deceased	1439.0	
	Pain and suffering of road accident victims	95.0	
Total intangible costs	vietilio		2782.0
Total economic costs			6027.4

a Includes the estimated loss of production resulting from past deaths from alcohol abuse and from present alcohol-induced morbidity. s.n.a. significant but not available Source: Collins and Lapsley (1991, p. 105).

The Tasman Institute claimed that the Collins and Lapsley study did not provide an accurate guide to the external costs associated with alcohol consumption because many of the costs included in the study are internal costs stemming from decisions made by individual consumers. It stated (1991, p. ii) that:

The great bulk of the costs estimated by Collins and Lapsley are those willingly borne by the consumer after evaluating the risks involved and deciding that there is greater value in the satisfaction obtained from consuming alcohol.

The Tasman Institute used the Collins and Lapsley data to segregate internal and external costs. It estimated the external costs of alcohol abuse in 1988 to be around \$900 million, or an average cost of about \$6 per litre of alcohol. The details of the estimate are shown in Table 10.2.

The major component of the Tasman Institute's estimate- around 65 per cent — is health care. These costs may be exacerbated by the nature of Australia's health system itself. Australia's health system is a combination of public and private hospitals. The public health system is financed from taxation revenue (ie the Medicare levy and general taxes) collected from all taxpayers. It takes no account of an individuals' 'health record', use of the public health system or whether or not they possess private health insurance. This reduces the incentive for individuals to take measures to protect their health. For example, an individual who does not abuse alcohol pays the same rate as an alcohol abuser, even though the non-abuser may be less likely to use a public hospital. In contrast, a privatised system would require individuals to selfinsure and would provide financial incentives to take adequate health care initiatives. In principle, a privatised system encompassing comprehensive health insurance could mean that all health care costs are internalised. However, in practice, implementation problems (eg some individualwould not be able to afford insurance or will simply refuse to insure), together with community goals of providing some minimum level of health support for each and every Australian, invariably meas that there will be some external costs.

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Cost	Nature of Costs	\$ <i>m</i>
Legal and court costs	Mainly external	14.0
Insurance administration	Internalised	-
Accident prevention	External	9.8
Losses to others	Mainly external	2.8
Vehicle damage	Internalised	-
Traffic delay	External	20.8
Net production costs	Internal	-
Health care	Treated as external	581.0
Mortality costs	Include only external	281.7
Alcohol consumption	Internalised	-
Total		896.2

To the extent that the Tasman Institute has considered some costs as completely internal (eg insurance administration and vehicle damage) which almost certainly have an external component, it's estimate would overstate the true cost. On the other hand, it is arguable that some of the health care costs regarded by the Tasman Institute as fully external costs can be regarded as private costs. Perhaps more importantly, it needs to be recognised that neither the Tasman Institute or Collins and Lapsley take account of the adverse effect of alcohol use on industry productivity (eg through increased absenteeism and higher levels of accidents in the workplace). Some overseas studies have found this to be the major component of the costs associated with alcohol abuse.

The Richardson and Crowley study (1991, p.7) related to both private and external costs. It concentrated on the consequences of present behaviour and new illnesses as it was considered more relevant for policy analysis:

Past behaviour cannot be changed, and, as with sunk costs generally, should not influence present policy.

To obtain an upper and lower limit to Australian costs, the study extrapolated from a number of major overseas studies to Australia. The cost of alcohol abuse to industry was derived by scaling down the overseas estimates of industrial costs according to both GDP per capita and alcohol intake per capita. Health care costs were scaled according to relative per capita health expenditures in the different countries. Current year estimates of mortality costs were calculated from Australian mortality data using Holman and Armstrong's research. These replaced the estimates in each of the original studies. In effect, the final estimates are an amalgam of the Australian cost of mortality and the effects of lower productivity, employment and other costs as extrapolated and adapted from overseas studies.

Using the data and methodologies employed in the original studies, the analysis estimated the total cost (ie private and external costs) per annum of alcohol abuse to range between \$1.82 billion to \$15.98 billion. Adjusting for omissions and methodological shortcomings, Richardson and Crowley estimated the cost to vary between \$6.7 billion and \$17.4 billion per annum, or an average cost of around \$45 to well over \$100 per litre of alcohol. The authors' note (p.7) that "in every study where they are included total cost is dominated by the costs to industry"¹⁰. However, they also state that the estimates of industry costs by the overseas studies vary to such an extent that the consistency of the methods adopted in the different studies must be seriously questioned. Based on the information in the study, it has not been possible for the Committee to estimate the proportion of costs which are external.

Estimates of the cost of alcohol abuse provided by these studies vary widely. Differences arise in estimates of the total costs, and subsequently in the classification of these aggregate costs between private costs borne by the consumer of alcohol and external costs borne by other members of society. Quite different methodologies and assumptions are used.

The Committee has not analysed these studies in depth. However, it is clear that estimating the costs of alcohol abuse is a difficult and contentious issue with no single, generally accepted procedure. The estimates reported by Collins and Lapsley and the adjusted estimates reported by Richardson and Crowley significantly overstate external costs, whereas the Tasman Institutes' estimates are likely to understate the true external cost.

10.4 Measures to control alcohol abuse

There are three broad classes into which policies directed at alcohol abuse can be categorised — control policies, taxation and information programs. In <u>practice</u>, it is common to employa mix of policy instruments falling into each of the three categories. There are also some measures which fall outside the

¹⁰ These include: reduced efficiency of the workforce;unemployment; lost productivity due to death; and reduced efficiency in the performance of non-market activities such as housework.

broad categories discussed below— such as devices to prevent the use of motor vehicles by intoxicated persons.

Control policies

Control policies typically involve placing some form of restriction on the manufacture, distribution and/or sale of alcoholic beverages. At one extreme is total prohibition, as occurred in the United States in the 1920s. This was claimed to substantially reduce alcohol-related mortality and morbidity (Noble 1984, p. 142). However, total prohibition also produces a range of negative side-effects:

- it encourages the production of poor quality 'backyard' alcodel ('moonshine') which can be more threatening to health than commercially manufactured alcohol;
- it encourages the establishment of a black market selling alcohol at inflated prices;
- the cost of law enforcement rises to police prohibition and prevent corruption and lawlessness; and
- it is an indiscriminate policy that penalises non-abusers and abusers equally.

It is possible to partially control the availability of alcohol in a number of ways. One common measure is to limit the sale of alcoholic beverages to particular individuals and/or to particular environments. For example, in Australia a minimum legal drinking age prohibits the sale of alcoholic beverages to anyone under 18 years of age. Although regulatory requirements vary by jurisdictions, controls on the hours, locations and number of sales outlets are also common in Australia. Concerns about excessive alcohol consumption in Halls Creek resulted in the Western Australian Government banning the sale of packaged liquor to take away prior to noon and imposing additional restrictions on the sale of cask wine. Other examples of partial restrictions include the 0.05 blood alcohol content restriction on motor vehicle drivers and limitations applying to some professions (eg taxi drivers and airline pilots who must have a zero blood alcohol content).

Research into the effectiveness of alcohol controls has focussed on alcohol consumption generally rather than its effect on alcohol abuse. United States data show an increase in the number of automobile collisions and fatalities involving young drivers after some states reduced the minimum legal drinking age (Noble 1984, p. 165). However, it is unclear whether this effect was produced by increased drinking by young people. In other words, the increase

could have been produced by factors other than increasing alcohol consumption. The susceptibility of Australian 16–18 year olds to binge drinking (see Section 10.2), even though the legal minimum drinking age is set at 18 years, creates some doubt about the effectiveness of restrictions on alcohol sales.

Research into the effect of retail outlet restrictions is also mixed. Macdonald and Whitehead (1983) found that increasing the number of retail outlets resulted in an increase in alcohol consumption. However, Frankel and Whitehead (1985) reported that nothing could be concluded about the relationship between overall alcohol consumption and the prevalence of alcohol outlets. They also suggested that the hours during which alcohol could be sold affected where and when alcohol was consumed, but not the rate or overall amount of alcohol consumed.

Taxation

The main purpose of taxation in relation to alcohol abuse is to compensate for the costs imposed on the community generally by individuals that misuse alcohol. To the extent that taxation increases the price of alcohol relative to other goods and services, it will also reduce consumption and the level of abuse.

In Australia, three broad types of taxation are levied on alcoholic beverages — excise duty and sales tax by the Commonwealth and a range of charges and taxes levied by the states and territories (see Chapter 11).

In 1991, the Northern Territory Government introduced the Living With Alcohol Program. A major feature of the program is a levy on liquor with an alcohol content greater than three per cent.¹ Consequently, low alcohol drinks are exempt from the state levy, lowering their price relative thigh alcohol drinks. The program's aim is to encourage the consumption of low alcohol drinks through the price differential thus reducing the incidence of alcohol abuse and alcohol-related harm in the community.

The Alcohol and Other Drugs Council of Australia (sub. 49, pf) argued that:

There is ample evidence to support the view that the social costs of alcohol use and abuse can be reduced by increased taxation. A well documented economic

¹¹ The funds raised by the levy are allocated exclusively for projects and activities expected to contribute to reduced levels of alcohol-related harm. The money is directed toward mass media and targeted education and information campaigns, community development projects, regulation and law enforcement, professional development and training, treatment and rehabilitation services, and research and evaluation activities.

principal is that as the price of any item rises, consumption of that item falls. [International studies] have consistently shown that when other factors remain unchanged, a rise in alcohol prices has generally led to a drop in the consumption of alcohol.

On the other hand, the use of taxation to help control alcohol abuse is commonly criticised on two grounds.

First, taxation affects alcohol abusers and non-abusers equally, even though the latter group do not impose the same costs on the rest of the community. While it is clearly true that responsible drinkers are penalised, it is arguably more equitable if the external costs of alcohol abuse are borne by the drinking population rather than by all members of the population. In this regard, it is also relevant to note that education and community education programs are also relatively blunt instruments in the sense that they are funded from consolidated revenue (ie by taxpayers generally), and are frequently disseminated widely through the media rather than targeted at 'high risk' groups.

The second criticism is that increasing the rate of taxation will have only a minor impact upon the incidence of alcohol dependency (ie alcoholics- like those dependent on other drugs— will forgo expenditures on even essential items (eg food) to obtain alcohol). Consequently, increasing the price of alcohol may have only a small impact on consumption by addicts. It is, however, likely to have a greater impact on binge drinkers. As noted above, binge drinking is normally associated with younger persons who are likely to be more price sensitive than older age groups (see Section 10.2).

Information programs

Information programs aim to prevent and/or reduce the incidence of alcohol abuse. Although they vary in terms of the method of communication, almost all rely upon educational approaches to provide drinkers with better information about alcohol consumption. Examples of information programs include the distribution of educational material to schoolsthe treatment of alcoholismand the provision of breathalysers in pubs ad hotels.

At present, the mass media is used extensively, particularly by governments, to educate the public about the levels of consumption which place drinkers at risk and the consequences of excessive drinking. In most jurisdictions, advertisements warning against drink-driving and other possible consequences of excessive alcohol consumption are broadcast in the media.

These measures are supported by wine industry funded initiatives to encourage the moderate consumption of alcohol. The industry has recently funded research undertaken by the School of Chemistry and the Department of Pharmacology of the University of Melbourne to investigate the effect of gender differences on safe drinking limits. The wine industry has also strongly supported the introduction of standard drinks labelling. This requirement — which will become mandatory in December 1995— is intended to inform drinkers of the alcoholic content of alcoholic beverages so that they can monitor their consumption.

The wine industry also has recommended that an alcohol education program, in conjunction with the Commonwealth Department of Community Health and Social Services, be undertaken to educate consumers of potential benefits and potential risks when alcohol is consumed under certain circumstances such as genetic predisposition to alcoholism, concurrent medication and during pregnancy.

The beverage and spirits industries also support alcohol information programs. For example, the brewing industry has provided research funding of over \$3 million since 1978 and the Distilled Spirits Industry Council has pledged \$5 million over five years for community education programs.

Information programs have two specific benefits. First, supplying the public with information allows the consumer to make more rational decisions about drinking. The consumer is better informed about the consequences of excessive drinking and what level of consumption is likely to induce harmful effects. Second, information programs can be targeted to groups and situations within the population where hazardous consumption has been identified.

The alcohol industry gains by promoting remedies and information to overcome alcohol abuse. Alcoholism creates a bad reputation for the industry's image and can impact on sales. However, information programs benefit all producers in the industry, even though only some producers may contribute to funding these programs. Consequently, programs must be funded by the industry as a whole or by governments.

A number of participants claimed that the funds currently provided by the Commonwealth Government for alcohol education and rehabilitation programs are inadequate. The Australian Democrats contended that the present level of funding (around \$36 million annually) should be progressively increased so that Commonwealth funding eventually matches expenditure by state and territory governments.

10.5 Summary

Many issues concerning alcohol consumption are contentious and remain unresolved. However, there is no doubt that excessive alcohol consumption constitutes a serious public health problem. It is widely accepted that alcohol — whether in the form of wine, beer or spirits— causes a significant number of deaths, is responsible for a significant number of hospital admissions and is the major contributor to drug-caused deaths among young people. On the other hand, the precise effects of alcohol on individual drinkers and the broader community are not known with any certainty. The effects of drinking alcohol are influenced by the manner in which it is drunk (ie the period of time over which it is consumed), the circumstances of its drinking (ie with or without food) and the frequency with which it is consumed. There is also evidence to suggest that alcohol consumed in moderate amounts can protect against cardiovascular mortality and bestow a range of psychological benefits on consumers.

A number of studies have attempted to estimate the costs associated with alcohol abuse. However, differences in the methodologies and assumptions employed, data constraints and difficulties in determining the appropriate allocation between private costs and external costs detract from the studies' estimates.

The information available on the contribution of different forms of alcohol to the overall cost of alcohol abuse is even more limited. The impact of consuming wine may differ from that of other alcoholic beverages. Indeed, there is some evidence to suggest that consumption patterns for wine differ from other forms of alcohol in terms of income group, age, gender and the circumstances of its consumption. It is also suggested that the effect of wine consumption is moderated by it being usually consumed with food and that wine — in particular red wine — is more cardioprotective than other forms of alcohol. However, other studies contradict these claims and/or contend that the findings are not relevant to the question of alcohol abuse. In these circumstances, assessments of the difference, if any, between the contribution made by wine and other alcoholic beverages to the overall level of alcohol abuse is necessarily somewhat subjective. To clarify the matter, further research is required to identify the types of persons who abuse alcoholthe nature of their consumption, levels of abusend how drinking patterns can be influenced.

11 TAXATION OF WINE AND BRANDY

This chapter is structured in three sections. Part A outlines existing tax structures and other matters underlying the Committee's consideration of the appropriate form and level of tax on wine, including a summary of the views expressed by participants. Part B contains the Committee's recommendations on the appropriate form and level of taxation on wine. Part C considers several matters concerning the taxation of brandy.

The Committee is in agreement on Part A, Part C and on those sections of Part B that discuss the rationale for taxing the domestic consumption of wine and the appropriate form of the tax on wine. However, the Committee has reached two different conclusions as to the level of tax which should be imposed on wine. The majority conclusion by Mr Brian Croser and Professor John Freebairn, and the alternative view of Mr Bill Scales, are detailed in Part B.

The Committee also considered several other Commonwealth, state and territory taxation issues — comprising matters explicitly referred to the Committee for examination (ie the tax treatment of wine given away at tastings) or raised as concerns by participants. These are discussed in Chapter 12. The Committee is in agreement on all of these matters.

Defining wine — the inquiry terms of reference

The Committee has been asked to recommend on the appropriate form and level of taxation and cash grants for the industry, taking into account the ability of the industry to achieve its domestic and export potential and the taxation regimes applied to alcoholic beverages in Australia and other countries, and to all Australian industries. In relation to the form and level of wine taxation, the Committee has interpreted the terms of reference as meaning that its considerations are restricted to wine products made from grapes — table wine, sparkling wine and fortified wine products classified to either Australian Food Standards P4 or P6 and wine based products classified to Food Standard P5 (such as wine coolers).

There are a range of other alcoholic beverages which are currently taxed in the same way as wine, namely:

- products such as perry, mead, sake, fruit wine, vegetable wine and cider; and
- alcoholic soft drinks (eg alcoholic drinks fermented from lemons or malt) which are relatively new to the market.

The Committee has made no recommendations on the taxation of these products. However, participants raised various 'anomalies' in the taxation of these products and other alcoholic beverages. The Committee draws its comments on these matters to the attention of the Government.

PART A: SETTING THE SCENE

11.1 Introduction

Taxation issues were a central focus for most participants in this inquiry. Virtually all from within the wine industry expressed opposition to the decision announced in the 1993 Federal Budget to increase the wholesale sales tax (WST) on wine from the then general rate of 20 per cent to 31 per cent. Subsequent to the 1993 Budget, the Commonwealth Government and the Winemakers' Federation of Australia (WFA) reached agreement that the WST on wine should be reduced to 22 per cent, increasing to 24 per cent on 1 July 1994 and to 26 per cent on 1 July 1995. In this inquiry, most industry representatives contended that taxation of wine should not be higher than 26 per cent WST (as agreed between the WFA and the Government in 1993), although some believe that the form of the tax should be changed.

Representatives of the brewing and distilled spirits industries argued that the Commonwealth Government's current taxation arrangements discriminate against their industries in favour of wine— particularly cask wine. These participants requested that specific matters— such as the concessional excise treatment for brandy relative to other potable spirits (see Part C) and the current taxation treatment of fortified wine based flavoured liqueurs and premixed spirituous beverages (see Chapter 12)— be addressed.

Some participants were primarily concerned about the effects of alcohol on health. Most of these participants argued that taxation should be used as one means of managing alcohol consumption and of recouping from drinkers the costs imposed on the community by excessive consumption. Their major concern was the relatively low rate of tax on wine— particularly cask wine— compared to other alcoholic beverages.

There were a number of other taxation matters raised by the wine industry. These matters— which are discussed in Chapter 12— included: the adverse effects on planning and investment in the industry arising from frequent changes in the tax regime; the application of WST to wine used for tastings and free samples; the basis for valuation of wine stocks for income tax purposes; and the impact of the fringe benefits tax on winemakers. Among smaller winemakers, there is particular concern about the liquidity pressures which result from the current taxation measures.

11.2 Indirect taxation in Australia

Australia applies significant taxes on many goods and services at all levels of government. The major Commonwealth taxes are the WST, excises applying to beer and spirits, tobacco products and refined petroleum products, and tariffs imposed at varying levels on many imported goods.

The WST is levied at the point of last wholesale sale on non-exempt goods manufactured in, or imported into, Australia for final consumption. Manufacturers of goods subject to excise and importers of like-excise goods must declare the liability on those goods and account to Customs for the goods until they are delivered into home consumption, sold under bond, used in another process, declared as waste or exported. Neither WST nor excise is paid on goods which are exported.

The WST is, in principle, a general consumption tax, although in practice it is not. There are five different WST rates, many other goods are exempt, and land, services and intangible property are not included within the WST schedule.

At the state, territory and local government level, the major forms of taxation are annual charges on motor vehicles, state franchise fees (on alcohol, tobacco and petroleum), taxes on financial transactions, gambling, insurance, property rates and land tax. These taxes are imposed mainly for revenue raising purposes, although in some cases they take the form of user charges or are intended to compensate the community for the external cost of the taxed activity. The major indirect taxes levied by the Commonwealth, state, territory and local governments are summarised in Table 11.1.

¹ Excise applies to only domestically produced goods. Customs duties— equivalent to the excise plus a protective duty component— apply to similar imported goods.

Tax	Taxing authority	Revenue collected (\$ million)	Primary purpose of tax ^a
Wholesale sales tax	Commonwealth	10 414	Revenue raising
Excises and levies	Mainly Commonwealth	11 955	Revenue raising, user charges, external costs
Taxes on trade (mostly import duties)	Commonwealth	3231	Mainly for industry policy purposes
Financial/capital transactions taxes	State/Territory	6005	Mainly revenue raising
Gambling taxes	State/Territory	2583	Revenue raising, some external costs
Insurance taxes	State/Territory	1522	Revenue raising, user charges
Motor vehicle taxes	State/Territory	3128	Mainly user charges
Franchise taxes (on petroleum, alcohol and tobacco)	State/Territory	3999	Revenue raising, user charges, some external costs
Other taxes on goods and charges for use of services	Commonwealth/State /Territory	2125	Mainly user charges
Rates and taxes on property	State/Territory/Local	6840	Revenue raising, user charges

The outcome is a highly disparate indirect taxation system. For example:

- a wide range of service sector activities such as airline travel, restaurant meals, sporting activities and concerts are completely free of tax. However, the consumption of some services (eg gambling and insurance) is taxed. Some services (eg opera) are subsidised;
- goods considered to be 'essentials', for example most food and clothing, are exempt from tax;

- other goods are taxed at a variety of rates. For example, from 1 July 1995 WST is levied on household goods and certain confectionery at 12 per cent, on soft drinks at 22 per cent, on television sets and jewellery at 32 per cent and on the value of luxury motor vehicles above a certain threshold (\$34 403 in 1994–95) at 45 per cent; and
- the taxation of beverages varies considerably (see Table 11.2). Beverages • considered to be 'essentials' (ie tea, coffee, pure milk and water) are tax exempt. Others such as flavoured milk and fruit juice are taxed at 12 per cent. Carbonated soft drinks and mineral water are taxed at 22 per cent. The WST on most wine is 26 per cen∉. Cider and alcoholic soft drinks are taxed in the same way as wine. Beer and spirits face WST at 22 per cent, with an additional excise based on alcohol content and indexed to movements in the Consumer Price Index³. As a result, there is great disparity in the taxation of alcoholic beverages. For example, Commonwealth taxes on beer, whisky and brandy, when converted to an ad valorem rate, are roughly 70 per cent, 187 per cent and 215 per cent respectively (see Table 11.3). When state franchise fees are included, the equivalent ad valorem tax rates on wine, beer, whisky and brandy are 42 per cent, 92 per cent, 224 per cent and 255 per cent respectively.

² Low alcohol wine is subject to WST at 12 per cent.

³ For beer, the excise is currently \$14.90 per litre of alcohol (applying to the alcohol content above 1.15 per cent). In the main, spirits face an excise of \$34.69 per litre of alcohol.

Beverage type	WST rate (%)	Excise rate ^a (dollars per litre of alcohol)	State/territory licence fee (%)	
Beer				
- alcohol content up to 1.15%	22	0)	
- alcohol content above 1.15% ^c	22	\$14.90 per lal ^b)	
Wine, cider ^c)	
- alcohol content up to 1.15%	12	0) 10–14	
- alcohol content above 1.15%	26	0)	
Brandy				
- wholly from grape wine	22	\$29.62 per lal)	
- other	22	\$34.69 per lal)	
Spirits (general)	22	\$34.69 per lal)	
Water	0	0	0	
Tea, Coffee	0	0	0	
Pure milk	0	0	0	
Flavoured milk	12	0	0	
Fruit juice	12	0	0	
Mineral water	22	0	0	
Carbonated soft drinks	22	0	0	

When taxes on alcoholic beverages are considered on the basis of their volume of alcohol, the tax relativities picture is somewhat different. On this basis, the tax on wine in 1993–94, on average, was approximately \$7 per litre of alcohol. Tax on ultra-premium wine is much higher- about the same level, or in some cases higher, than the tax on beer, and far higher than the tax on non-premium wine. At the 26 per cent WST rate, and assuming typical margins, tax equivalent to approximately \$21 per litre of alcohol is paid on a bottle of wine retailing at \$15. A four litre cask of wine is taxed at about \$3.70 per litre of alcohol. In comparison, regular strength beer is taxed at around \$20 per litre of alcohol, low alcohol beer is taxed at about \$21 per litre of alcohol⁴, a bottle of Australian brandy retailing at \$21 is taxed at about \$40

The tax on low alcohol beer applies to a very small volume of alcohol. Thus, although low alcohol beer as a product is taxed more lightly than regular beer, the alcohol in low alcohol beer is taxed at a higher rate than the alcohol in regular beer.

per litre of alcohol and a bottle of imported whisky retailing at \$27 is taxed at about \$50 per litre of alcohol. The equivalent tax rates for these beverages, expressed on a per litre of alcohol basis, are summarised in Table 11.4.

	rem equivalent tax rate ritory liquor licence fe it)	-
Beverage	Ad valorem equivalent of WST and excise	Ad valorem equivalent of WST, excise and state/territory licence fee
Fruit juice	12	12
Soft drink	22	22
Wine (cask and bottle)	26	42
Low alcohol beer	43	43
Regular beer	70	92
Whisky ^b	187	224
Brandy ^c	215	255
	fees expressed as a percentage of pre- fee component assumed to be 13 j	1
-	-	

Table 11.4:Various alcoholic beverages, equivalent WST plus
excise on a per litre of alcohol basis
(dollars per litre of alcohol)

Alcoholic beverage	Equivalent of WST and excise		
Four litre cask wine (retail price \$10) ^a	3.70		
Premium wine (retail price \$10) ^b	14.60		
Ultra-premium bottled wine (retail price \$15) ^b	21.10		
Average all wine 1993–94	7.00		
Regular beer	20.00		
Low alcohol beer	21.20		
Domestic brandy	40.20		
Imported whisky (700 ml)	50.10		
 a Assumes alcohol content 10 per cent. b Assumes alcohol content 12.5 per cent. Sources: Committee estimates; Commonwealth Treasury 	у		

The taxation of wine — a brief history

Commonwealth taxation of Australian wine has varied considerably since 1930 when the WST was first introduced. At that time, all wine and brandy sales were taxed at the general rate of 2.5 per cent. The WST on Australian produced wine was removed soon afterwards (July 1931) and there was no Commonwealth tax applied to domestic wine until August 1984 when WST at the rate of 10 per cent was introduced. In August 1986, the rate of WST on wine was increased to the (then) general rate of 20 per cent.

In the 1993 Budget, the Commonwealth Government increased the rate of WST on wine to 31 per cent. Following the Budget, the Government and the WFA agreed to reduce the rate of WST applied to wine— to 22 per cent from 21 October 1993, rising to 24 per cent from 1 July 1994 and 26 per cent from 1 July 1995. These tax rates applied also to products such as cider and alcoholic soft drinks.

⁵ From August 1930 to August 1984, imported wine was subject to WST at the general rate. In August 1984, when WST at 10 per cent was applied to domestic wine, WST on imported wine was reduced to 10 per cent and customs duties were increased to maintain the wholesale price at the pre-August 1984 level.

Wine was subject to excise for a brief period in the 1970s. The excise (of 50 cents per gallon) was first levied in August 1970, halved in August 1972 and removed completely in December 1972. Concerns about administration appear to be one factor militating against the application of excise to wine. Wine, unlike beer and spirits, is produced by around 800 geographically dispersed and mostly very small establishments. The Australian Customs Service (Customs) referred to several disadvantages in applying an excise to wine, including high collection and enforcement costs compared to revenue, and the demands it would place on winemakers in relation to the information they would be required to supply and the reporting obligations and security arrangements they would have to maintain.

Fortified wine was subject to an excise for much of this century through an excise on fortifying spirit. The excise on fortifying spirit was levied from 1901 until 1970, when it was abolished in favour of the broader excise on all wine, including fortified wine. After the abolition of the wine excise, fortified wine remained excise-free until August 1983, when the excise on fortifying spirit was reintroduced at the rate of \$2.61 per litre of alcohol. The excise on fortifying spirit was reduced to \$1.50 per litre of alcohol in September 1983 and removed completely in June 1984. Since June 1984, fortifying spirit (and as a consequence fortified wines) have been free of excise.

Brandy has been subject to excise since 1901, generally at a rate less than that applying to other potable spirits. For example, the excise on brandy was about half that on other spirits up to 1972. The excise concession for brandy was completely removed in 1975, but, as an industry assistance measure, was restored in 1979 at the rate of \$2 per litre of alcohol . Now, as a result of the indexation, the concession for brandy relative to other potable spirits is \$5.07 per litre of alcohol.

In addition to Commonwealth taxes, each state and territory levies liquor licence fees on wine, and all other alcoholic beverages, sold within its borders. Fees are generally collected at the retail level, with the charge calculated as a minimum fee plus a percentage of purchases in a specified previous period. The percentage component of the fee varies among states and territories—ranging from 10 per cent in Queensland (14 per cent wholesale) to 11 per cent (Victoria, South Australia, Western Australia, Tasmania and the Northern Territory) to 13 per cent (New South Wales and the Australian Capital Territory).

⁶ Some wineries are already licensed and monitored by Customs because of their use of fortifying spirit obtained free of excise for use in producing fortified wines.

Revenue collected from taxation of alcoholic beverages

Both the WST and the excise system are significant revenue earners for the Commonwealth Government. In 1993–94, WST collected from all products returned a total of \$10.4 billion. Customs duty and excise on beer and spirits, tobacco products and refined petroleum products raised a further \$11.6 billion.

Commonwealth taxation of beer, wine and spirits raised approximately \$2.5 billion — around 2.4 per cent of the Commonwealth's revenue from all sources in 1993–94. Some \$1 billion was collected from WST on alcoholic beverages — about 10 per cent of total revenue raised through the WST. Customs duty and excise on alcoholic beverages— about \$1.5 billion — represented almost 13 per cent of the total excise and customs duty collection. Taxation of wine alone raised \$265 million— just over 10 per cent of the \$2.5 billion in revenue collected by the Commonwealth from the taxation of all alcoholic beverages.

The states and territories collected \$655 million from liquor licence fees applied to all forms of alcoholic beverages in 1993–94. While the available data do not attribute revenue collected among the different beverages, a notional breakdown of the aggregate data suggests that about \$155 million related to sales of wine.

Table 11.5 shows the estimated revenue collected from the taxation of alcoholic beverages in 1993–94 by the Commonwealth, state and territory governments.

Table 11.5: Estimated revenue collections from alcoholic beverages, 1993–94 (\$ million)

		Commonwealth ^a		States and Territories
	WST	Excise/customs duty	Total Commonwealt h	Liquor licence fees ^a
Beer	550	830	1 380	357
Wine	260	5	265	155
Spirits	220	670	890	143
Total	1 030	1 505	2 535	655

a Notional breakdown of total revenue collected from Commonwealth, state and territory taxation of alcoholic beverages. The Australian Taxation Office does not maintain separate data on WST collections by beverage type or on revenue collected from state/territory licensing fees.

Sources: Commonwealth Treasury; Committee estimates

11.3 Guidelines for judging taxation measures

Taxation efficiency

Broadly speaking, indirect taxes on the domestic consumption of goods and services are judged through the criterion of efficiency. In essence, the efficiency of a tax relates to its impact on production and consumption decisions. Ideally, taxes should not distort production decisions by firms or purchasing decisions by consumers— unless this is a specific objective. In other words, while all taxes affect the absolute level of consumption of goods and services, an efficient tax regime would leave pre-tax and post-tax patterns of production and consumption unchanged (ie the proportion of output/consumption attributable to each product or service would be the same). In this sense, it would treat all goods and services in the same way.

Price distortions generated by differences in tax rates among goods and services result in an economic loss to the community in two ways. First, they encourage consumers to purchase more of the products favoured by the differential tax structure which, in the absence of the tax differential, they consider to be less desirable. Second, they encourage the use of more of the community's scarce resources in the production of goods that, without the tax advantage, would not normally provide a high enough return to warrant that level of activity (ie production would be lower under a more uniform tax regime).

Taxes are levied at all levels of government and take many forms. They apply to a wide spectrum of activity, including: the income of households and firms (eg personal income tax, corporate income tax, fringe benefits tax and capital gains tax); and the purchases and production of households and firms (eg WST, excise and import duties). It is inevitable that taxes will to some extent affect choices between the consumption of different goods and services, and between work and leisure. Within the broad goal of minimising distortions in production and consumption, therefore, other factors— such as simplicity, compliance costs and minimising incentives for avoidance and equity— come into play.

Ideally, a tax system should be structured so that taxes bear most heavily on products for which demand and supply is relatively insensitive to changes in the prices.⁷ This would minimise the impact of taxation on patterns of

⁷ Efficiency is enhanced when tax induced substitution between products is minimised. Thus, for efficient taxation, a change in the level of tax should lead to equiproportional changes in the demand for each taxed item, assuming there is no change in consumers' income. Hence, the 'ideal' of structuring tax levels in accordance with effects of price on demand and supply requires consideration of all

production and consumption. However, in practice, such an approach is difficult to apply on an economy wide basis. It requires identification of the market conditions for each product and highly specific product definitions (with associated policing costs and incentives for unproductive tax avoidance activity). Furthermore, if market conditions change, it may be necessary to change tax structures. In addition, governments are reluctant to heavily tax those price insensitive products which are viewed as 'necessities of life' such as many basic foods, water and housing. Governments have tended to exempt such necessities rather than subject them to higher taxes.

Given these constraints, an alternative approach is to apply a broad based tax structure with minimal concessions/exemptions applied at the final consumption or retail level. However, there are some difficulties with this. For example, some products— in particular leisure— cannot be directly taxed. Nonetheless, this is the approach which is favoured in most developed countries.

In Australia, governments have chosen not to introduce a broad based consumption tax. Instead, there exists the highly fragmented arrangements outlined above. Even within such a system, however, it is desirable that, as far as is practical, products which are close substitutes be taxed at similar rates. This minimises both efficiency losses and the loss of revenue that would otherwise occur through movement to the lower taxed substitute product.

Specific taxes on particular goods and services can also be justified on efficiency grounds if production or consumption of these goods and services imposes costs on the broader community. In essence, these costs to the community— commonly called 'external' costs or 'spillover costs'— are not reflected in market prices[§] As a result, decisions by producers or consumers creating the externality take no account of the effects on others. The imposition of a tax on activities that generate an external cost is intended to ensure that the prices faced by producers and consumers reflect all costs (including those imposed on the community).

Equity

Equity is another factor influencing government decisions on taxation matters. It has two dimensions. A tax is said to provide *horizontal equity* if it ensures that those with a similar taxable capacity pay the same tax. *Vertical equity* concerns the incidence of a tax on various groups. It requires judgments

price effects (ie including all cross-price effects) Cross-price elasticities are zero only where taxed items are neither substitutes nor complements.

⁸ See Chapter 10 for a discussion of the external effects of alcohol consumption.

about the appropriate treatment of taxpayers whose economic positions differ prior to the tax.

Broadly speaking, taxes instigated for revenue raising purposes which bear most heavily on higher income groups (ie progressive taxes) are seen by governments as more equitable than those which impact mainly on lower income groups. Consequently, governments sometimes tax 'essentials' relatively lightly and/or 'luxuries' relatively heavily. Within the WST, for example, there are general schedules taxing 'essentials' at zero, 'luxuries' at the highest rate and most other goods at a middle rate.

Box 11.1 below provides a brief definition of some of the concepts relevant to this discussion of taxation guidelines.

Ad valorem and specific rate taxes

An ad valorem tax— such as the WST— is expressed as a percentage of the price of a product at some point in the marketing chain. In contrast, a specific rate or volumetric tax— such as an excise— is expressed as a dollar value per physical unit of the good.

The form of tax applied affects the relative after-tax price of products — and consequently consumers' purchasing decisions and firms' production decisions. Because an ad valorem tax only takes account of price, where it is applied to the retail price of products at the same rate it will provide a uniform tax treatment in the sense that the*proportion* of tax included in the purchase price is the same — and their relative prices are unchanged— irrespective of the nature of the product. Because a specific rate tax (or volumetric tax) is expressed in terms of quantity rather than price, it imposes the same dollar amount of tax per physical unit of product, regardless of price. Thus, it will form a greater proportion of the price of a cheaper product than of a similar more expensive product.

There are also differences between the two forms of tax in the mechanism for adjusting tax rates. Because an ad valorem tax is based on price, the effective tax rate adjusts automatically in response to price changes. However, inflation undermines both the effective tax rate and real value of revenue from a specific rate or volumetric tax. In the case of excises, the erosion of the tax base is overcome by indexing excise to the Consumer Price Index.

⁹ The three main rate schedules in the WST applying to non-exempt goods are 12, 22 and 32 per cent — with a 'general' tax rate of 22 per cent applying to most products. The WST also has two other tax rates: 26 per cent for wine and 45 per cent which applies to the amount by which the wholesale value of a luxury car exceeds a given threshold (\$34 403 in 1994–95).

Box 11.1: Defining the terms

This discussion of taxation guidelines uses a number of terms. A brief definition of each is provided below.

Taxation efficiency : an efficient tax is administratively simple, easily understood and does not alter production and consumption patterns, unless this is a specific objective of the tax system..

Horizontal equity : a situation in which taxpayers with identical taxable capacity pay identical taxes.

Vertical equity : circumstances in which the tax paid reflects taxpayers' differing capacities to pay tax (ie higher income earners pay higher tax).

Progressive/regressive tax : where a tax is progressive, the proportion of a taxpayer's income paid in tax rises with income. In contrast, tax paid as a proportion of income falls as income rises if a tax is regressive.

Tax incidence: the point at which the tax burden rests. The 1 *egal* or *first round incidence* — the point at which the tax is imposed — may differ from the *economic* or *final incidence* — the point at which the tax burden ultimately rests. Thus, the *legal incidence* of the WST falls on producers. However, if producers increase the price of the good by the amount of the tax and (in the unlikely event that) consumers do not reduce their purchases, the final burden — or the *economic incidence* — will have been shifted entirely onto consumers.

Tax avoidance : actions by taxpayers to arrange their affairs within the law so as to minimise taxation. In contrast, *tax evasion* refers to illegal actions undertaken to reduce tax liabilities.

Ad valorem tax: a tax expressed as a percentage of the price of a product at some point in the marketing chain. For example, the WST is an ad valorem tax imposed at the wholesale level.

Specific rate tax or volumetric tax: a tax expressed as a specific dollar value per unit of a good. For example, excise is a *specific rate tax* or a *volumetric tax* levied, in the case of beer and spirits, as a dollar value per litre of alcohol.

Stability and certainty

It is desirable that, as far as possible, there be a high degree of certainty and stability in taxation arrangements. In this inquiry, participants stated that future uncertainty about the tax on wine has discouraged investment. For

example, Australia's largest wine company, Southcorp, stated that it had deferred the remaining \$35 million of its \$100 million vineyard investment program pending the release of the Committee's report and the Commonwealth Government determining its course of action in regard to taxation.

The Committee acknowledges the importance to the industry of a relatively stable taxation environment. However, in practice, the important role that taxation plays in macroeconomic management means that a degree of uncertainty inevitably will exist. In the case of wine, pressures for higher taxation almost certainly will continue as long as there is a large difference in the tax treatment of wine, beer and spirits. However, in the short term, uncertainty *may* be reduced if there is an agreed program in place to reduce disparities in taxation.

11.4 Participants' views about the form and level of taxes on wine

In their initial submissions to the inquiry, representatives of the winegrape and wine industry submitted that the phased increase in WST on wine (to 26 per cent from 1 July 1995) agreed between the WFA and the Government was too high. Most supported the view put by the WFWGC, that the tax on wine should be equivalent to the general WST rate (22 per cent). A few smaller winemakers argued that wine should not be taxed at all.

Following the release of the draft report, the industry's national bodies while continuing to support the principle that wine be taxed at the general WST rate— accepted they could 'live with' the current tax rate of 26 per cent. However, they emphasised that any further increase in tax is unacceptable. In this context, the WFWGC (sub. 181, p. 60) stated:

... the Australian wine and wine grape industry accepts the current rate of 26 per cent and, whilst differing on the form of taxation, rejects any further taxation increases. Industry acceptance of the 26 per cent level is contingent upon Government endorsing a comprehensive industry plan guaranteeing stability [of tax rates].

The state wine industry associations expressed varying views as to the appropriate *level* of tax on wine. For example, the New South Wales and Victorian associations continued to argue for a purely ad valorem WST set at the rate of 22 per cent, while the Western Australian body accepted the WFWGC view on the level of tax. Some other bodies, for example the Independent Wineries Association (IWA), advocated that wine be taxed in

line with basic food products such as pure milk and bread, ie that wine should be exempt from tax.

There is little unanimity within the industry about the appropriat *form* of taxation of wine. In their joint submissions, the national winemaker and grapegrower associations argued strongly in support of a wholly ad valorem tax. In this context, the WFWGC (transcript, p. 1247) stated:

With the right emphasis on the key need for policy certainty and with the right recognition of the industry's planned growth, the Winegrape Growers' Council of Australia considers a wholesale tax of 26 per cent is bearable, as long as the cask wine sector only pays the equivalent of 26 per cent.

In contrast, the AWF considered that a composite ad valorem and volumetric WST has 'merit', although it rejected the rationale outlined in the draft report for a volumetric tax on wine— ie to compensate for the external costs of alcohol abuse. The AWF supported a composite tax *provided* that the volumetric component is administered in a simple, low cost way and that the Government guarantees the long term stability of tax rates.

The views expressed by the state wine industry associations on the appropriate form of tax differed. Both the VWIA and the NSWWIA supported a wholly ad valorem structure. The VWIA expressed considerable concern that a composite ad valorem / volumetric tax will mean an 'extra' tax able to be readily increased by governments. The WIAWA supported the view expressed by the AWF— ie acceptance of a composite WST— conditional on there being no further increases in taxation other than general increases in WST.

Other industry participants argued for a wholly volumetric tax. For example, the Margaret River Wine Industry Association (MRWIA) advocated a differential rate wholly volumetric tax (ie separate rates for cask wine and bottled wine). It submitted that, under such a structure, it would be appropriate to set the tax rates to raise revenue equivalent to that currently collected by the WST on wine. However, the MRWIA's proposed tax structure would increase considerably the tax burden facing non-premium wine relative to premium wine. In this respect, participants supporting a volumetric structure argued that the current ad valorem WST places an "unconscionable burden on higher-priced wines, and thence on the pursuit of quality" because it results in a higher per unit of alcohol tax for bottled wine. Proponents of a wholly volumetric tax consider that the long term future of the industry requires that taxation policy discriminate in favour of the premium and ultra-premium sectors. For example, Dr John Gladstones (sub. 146, p. 2) stated:

'Efficient' taxation, rightly seen in the context of the whole and long-term economy, will thus seek to encourage relatively that part of the industry producing higher quality wines [premium and ultra-premium wines]. That is the opposite of what is being achieved by the present WST system.

Representatives of the beer and spirits industries argued that the tax regime facing alcoholic beverages should be more neutral across the different products. They contended that the different forms of alcohol are often substitutes in consumption and that, as a result, the present differences in tax treatment provide a significant advantage for wine.

The wine industry rejected this view— claiming that beer and spirituous beverages are an "overtaxed anomaly". In this context, the WFWGC (sub. 181, p. 44) stated that:

The accident of current beer tax or current spirits tax cannot be picked out as an appropriate benchmark, except as a tautology whereby beer is defined to be the appropriate benchmark because wine is assumed to be a substitute for beer.

In rejecting comparison with beer and spirits, wine industry representatives stressed that they are not seeking preferential treatment for their industry. In this context, the WFWGC (sub. 30, p. 151) stated that:

The Wine Industry ... recognises that it must (and indeed wants to) pay its*fair* share of taxes. In the overall context, the industry does not expect any unfair tax concessions because it realises that this means other industries, or sectors of the economy, will have to pay more than their fair share.

Most health professionals submitted that the external costs of alcohol consumption are such that a substantial increase in tax on wine is warranted. In general, they argued that taxation of each beverage should be linked to its alcohol content and that the differences in the tax treatment of the various alcoholic beverages should be reduced. In this respect, the Western Australian Department of Health (sub. 162, p. 10) stated:

... the Inquiry should brief the Government on the need to consider further measures to bring the volumetric excise on all alcoholic beverages into alignment.

Arguments supporting the WFWGC view

The major strands of the WFWGC's argument that wine be taxed at no more than 26 per cent are that:

- there is little justification for treating wine as a luxury good and subjecting it to higher taxation rates than most other goods;
- there is no evidence to suggest that substitution between wine and beer and spirits is greater than substitution between wine and many other products;

- wine unlike beer and spirits is a 'marginal contributor' to the external costs associated with alcohol abuse;
- there would be significant adverse effects on the growth of the industry from increased tax;
- winegrape growing and winemaking, because of their regional dispersion, make a disproportionate contribution to regional development;
- the process of winemaking has a number of unique characteristics which justify special consideration in setting tax rates;
- the Australian wine industry is disadvantaged in relation to its overseas competitors because taxes on wine are lower overseas and government subsidisation of wine is higher; and
- recent growth means that taxation revenue generated by the industry is rapidly increasing.

Each of these arguments is discussed below.

Is wine a luxury good?

Most industry representatives contended that wine has little in common with those goods which currently attract WST at 32 per cent— the so-called 'luxury rate'. For example, the WFWGC (sub. 31, p. 153) stated that:

... the types of goods that are included as luxury items, such as furs, jewellery, watches, televisions and videos, bear no relationship with alcoholic wines and ciders. That is, wine has few, if any, attributes in common with goods contained within the "luxury" goods classification; no more at least than tea and coffee, which are goods exempt from sales tax.

In similar vein, the VWIA (sub. 114, p. 23) stated that:

The only goods currently receiving similar treatment (ie taxed above the general rate) in terms of sales tax are luxury goods, furs, jewellery, electronics etc. We believe that treating wine in a similar way to these goods for sales tax purposes cannot be justified. The consumption pattern for wine is nothing like consumption patterns for such products.

There is insufficient available information to conclude, in a technical sense, that wine is a luxury good. Technically, a luxury is defined as a good or service on which an increasing proportion of income is spent as income rises, ie the income elasticity of demand for the good or service is greater than one.

The 1988–89 ABS Household Expenditure Survey (HES) provides some information on expenditure patterns for many goods and services. The HES

data for wine¹⁰ and some other goods and services are reported in Table 11.6. The data show that the pattern of spending on wine was broadly similar to that on meals consumed in restaurants and hotels, and had some similarities with spending on overseas holidays— both of which are perceived by many people to be luxuries. For example, apart from the lowest income quintile, the proportion of household income devoted to purchasing both wine and restaurant meals remained relatively constant as income increased. In contrast, the proportion of household income devoted to most non-alcoholic beverages, and to beer, declined with increases in income.

However, as pointed out by the South Australian Government, when account is taken of the sampling variability, the HES data cannot be reliably interpreted as showing that wine meets the technical definition of a luxury good. On the same basis, given the available information, it also cannot be shown that all the other goods currently taxed at the 'luxury' WST rate are, in a technical sense, luxury items. However, many are commonly perceived as luxury goods (as are some goods taxed at lower rates).

This aside, there are clearly some similarities between some goods taxed at the 'luxury rate' and wine. For example, for some consumers, wine— in particular premium and ultra-premium wine— is similar to many 'luxury rate' goods in that expenditure is discretionary and demand is relatively price inelastic. On the other hand, there are also some differences. For example, some goods taxed at 32 per cent (eg furs, watches and television sets) are infrequent purchases, whereas wine is often purchased on a regular basis.

The similarities between wine and other goods taxed above the general rate are greater if the latter group of products is considered to also include beer and spirits. The case for including beer and spirits in the category of goods taxed as 'luxuries' rests on the presumption that the revenue raising component of beer and spirits taxes is considerably higher than the 22 per cent WST which applies to each. As has been reported earlier, both beer and spirits also face excises based on their alcohol content. These excises were first imposed in 1901, entirely for the purpose of raising revenue. It is possible that, today, a proportion of the excises and customs duties on beer and spirits could be regarded as a means of meeting the external costs arising from alcohol abuse. However, it is not realistic to assume that this is the sole

¹⁰ The HES data treat wine as a homogeneous product, whereas there are likely to be considerable differences in patterns of expenditure on wine of different quality. For example, intuitively, non-premium wine is more a staple good consumed by individuals in all income brackets. In contrast, ultra-premium wine is regarded by many as a luxury, and is likely to be consumed mainly by households in the higher income groups.

justification. It is more appropriate to regard the bulk of the excises as predominantly serving the same objective as the WST— ie raising Commonwealth Government revenue. Thus, in practical terms, the revenue raising component of the tax on beer and spirits is probably much higher than the 'luxury' WST rate. For example, if it is (conservatively) assumed that 50 per cent of the total excise paid on beer and spirits is for general revenue raising purposes (with the remainder of the excise viewed as a tax to compensate for the external costs of alcohol abuse), the ad valorem equivalent of the WST *plus* the 50 per cent revenue raising component of the excise on beer and spirits would be of the order of 46 per cent and 104 per cent respectively.

Product	Lowest	Second	Third	Fourth	Fifth
	quintile	quintile	quintile	quintile	quintile
Fresh milk and cream	2.08	1.29	0.92	0.68	0.41
Packaged tea	0.36	0.18	0.10	0.07	0.05
Packaged coffee	0.59	0.33	0.19	0.15	0.09
Soft drinks and aerated waters	0.98	0.80	0.74	0.63	0.45
Beer	2.87	2.07	1.77	1.58	1.14
Spirits	0.73	0.65	0.44	0.47	0.40
Wine	0.87	0.46	0.42	0.46	0.48
Total non-alcoholic beverages	1.82	1.44	1.33	1.13	0.83
Total alcoholic beverages	4.75	3.38	2.76	2.67	2.22
Holiday air travel within Australia	0.47	0.22	0.23	0.29	0.32
Overseas holidays	1.85	1.15	0.78	0.81	1.11
Meals; restaurants, hotels and clubs	2.61	1.61	1.66	1.53	1.67

Substitution between alcoholic beverages

Following the draft report, the wine industry rejected the argument that substitution between wine and other alcoholic beverages is stronger than substitution between wine and all other goods and services. Accordingly, the industry rejects the view that taxes on wine and on other alcoholic beverages should be more closely aligned.

Two products are said to be substitutes if an increase in the price of one product induces a fall in the demand for that product and an increase in the demand for the other. Thus, wine and, say, beer would be considered substitutes if an increase in the price of beer leads to a fall in the demand for beer and a rise in the demand for wine. Conversely, wine and beer would be complements if an increase in the price of beer causes the demand for both beer and wine to fall.

The existence or otherwise of substitution within the alcoholic beverage group is hotly debated. Contemporary empirical work is limited. However, available studies tend to suggest that substitution between wine and other alcoholic beverages is of no greater statistical significance than substitution between wine and other goods and services. Some studies suggest there might be substitution between alcoholic beverages, while others suggest that alcoholic beverages might be complements for each other.

Some of the information provided to the Committee suggests that there is a degree of substitution among alcoholic beverages— particularly between beer and cask wine. For example, the WFA has, in the past, been concerned about substitution induced by changes in tax relativities. It stated (1993, p. 14):

There is evidence from previous significant relative price changes that substantial substitution occurs between different beverages as relative prices change. Indeed, the wine industry has faced increased competition from low alcohol beer since the tax on such beer was reduced.

Similarly, Australian Associated Brewers (AAB) (sub. 75, p. 4) stated:

Since the 1970s, the consumption of cask wine has substituted for the consumption of beer— cask wine has been a key competitor to beer.

The WFWGC submitted the results of a survey of household beverage preferences conducted on behalf of the WFA by the ABS as evidence that substitution between wine and other alcoholic beverages is less than that between wine and non-alcoholic beverages.¹ For the purposes of this survey, the ABS asked households to nominate their most frequently consumed alcoholic drink, together with the (alcoholic or non-alcoholic) drinks they would consume more of if their preferred drink was not available. In summary, the survey results indicated that:

- some 72 per cent of wine drinkers surveyed chose a non-alcoholic beverage;
- some 58 per cent of beer drinkers chose a non-alcoholic beverage; and
- some 62 per cent of spirits drinkers chose a non-alcoholic beverage.

However, the survey did not seek respondents' preferences in the event of a change in the price of their preferred alcoholic beverage, nor did it seek information about preferred non-beverage alternatives in the event that the

¹¹ ABS, Population Survey Monitor, May, August and November 1994.

preferred alcoholic beverage was not available. Accordingly, the results do not provide any evidence either for or against the proposition that substitution between wine and other alcoholic beverages is stronger than substitution between wine and all other goods and services. The results indicate only that, if the preferred alcoholic beverage is not available, most wine drinkers— if they are constrained to choose another beverage— would select a non-alcoholic drink (although a substantial number would choose another form of alcoholic beverage).

In submissions following the release of the draft report, the wine industry stated that, in its opinion, the available econometric and other evidence does not support the proposition that substitution between wine and other alcoholic beverages is stronger than substitution between wine and all other goods and services. On this basis, the WFWGC argued that there is no case for aligning the taxation regimes facing alcoholic beverages. The AWF supported the view of the WFWGC, stating that "wine is not a substitute to other alcoholic beverages therefore a parity in taxation with other alcohols such as beer and spirits is unwarranted".

The AAB challenged the wine industry view. It contended that there is substantial evidence that consumers substitute between wine and beer. The AAB provided a range of survey data showing that, to some degree, consumers of wine and beer overlap. Data from a 1994 survey of around 14 000 individuals show that some 42 per cent of people consumed beer or wine in the week prior to interview and that 13 per cent of these had consumed both beer and wine. Some 45 per cent of wine drinkers also drank beer and around 37 per cent of beer drinkers also drank wine in the week prior to interview. However, as with the survey data supplied by the WFWGC, these data do not reflect consumers' responses to price changes and so show only the possibility that substitution might occur.

Because of this limitation, the AAB commissioned a market survey undertaken specifically to investigate the issue of substitution between wine and other alcoholic beverages. Consistent with the 1994 survey, the AAB survey provided evidence to suggest that significant numbers of people consume both wine and beer. For example, around two-thirds of the wine purchasers surveyed— some 86 per cent of males and 48 per cent of females — also drank beer. The survey also indicated that, in the event of a 10 per cent rise in the price of wine, some 15 per cent of wine drinkers would switch their purchases wholly or partially from wine to another product. Of this group, about 20 per cent would change to beer, while just over one-quarter

¹² Brian Sweeney and Associates, 1995. Sample survey of 993 people who had purchased wine in the past month.

would choose some other alcoholic beverage (ie cider, spirits or mixed drinks). Just over one-quarter would purchase a non-alcoholic beverage, while a similar proportion would select some other non-beverage good or service. Thus, about half of the wine drinkers who would switch away from wine in response to a 10 per cent increase in the price of wine would purchase another alcoholic beverage, while about half would select an item from the much broader category encompassing all other goods and services (including non-alcoholic beverages). These outcomes indicate that, within the group surveyed, substitution between wine and other alcoholic beverages is as strong as substitution between wine and all other goods and services. However, it is not clear that the survey sample size and sampling techniques allow conclusive inferences to be drawn about the population at large.

External costs

Industry representatives contended that, unlike beer and spirits, there are very few external costs associated with wine consumption. For example, the WFWGC (transcript, p. 1252) stated:

... the wine industry ... is a very minor contributor to the external costs of alcohol, and that basically is because wine is a disproportionate contributor to the benefits of moderate alcohol consumption and a less than proportionate contributor to the costs of alcohol consumption.

Similarly, the VWIA (sub. 114, p. 23) stated:

There is strong evidence that the vast majority of wine consumption is in moderation and so does not give rise to significant social costs.

More generally, the WFWGC contended that taxation is not an efficient means of addressing problems caused by alcohol abuse. It argued (sub. 30, p. 204) that:

... the cultural issues regarding intoxication need to be addressed, and advertising and education are the appropriate vehicles to do this. Such a campaign is already being conducted by the alcohol industry and, in particular, the wine industry. However, despite advertising and education, alcohol consumption remains the responsibility of the individual.

As discussed in the preceding chapter, the Committee accepts that— in some respects — the circumstances in which wine is consumed differs from that of other alcohol. However, this does not necessarily mean that wine is not abused, or that the level of abuse is necessarily lower than that of alternative alcoholic drinks. In this context, the Alcohol and Other Drugs Council of Australia (sub. 49, p. 3) commented that:

Wine, like other alcoholic beverages, contributes to the social and health costs of alcohol use and abuse. Packaged or bulk wine is clearly the preference for

consumers who desire to become intoxicated as cheaply as possible. ... Due to its relative cheapness, bulk wines are often the first choice of people who desire to become intoxicated for the least amount of money.

While there was general agreement from participants involved in the health field that moderate consumption of alcoholic beverages could have a beneficial health effect, there was some debate as to the relative contribution of the different alcoholic beverages. Most authorities contended there was little difference, if any, in the contribution of the different alcoholic beverages. For example, the National Centre for Research into the Prevention of Drug Abuse commented that any benefit appears to relate to all forms of alcoholic beverage and not exclusively wine. However, as reported in the previous chapter, the AMA endorsed a recent study that reports health benefits arising from the consumption of wine, but not from beer or spirits.

There has been little empirical research directly linking wine consumption and behavioural patterns to support industry claims that the external costs associated with excessive wine consumption are minor, or to confirm claims such as that of the Alcohol and Other Drugs Council that considerable external costs are associated with the consumption of bulk wine. Equally, the evidence as to the differential health effects of wine and other alcoholic beverages remains contentious. However, the Committee considers industry statements that external costs are trivial or non-existent understate the true social costs. The availability of cask wine at prices which are not substantially higher than many soft drinks must, in the Committee's view, add to drinking problems and, hence, to external costs.

The Committee accepts that taxation is a relatively blunt instrument for addressing problems caused by alcohol in that it targets all drinkers rather than just those that abuse alcohol. The Committee also acknowledges that the success of taxation policy in reducing alcohol abuse may be limited. For example, by raising prices of alcoholic beverages, taxes almost certainly reduce incidents of binge drinking (because binge drinking is mainly associated with younger people who are likely to be more price sensitive), but price increases may have little effect on individuals addicted to alcohol. Nonetheless, as discussed in the previous chapter, there are also some shortcomings associated with alternative measures for addressing alcoholrelated problems (eg education programs). In these circumstances, the Committee considers that the case for the imposition of an 'alcohol tax' on wine cannot be dismissed.

Effects on the growth of the wine industry

A number of participants opposed any increase in taxation on the grounds that sales would contract and some smaller producers would be forced out of the industry. Others contended that any increase in tax over the existing general rate of WST would stifle growth prospects and lead to the abandonment of new investment proposals.

The IWA (sub. 61, p. 1), which represents mainly small wineries, stated:

... the increase in Wholesale Sales Tax (WST) from 20% to 24% and perhaps ultimately to 31% will slow or stop the potential growth of the Industry.

Similarly, the WIAWA (sub. 40, p. 19) claimed that:

... the Margaret River area alone constitutes an investment in wine infrastructure of approximately \$75 million— the future of this investment could be jeopardised by an unfavourable and unsympathetic tax regime.

One larger company— McWilliam's Wines (sub. 63, pp. 2–3)— expressed pessimism about future prospects if additional tax is imposed on the industry:

The company now faces a threat to its viability and future from existing overtaxation burden and now the intimidation of expanded taxation.

.... any incremental taxes of any nature would have damaging consequences for the McWilliam's company. Any illogical imposition of these taxes on the industry would impel the McWilliam's family to reconsider its development of their premium wine strategy, if not its overall future within the wine industry.

The effect of any increase in taxation on activity levels in the winegrape and wine industry will largely depend on the level and form of taxes and the supply and demand conditions for wine (ie the elasticities of supply and demand). As both sales tax and excise apply only to products sold in the domestic market, the adverse impact of any increase in tax on wine would initially be confined to domestic sales.

The impact on export sales is less certain. If, as some winemakers claim, returns on export sales are similar to those achieved on domestic sales, higher taxes on domestic sales would make exporting a more attractive proposition. Normally, a situation in which export returns are lower than returns in the domestic market would not be sustained because product would generally be diverted to the domestic market until such time as the returns are approximately the same. However, some participants stated that export returns are low relative to domestic market returns, and that the development of export markets depends on domestic sales (and margins) being maintained at current levels. Thus, some participants believe that any reduction in domestic sales or profit margins associated with increased taxation would impact adversely on the capacity of Australian producers to compete on export markets.

The effect of higher taxes on domestic sales is also uncertain. In this regard, the Commonwealth Treasury (sub. 95, p. 18) noted that, following the

increases in WST in August 1984 and August 1986, domestic sales did not fall.

It is relevant to note that sales tax was originally imposed on wine at the 10 per cent rate in August 1984. The sales tax rate was increased to 20 per cent (a 100 per cent increase) in August 1986. The data for domestic sales of wine in the years following these increases suggest that the price increases which followed the higher rates of sales tax resulted in lower growth of sales rather than reduced sales.

Total domestic sales of wine increased both after WST was first imposed and in each of the two years following the increase in WST to 20 per cent. In the latter two years, there was significant growth in sales of bottled wine. Total wine sales fell in 1988–89 and the subsequent two years, mainly due to a fall in sales of non-premium wine!³ However, the timing of the downturn suggests that it could have been due to factors such as shifts in consumer tastes and general economic activity, rather than the tax increases in the mid-1980s.

The Treasury's observation could be construed as implying that a relatively modest increase in tax, or a phased increase, would have little effect on the winegrape and wine industry. However, it needs to be recognised that the observation reflects past market conditions and does not take account of simultaneous changes in other factors which impinge on the demand and supply of wine (eg changes in the level of economic activity generally). Consequently, while the data provide useful historical insights, they cannot be accepted as convincing evidence of the effect of any further increase in tax on the industry.

From a taxation policy perspective, the key issue is whether a potential decrease in activity in the winegrape and wine industry— and an associated decline in some regional economies— would justify dispensing with a tax increase warranted on other grounds. In the Committee's view, an expected decline in wine industry activity would not, in itself, militate against a tax warranted on other grounds, unless the tax increase resulted in a particularly severe fall in activity or other exceptional circumstances were found to exist.

In essence, a tax increase is not viewed favourably by *any* industry. All industries can point to potentially adverse consequences that will follow a tax increase. Moreover, any increase in taxation avoided by one industry generally has to be compensated for by an increase in tax elsewhere in the economy. In other words, other sectorshave to bear higher tax burdens (and

¹³ Sales of non-premium wine declined each year between 1986–87 and 1990–91 (falling by 10.9 per cent in 1988–89 from the previous year). Sales of non-premium wine rose by 8.6 per cent in 1991–92 over the previous year, but have declined since.

face a decline in activity levels) to pay for tax concessions afforded industries singled out for preferential treatment.

Consequently, while the Committee considers that it is important that governments take account of the effect of increasing tax on the winegrape and wine industry, and on regions in which it is located, the likelihood of any decline in activity should not, of itself, be seen as an overriding consideration. Account must also be taken of broader economic benefits associated with the establishment of a more efficient tax regime. If change is considered to severely impact on particular regional economies, it may well be appropriate for governments to provide measures to help the region adjust to the changed circumstances rather than to defer the implementation of more efficient taxation arrangements.

Contribution to regional development

Many participants believed that, in considering the appropriate level and form of taxation, some allowance should be made for benefits associated with the industry's activities which they claim accrue to regions in which it is located. The underlying premise is that the industry generates external benefits for the region for which it is not fully compensated. In this context, particular mention was made of benefits said to flow to regions because of increased tourism and greater employment opportunities.

Arguments based on employment creation *isolation* are difficult to sustain, mainly because virtually all industries can claim to make financial outlays which directly boost demand, and employment, in local businesses. Consequently, even if it were accepted that employment maintenance and/or creation in rural areas was of benefit to the nation as a whole, there would be no convincing case for differentiating between the tax treatment accorded the wine industry and all other industries which contribute to regional employment.

However, when linked with tourism, the argument is somewhat different.

A number in the industry claim that, in many regions, wineries are the focal point of tourism, and that the tourists they attract benefit other local businesses and promote growth in the region generally. While the industry can negotiate to share in the benefits of business it directs to local suppliers (ie negotiate on conditions of sale), this is more difficult to achieve when there is no direct financial transaction involved. Consequently, it is quite possible that some local businesses profit from tourists attracted to regions by wineries. However, it is important to recognise that:

- wineries are not unique in their capacity to attract tourists. The are frequently a number of natural features and commercial activities that contribute to regional tourism such as theme parks, resorts, sporting facilities (eg golf courses and race tracks), cottage industries, restaurants and clubs, commercial activities centred around natural attractions (eg forests, caves, beaches, nature reserves etc) and historic buildings/monuments;
- while other regional activities (as well as wineries themselves) may benefit from tourists attracted to the region by wineries, wineries also benefit from those who visit the region for other reasons (eg to holiday at a resort or to view scenic attractions); and
- if wineries consider they are providing significant benefits to other commercial activities in a region, there is some scope for them to appropriate some of the benefits themselves by extending their commercial interests. To some extent, this is already occurring as evidenced by the establishment of restaurants, craft shops and motels by wineries, or by other commercial interests in conjunction with wineries.

The Committee acknowledges that there could well be some substance to the industry's argument for some regions and for particular wineries in those regions. However, in the Committee's view, it is not at all clear that the winegrape and wine industry *as a whole* generates significant regional benefits for which it receives no compensation. In these circumstances, an industry wide— or state-wide— tax concession, such as a reduction in WST or a tax exemption for wine sold at the cellar door, is not an efficient means of dealing with the issue. To the extent that regional development is a government policy objective, it is likely to be more efficiently addressed by generally available regional measures (regional grants) rather than by selective assistance to particular industries or activities.

Wine production processes are unique

Another justification for special consideration in relation to taxes on wine advanced by the industry is the perceived 'unique' nature of the wine production process. Participants gave specific examples of this 'uniqueness', including the industry's vulnerability to seasonal influences and natural hazards, the four year lead time before vines become productive and the need to hold significant stocks!⁴ They argued that these factors distinguished wine from most other activities, and particularly from the brewing industry which was characterised by some winemakers as a '365 day a year industrial process'. In addition, winemakers claimed that the nature of their product

¹⁴ The tax treatment of stock is discussed in Chapter 12.

promotion provides general benefits to Australia because wine's 'clean and green' image attracts tourists to Australia and buyers to other Australian products.

The Committee acknowledges that there may well be some features which are unique to the wine industry. However, just as winemaking is characterised by, for example, a heavy dependence on holding stocks of some wine types and a susceptibility to natural hazards, so other industries have their own particular characteristics. For example, the hospitality industry is labour intensive, wheat farming requires large areas of land, and timber production involves long periods of stock holding. Similarly, a number of industries promote their products overseas as being 'clean and green'.

Structuring tax measures to take account of any particular industry's operating characteristics, or with the level of risk associated with the manufacture of its products, would have wide implications. It is likely that virtually every industry would be able to point to 'unique' characteristics to support a case for special tax treatment. Taking the concept to a logical conclusion, it would mean that butter— being the product of a primary industry subject to natural hazards and with a considerable lead time-would be taxed differently from margarine, which some would say is more a manufactured product. Similarly, woollen, cotton. acrvlic and natural/synthetic blended clothing would all be taxed differently. Even within the wine industry, it would imply that red wine should be taxed generally less than white wine, and some red wine less than other red wine depending on maturation periods. For these reasons, the Committee does not consider that providing special tax treatment for different industries on the basis of their 'unique' operating characteristics makes a great deal of sense.

Neither does the Committee see a strong case for preferential tax treatment for wine on the basis of its promotion of a 'clean and green' image. Were special tax treatment to be provided for the wine industry for this reason, industries which also promote a healthy image overseas— eg travel and tourism would have a basis for claiming equivalent treatment. In any case, it is not clear that the wine industry itself does not appropriate most of the benefits of its product promotion.

Overseas taxation and subsidisation of wine producers

Some advocates for a reduction in the rate of tax applying to the Australian wine industry justified their argument on the ground that other countries—particularly other wine producing nations—place a lower taxation burden on their domestic wine industry than does Australia and offer significant subsidies to their domestic industry.

The WFWGC (1994, p. 9) stated that:

... successive tax increases have moved Australia's effective wine taxes to a level more than 2.5 times greater than the average imposed in other wine producing countries.

Southcorp (transcript, p. 729) commented that:

Australia is the second highest taxed wine producing country in the world - New Zealand just happens to be the highest - and the tax on Australian wine is about two and a half times that of the average of the other wine producers, and its about eight times higher than the tax on the lowest taxed wine producer, which just happens to be Italy.

In relation to subsidies provided by overseas countries to their domestic industries, Southcorp (transcript, p. 878) stated:

... tax isn't the major issue. ... the combined impacts of the subsidies ... you're talking about \$US3 billion [provided by the European Community], ... the Australian equivalent of that would be \$210 million ... and ... the US Government hands across to the Californian wine industry \$9 million to mount generic marketing programs. These are the real international competitive issues.

The most recent overseas data available to the Committee on revenue collected from alcohol taxation relate to 199^{11,5} In that year, most European countries — including France, Germany, Spain, Portugal, Belgium, Austria and the Netherlands— collected between 1 per cent and 1.6 per cent of total revenue from alcohol taxes. Japan collected 1.5 per cent of revenue from taxes on alcoholic beverages. Higher taxes were collected by the United Kingdom (4 per cent) and lower taxes by the United States (0.9 per cent). By comparison, Australia collected some 2.4 per cent of its total tax revenue from alcoholic beverages.

Australia's taxation of domestic wine consumption is also high compared with other wine producing nations. Amongst the wine producers, only in New Zealand was taxation of wine higher than in Australia in 1991⁶. At that time, taxation of domestic wine consumption by the major European wine producing countries— Italy, France and Spain— was around one-eighth to one-third the level of Australia. On the other hand, taxation of domestic wine consumption by many non-wine producing nations was far higher than in Australia. For example, the level of taxation in Canada, the United Kingdom

¹⁵ Total revenue collected by the Federal and regional governments.

¹⁶ In New Zealand, there is an identical excise on wine and beer (currently \$NZ18.023 per litre of alcohol) and a higher excise on spirits (currently \$NZ32.824 per litre of alcohol), in addition to a goods and services tax of 12.5 per cent which applies to all goods and services.

and Denmark was more than double that in Australia. Tax on wine in Sweden, Norway, Finland and Ireland was even higher.

The most recent taxation data for European countries available to the Committee show that, at 1 April 1994, the major wine producing countries applied a value added tax (VAT) at rates of between 13 and 19 per cent to wine consumption, with minimal or nil excise. Table 11.7 illustrates the taxation of wine in Australia and a number of European countries.

A further international comparison which concerns the wine industry is the extent to which taxation impacts on Australian winemakers relative to producers of other alcoholic beverages.

In most countries, the total taxation burdeh⁷ — as gauged by the equivalent tax on alcohol contained in the beverage— is higher for distilled spirits and beer than for wine. On average, Western nations in 1991 taxed spirits at about twice the rate of beer, and table wine at about 90 per cent of the rate of beer. Wine producing countries tended to tax wine more lightly than this. For example, in 1991, France taxed table wine at about 50 per cent of the level of beer and Italy taxed table wine at about 10 per cent of the level of beer (Brewers Association of Canada, 1992, p. 523). By comparison, the ad valorem equivalent taxes on table wine and beer in Australia are 42 per cent and 92 per cent respectively (see Table 11.3).

¹⁷ Including specific alcohol taxes and general consumption taxes.

Country	Tax on wine 1991	Tax on wine April 1994		
	(\$US per gallon of pure alcohol)	value added tax (%)	excise (\$A per litre of alcohol)	
Australia	48.19 ^a	b	0	
Belgium	60.68	20.5 25.0 18.6	0.61 ^c	
Denmark	101.14		1.40 0.05	
France	13.91			
Germany	28.14	15.0	0	
Greece	n.a.	18.0	0	
Ireland	164.56	21.0	4.40	
Italy	6.67	13.0	0	
Luxembourg	6.14	12.0	0	
Netherlands	48.06	17.5	0.80	
Portugal	15.72	5.0 ^d	0	
Spain	18.73	15.0	0	
United Kingdom	119.64	17.5	2.80	

Table 11.7: Illustrative comparisons of taxation arrangentse for wine in Australia and European countries

12 per cent with effect from 1 January 1993. As at 1 April 1994, Portugal had yet to take action. Sources: Commonwealth Treasury; Steve L. Barsby and Associates Inc (1994); Brewers

d EC Directive 92/77/EEC required VAT rates on alcoholic beverages to be increased to at least

Association of Canada (1992)

While the above comparisons demonstrate that consumption taxes on wine are higher in Australia than in most wine producing nations, they do not in themselves 'prove' that the wine industry in Australia is overly taxed. It will always be possible to find examples of tax regimes for particular industries which are lower overseas than in Australia. Moreover, a comprehensive comparison of taxation rates would require consideration of all direct and indirect taxation and related arrangements (eg company taxes, depreciation allowances etc), as well as any infrastructure and services provided by governments at concessional rates. The Committee accepts that investment decisions by larger companies are influenced by taxation regimes prevailing in different countries. However, from the perspective of a nation, it is simply not practical, or efficient, to determine (or change) levels of taxation for particular industries based on the most 'competitive' overseas rate. More fundamentally, given Australia's size, its geographical isolation, its low population density, its physical endowments and its culture, there is no reason why Australia's tax structures should mirror those of any particular overseas country. In this context, there is little to be gained in arguing that Australia should directly match overseas tax arrangements.

In considering the comparative taxation environments of Australia and its competitors, it should be noted that exports are not subject to either the WST or excise. As a consequence, any taxation disadvantage suffered by the Australian wine industry compared to wine industries in other countries is unlikely to directly affect the ability of Australian wine to compete on international markets.

In contrast, taxes imposed by overseas countries which discriminate between domestic wine and imported wine and subsidies provided by overseas governments to their domestic wine industries can erode the capacity of Australian wine to compete overseas. However, such matters are better dealt with through negotiation at the international level, rather than by Australia providing 'compensating' tax treatment or subsidisation for its wine industry. In this regard, the agreement on agriculture arising from the Uruguay Round of multilateral trade negotiations should reduce some of the distortions to free trade reported by Southcorp. The long term objective of the agreement on agriculture is to establish a fair and market oriented agricultural trading system to be achieved through progressive reductions in agricultural support and protection. As part of the process, the European Community (EC) agreed to abolish its reference price system for wines (a minimum import price system) as of 1 July 1995, and ruled out replacing it with a tariff. In addition, member countries of the World Trade Organization are required to progressively reduce export subsidies and the volumes of exports benefiting from such subsidies. In common with other commodities, subsidised wine exports will have to be reduced in quantity by 21 per cent over six years and financial outlays for subsidies will have to be reduced by 36 per cent. The EC has already reduced refunds for most wine exports to non-EC countries by 20 per cent and, more recently, has reduced financial outlays for subsidies to wine producers by an additional 10 per cent⁸.

Revenue collected is increasing in absolute terms

According to the WFWGC, the increase in the rate of WST to 26 per cent, the overall growth in wine sales and the increasing proportion of the market held

¹⁸ FAO Committee on Commodity Problems, Intergovernmental Group on Wine and Vine Products, 1994.

by bottled wine, mean that tax on wine will yield an additional \$123 million in revenue over the four years to 1996–97. The WFWGC believes this increase is, in effect, a form of 'bracket-creep' which far exceeds projected increases in revenue collection generally and for the alcoholic beverage sector as a whole. Some in the industry also argue that, at current tax rates, with domestic sales of bottled wine forming an increasing proportion of total domestic wine sales, the tax paid by wine on a per litre of alcohol basis will eventually move to a level commensurate with beer.

Increasing taxation revenue is a feature of a growing economy. In the current circumstances, virtually all industries— not just the wine industry— are likely to be making larger contributions to taxation revenue. Accordingly, the increase in tax revenue collected from the wine industry is not in itself an argument for reducing the rate of tax applying to wine.

As a result of increasing sales of higher priced bottled wine relative to nonpremium wine, the overall level of tax on wine, when considered on a volume of alcohol basis, is moving a little closer to that on beer. However, on this basis, there is still only a small proportion of sales taxed commensurately with beer.¹⁹

While comparisons on a per litre of alcohol basis may be appropriate for considering the taxation revenue collected for addressing the external costs of alcohol consumption, they are not appropriate for considering the incidence of a tax for revenue raising purposes. The appropriate measure is the incidence expressed in ad valorem terms. As noted above, the ad valorem tax on wine is substantially lower than that on beer and spirits.

PART B: THE COMMITTEE'S RECOMMENDATIONS

The Committee has tried to identify the most appropriate form and level of taxation arrangements for the winegrape and wine industry. In making its recommendations, the Committee has relied on its own analysis and, of necessity in a task of this nature, a degree of judgment.

The Committee has reached agreement on the form of the taxation arrangements which should be applied to wine. However, it has reached two

¹⁹ At 26 per cent WST, bottled table wine retailing at \$10 and \$15 would be taxed at about \$15 per litre of alcohol and \$21 per litre of alcohol respectively. Regular strength beer is taxed (WST and excise on the alcohol content above 1.15 per cent) at about \$20 per litre of alcohol and low alcohol beer at about \$21 per litre of alcohol. When the state and territory licence fee is taken into account, the tax per litre of alcohol for bottled wine (retailing at \$10 and \$15) and regular beer is approximately \$20, \$29 and \$25.60 respectively.

different conclusions on the appropriate level of tax. This part of the chapter summarises the analysis underlying the Committee's recommendations, reports the agreed recommendation on the form of the tax and outlines the majority and minority opinions on the level of the tax.

The Committee commissioned the CIE to undertake a major research project, including the development of a winegrape and wine industry econometric model. The Committee's intention was to use the CIE's work to assist its understanding of the industry and to help gauge the possible long term effects of the taxation options under consideration.

The CIE's research showed that the key wine demand and grape supply elasticities — which measure the response of wine consumers and grape growers to changes in price — are critically important to its model of the industry. However, despite investing considerable resources in the collection of information, the CIE could not obtain sufficient reliable data to develop contemporary estimates of the key parameters. As a result, the CIE used previous estimates, about which the Committee has considerable reservations. Because of this, the Committee has relied upon only the general information about the industry provided by the CIE.

11.5 Taxation recommendations

The Committee believes that there are two major factors that must be considered in determining the level of taxation of wine. First, as far as possible, the tax should not impair economic efficiency— ie revenue should be raised in a manner that does not bias consumption and production decisions (unless this is intended). Second, the tax on wine should, to some degree at least, reflect any external costs associated with the consumption of wine.

From an economic efficiency perspective, it could be argued that it would be best to pursue revenue raising objectives by imposing a broadly based consumption tax on all goods and services (thus widening the tax base, treating all goods and services neutrally and minimising the incentive for tax avoidance activity). Within this framework, external costs could be addressed by the application of an additional tax on products which impose costs on other groups in the community. However, this would entail a comprehensive review of Australia's present taxation arrangements and is clearly beyond the scope of the terms of reference for this inquiry. Consequently, in developing its recommendations for the taxation of wine, the Committee has accepted as fixed the broad parameters of the existing taxation framework, including the taxation arrangements applying to possible substitutes with wine.

Revenue raising

On efficiency grounds, there is some argument for taxing products which are relatively price inelastic at higher rates than other goods and services. In this context, there is some evidence to suggest that the price responsiveness of demand for ultra-premium, premium and non-premium wine is different (ie the demand for non-premium wine is the most responsive to price changes). In this situation, a higher tax imposed uniformly on all types of wine may not be an efficient means of raising revenue. While it might be argued that the taxation arrangements could be structured to distinguish between ultrapremium, premium and non-premium wine, the Committee considers that this approach would suffer significant administrative drawbacks. It could also encourage producers to move their product between the different wine categories in order to take advantage of any taxation advantages available to one category over the others.

Competitive neutrality considerations— reflecting judgments about the extent to which wine and other goods substitute for each other— suggest three possible levels at which the rate of WST on wine might be set for revenue raising purposes.

First, as outlined in Section 11.2, there is great diversity in the indirect taxation applied to goods and services consumed in Australia. Many goods (eg most food and clothing) and most services are free from tax. On the other hand, the consumption of a few products— such as cigarettes and petrol— is very heavily taxed, with some being taxed at equivalent ad valorem rates of well over 200 per cent. Taxes and charges are levied in respect of services such as gambling, insurance and banking, while the consumption of some other services is subsidised. The average expenditure-weighted level of taxation on all goods and services is in the order of 15 per cent. The revenue raising component (ie after excluding indirect taxes imposed for externality reasons or as user charges) is about 10 per cent.

According to some Australian studies, the substitution in consumption between wine and other alcoholic beverages is not statistically different to the substitution between wine and other goods and services. If this premise is accepted, there is a case on neutrality grounds for taxing wine, for revenue raising purposes, at around the average for all goods and services— ie 10 per cent.

The second scenario which might be used to establish the appropriate level for a revenue raising tax on wine presumes that wine is most closely substitutable with other beverages, including non-alcoholic beverages such as mineral water, soft drinks and milk. Tea, coffee, pure milk and water are exempt from WST. Most non-alcoholic beverages— such as carbonated soft drinks and mineral water— are taxed at the general rate of 22 per cent. Beer and spirits pay WST of 22 per cent although, as argued above, if it is recognised that a significant part of the excise component is for revenue raising purposes, their contribution to revenue is significantly higher than 22 per cent. Hence, on the basis that the primary substitution is between wine and all other alcoholic and non-alcoholic beverages, a tax on wine for revenue raising purposes of 22 per cent could be justified.

Third, it could be argued that the primary substitutes for wine are other alcoholic beverages — most notably beer — and that, as a result, it is appropriate to tax wine for revenue raising purposes in similar fashion to beer and perhaps spirits. If wine and beer*are* substitutes for each other, there is a strong case, on economic efficiency grounds, for a more uniform taxation regime. On the basis that a considerable portion of the excise on beer has been imposed for revenue raising purposes, there is a case for imposing WST on wine at a much higher rate than 22 per cent.

Concerns about the efficiency of resource use arising from possible substitution among alcoholic beverages generally, and between wine and beer in particular, could, in principle, be addressed by reducing the taxation of other alcoholic beverages. However, as discussed above, the Committee considers that this option is beyond this inquiry's terms of reference.

External costs

In recent years, some tax rates have been influenced by the view that the social costs of certain activities are not fully reflected in market prices. Thus, a high tax on cigarettes is justified, in part, as a means of reducing harmful tobacco consumption, and the excise differential between leaded and unleaded petrol is seen as a means of reducing a particularly harmful pollutant.

In this context, considerable debate has ensued about the extent to which consumption of wine contributes to the costs associated with alcohol abuse. There are arguments that moderate consumption of alcohol, particularly consumption of certain types of wine, provides a health benefit. The wine industry also argues that the circumstances in which wine is consumed means that it does not contribute to external costs to the same extent as beer and spirits.

The empirical work necessary to substantiate these claims is, at the present moment, limited. While there are studies that show that moderate consumption of wine (and other alcohol) can be beneficial, there is no substantive research about the level of abuse associated with the different alcoholic drinks. Consequently, while the Committee accepts that there are differences in the consumption patterns of wine and other alcoholic beverages, it cannot accept that wine does*not* contribute to some extent to long term alcohol-related health problems and to external costs associated with alcohol abuse. This is particularly the case given the ready availability of a cheap, high alcohol product in the form of cask wine and some fortified wines sold in flagons.

Even if it is assumed that the existing tax on alcoholic beverages above the 22 per cent general WST rate is a contribution towards meeting the external costs of consumption, it is clear that wine currently pays little compensation for external costs. Assuming 1993–94 alcohol consumption figures, and leaving aside state and territory licence fees, the revenue collected from WST above the general rate on wine and the excise on beer and spirits— expressed in terms of alcohol by volume for each beverage— was roughly \$1 per litre of alcohol, \$11 per litre of alcohol and \$29per litre of alcohol respectively.

The Committee accepts that the total tax (ie including state and territory licence fees) on more expensive ultra-premium wine (ie bottled wine retailing for about \$15 per bottle)— expressed in terms of tax per litre of alcohol— exceeds that on beer, and that the growing popularity of bottled wines means that, overall, taxation of wine per litre of alcohol is moving closer to taxation on beer over time. However, the extent of the existing discrepancies, and the small market share held by ultra-premium wine, suggest that the tax paid by the various alcoholic beverages will remain substantially different for a considerable period of time if the current taxation arrangements are unchanged.

To the extent that wine drinkers are not meeting the full costs to society of wine consumption, winemaking and wine consumption are being subsidised by other economic activities. Furthermore, any external cost objectives of taxing alcohol products more highly (ie encouraging reductions in alcohol consumption) will be eroded over time if consumers are able to substitute from high taxed beverages (beer and spirits) to lower taxed wine. Such substitution, while benefiting the wine industry, is not necessarily of benefit to society as a whole.

The form of tax

As described above, some participants sought a purely volumetric tax in place of the current WST. However, the Committee considers that there are a number of difficulties with this approach. Most importantly, while a volumetric tax would have some benefits in targeting alcohol abuse, it would not be the best way to meet the revenue raising objective of wine taxation. Unlike an ad valorem tax, which maintains the relativity between pre- and post-tax prices of different products, a volumetric tax would result in non-premium wines bearing the major proportion of the revenue raising burden. This would artificially bias investment decisions in favour of premium wine production and the objective of tax efficiency would be lost. Thus, a purely volumetric tax would not be the most efficient means of addressing *both* of the major objectives underlying the imposition of the tax in the first place. There is also a high potential for regional disruption— a purely volumetric tax would impact very heavily on regions producing non-premium grape varieties.

As outlined above, the primary rationales for taxing the domestic consumption of wine are, first, to raise revenue efficiently and, second, to compensate the community for the external costs imposed by excessive consumption. On economic efficiency grounds, a tax imposed for revenue raising purposes should be imposed as a proportion of product value, ie as an ad valorem tax, and imposed uniformly across the range of substitutable products.

The costs imposed on the community attributable to alcohol consumption and, in particular, the component attributable to wine consumption vis-a-vis the consumption of other alcoholic beverages, is contentious. However, irrespective of the extent of the costs, there are sound reasons why, in principle, a volumetric tax based on alcohol content rather than an ad valorem tax is the preferred form of tax for dealing with such externalities. The fundamental reason is that a volumetric (or specific rate) tax can be directly related to the cause of the externality— the amount of alcohol contained in alcoholic beverages. In contrast, an ad valorem tax can only be related to product values. Hence, its incidence varies according to value. Thus, for a given ad valorem tax rate, the amount of tax paid per litre of alcohol will be least for non-premium wine and most for ultra-premium wine. This variation in tax is highly unlikely to accord with the extent to which the different wine types are abused.

The Committee accepts the concerns expressed by representatives of the alcohol industry that taxation is a relatively blunt instrument for dealing with alcohol consumption problems because it targets all drinkers rather than just those who abuse alcohol. It also acknowledges that the alcohol industry—including the wine industry— is taking a number of steps to reduce abusive consumption. However, there are some difficulties with alternative approaches to addressing problems of abuse (see Chapter 10). In these circumstances, the Committee considers there is a case for taxing wine to help

meet external costs, in conjunction with other measures such as education and policing programs.

The Committee proposes a composite tax on the domestic consumption of wine, levied as an ad valorem WST coupled with a specific rate (volumetric) tax collected at the consumption stage in conjunction with the WST. This would most efficiently address both the revenue raising and externality objectives of taxation.

In the Committee's view, a composite tax could be imposed with relatively little addition to administration costs by establishing an arrangement whereby broad categories of wine are deemed to contain a certain quantity of alcohol. The deemed tax rates should take account of the total alcohol content of the product. For example, in relation to fortified wine, it should take account of the alcohol contained in the base wine *and* the alcohol contained in the fortifying spirit. The composite tax should be collected by the ATO — the body responsible for collecting the current ad valorem WST.

The recommended deeming arrangement is:

- wine and wine products with alcohol content no more than 1.15 per cent would be deemed at 0 per cent;
- wine and wine products with alcohol content greater than 1.15 per cent but no more than 5 per cent would be deemed at 3.5 per cent;
- wine and wine products with alcohol content greater than 5 per cent but no more than 8 per cent would be deemed at 6 per cent;
- wine and wine products with alcohol content greater than 8 per cent but no more than 15.5 per cent would be deemed at 11 per cent; and
- wine and wine products with alcohol content greater than 15.5 per cent would be deemed at 17 per cent.

The majority view — Mr Croser and Professor Freebairn

Introduction

Mr Croser and Professor Freebairn consider that any recommendation to change the existing taxation arrangements of the Australian winegrape, wine and brandy industry must demonstrate:

- that the change is alleviating an historical inconsistency in the tax treatment of wine or brandy with respect to other products; and
- that the change will improve the overall allocation of Australia's resources.

Further the recommendation for change must take account of the effects of change on the winegrape, wine and brandy industry, the need for adjustment arrangements and the revenue and expenditure implications for government.

There are a number of special taxation arrangements which have evolved between government and the wine industry. Examined against the context of taxation efficiency and equity, some change to these arrangements can be recommended. The removal of such anomalies is most likely to move the economy in the right direction despite the immediate detrimental effects on a significant component of the winegrape, wine and brandy industry.

The fact that beer and spirits are both subject to a volumetric tax which is more than sufficient to compensate for the net external costs to the community of excessive alcohol consumption, and that wine is not subject to this form of taxation, is one such anomaly. The rationale for a volumetric tax is that it is applied on the quantity of alcohol consumed and therefore recovers costs in proportion to the underlying cause of the net external costs to society (ie alcohol).

Despite the fact that, in many cases, the excessive consumption of alcohol is only the effect of more fundamental causal factors in society, Mr Croser and Professor Freebairn recommend a change to the structure of the WST on wine to include a volumetric component.

However, any change to the aggregate level (as opposed to the form) of taxation on wine requires rigorous and robust proof of improvement to the overall allocation of Australia's resources. In Mr Croser's and Professor Freebairn's opinion, that proof is lacking.

In the absence of convincing evidence that change to the aggregate level of taxation on wine will improve the allocation of Australia's resources, Mr Croser and Professor Freebairn recommend that the aggregate level of indirect tax collected from the wine industry by the Commonwealth Government not exceed that from the 26 per cent ruling WST rate.

Because of the evolution of the mix of wine products sold domestically, the new recommended mixture of an ad valorem and a volumetric tax will not yield a constant or exactly equivalent amount for aggregate tax revenue as the 26 per cent WST in future years. The amount of tax which would be collected by the 26 per cent WST in 1995–96 has been used to establish the combined and ad valorem taxes required for revenue neutrality.

General reasoning

There is significant doubt and uncertainty that change in the aggregate indirect taxation of the wine industry would improve the productivity of the overall allocation of Australia's resources.

There are two apparent reasons for taxing wine:

- to signal to domestic wine consumers the cost to society of the external damage on third parties of wine consumption and to recover costs of alleviation programs; and
- the contribution of wine, as a subject of indirect taxation, to the general revenue of the Commonwealth Government.

An appropriate recovery of the external costs of wine consumption to society involves the measurement of the overall external damage/costs to society of alcohol abuse, less any external benefits of moderate consumption, and the apportionment of the share of the total to wine according to its role.

Determining the appropriate revenue contribution involves the identification of those items of consumption which compete with wine for the consumer's dollar, and ensuring that the taxation system does not unfairly (inefficiently) bias consumer expenditure and use of scarce resources to any one or other of those products, including wine.

The doubt and uncertainty that a significant change in aggregate indirect taxation of the wine industry would improve the overall allocation of Australia's resources is derived from:

- conceptual difficulties, and most especially empirical uncertainties, in the measurement of the external costs of excessive alcohol consumption, and further difficulty in determining wine's share;
- conceptual difficulties, and especially empirical uncertainties, in the measurement of the external benefits of moderate consumption of alcohol in general and wine in particular;
- the lack of certainty about which products compete more strongly with wine for the consumer's dollar and the widely varying and inconsistently applied levels of indirect taxation among those products; and
- doubts about the severity of effect on the industry itself of a change in the aggregate level of indirect taxation on wine, and therefore on the

adjustment costs to the community and the revenue and expenditure implications for the Government.

Given all of this uncertainty about the gross benefits of change, combined with the uncertainty about the incidence, and uncertainty about the extent of the costs of change, Mr Croser and Professor Freebairn judge that change cannot be justified by the evidence at hand and that change is unlikely to increase the efficiency of the allocation of Australia's resources.

However some things are clear:

- beer and spirits are not the only, nor probably the most important, alternatives for the consumer's expenditure on wine;
- beer and spirits have been used historically as extraordinary revenue providers by government and the current high level of taxation imposed on those products in all probability does not lead to the most efficient allocation of Australia's resources; and
- excessive consumption of alcohol does cause costs to fall on others in society and a part of the solution is to impose a tax on the underlying source, namely alcohol consumed via wine.

Mr Croser and Professor Freebairn therefore recommend a shift of part of the ad valorem tax now imposed on wine to compensate for the net external costs of consumption, to a tax on the volume of alcohol (volumetric tax). This proposed change in the form of taxation on wine will cause significant adjustment problems particularly for growers of non-premium grapes in the hot irrigation areas and, thus, a forewarned and extended adjustment period is proposed.

Externality arguments

While many of the benefits and costs of wine consumption fall on the consumer, there are some costs and benefits which also fall on third parties. In terms of an efficient allocation of national resources and, in some senses, from an equity perspective, wine consumers should include these external or spillover effects in their decisions. A tax representing the net effect of the externalities is one way of achieving this adjustment.

Mr Croser and Professor Freebairn are concerned about the methodology of estimating external costs and especially of the ability to achieve meaningful numerical estimates, given the wide range of estimates from the most recent studies and the very broad and controversial assumptions upon which they are based. The most recent quantitative studies for Australia are those of Richardson and Crowley (1991) based on a mixture of Australian and overseas data, and Collins and Lapsley (1990) whose work is based on 1988 Australian data. The Tasman Institute has done an analysis of the Collins and Lapsley study to achieve an external cost of all alcohol consumption to the community of \$896 million per annum, based on 1988 data. These studies are examined in more detail in Chapter 10.

Alcohol — the external costs

The areas and gross assumptions generating uncertainty are:

- whether alcohol is the main or sole cause of these external costs, given that the consumption of alcohol may be an effect of other underlying problems rather than a primary cause of those costs. Underlying social problems contribute to some of the most abusive circumstances;
- whether 30 per cent of all alcohol consumed is consumed in abusive circumstances, a figure the Collins and Lapsley study relies upon for its estimates;
- the external costs of motor vehicle accidents; clearly the costs borne by consumers and those relating to their vehicles are private costs and those of innocent third parties are external costs. The case of willing passengers and damage to third party property, given insurance, is mixed although primarily a private cost;
- health costs; a fundamental issue is to obtain estimates of the cost of alcohol abuse over the lifetime of an excessive consumer of alcohol relative to those of other people over their lifetime. Also, some part of those net health costs are private costs, a point missed in the Tasman Institute estimates; because of private insurance and because of some co-payments with Medicare; and
- health benefits; information about the benefits of moderate alcohol consumption has really emerged strongly only in the past few years and both Collins and Lapsley (1990) and Richardson and Crowley (1991) were published before the extent of those benefits has become more apparent.

The September 1994 edition of the Journal of the American Medical Association (JAMA) contains a technical paper on the apparent beneficial role of moderate alcohol consumption on cardiovascular disease. The paper outlines a new mechanism of protection to complement the known existing cardiovascular protection mechanism of moderate consumption of alcohol. The editorial of this edition of the JAMA reflects on "the clinician's conundrum" with respect to patient care when the number of alcohol-related deaths in America in a year is 100 000 and the mean estimate of additional oronary heart disease death that would occur because of abstinence is 8 000.

The JAMA editorialises that "generalised messages to abstain from alcohol are probably no more responsible than generalised recommendations to drink it".

Evidence to support the specific health benefits of moderate wine consumption relative to other alcohol is provided by an authoritative Danish study of 6051 men and 7234 women published in the British Medical Journal (volume 310) in May 1995.

The study concluded that the isk of dying steadily decreased with an increasing intake of wine— from a relative risk of 1.00 for the subjects who never drank wine to a 0.51 (95 per cent confidence interval 0.32 to 0.81) for those who drank three to five glasses a day. Intake of neither beer nor spirits, however, was associated with reduced risk.

worker productivity costs: Mr Croser and Professor Freebairn accept that excessive alcohol consumption reduces worker productivity. The real question and uncertain answer is how much of this lower productivity is reflected in slower rates of promotion and higher rates of dismissal, clearly private costs, and how much is disguised to the employer and absorbed as lower wages all round. Almost certainly the answer is a bit of both.

Whatever the balance, the new culture and environment of the Australian workplace with more emphasis on quality assurance and international competitiveness is becoming less tolerant of, or conducive to, alcohol abuse during work hours.

The new fringe benefits tax regime and changed corporate attitudes to the 'business lunch' are surely contributing to the amelioration of alcohol-related productivity costs.

Wine — the external costs

There is some empirical evidence leading Mr Croser and Professor Freebairn to believe that the external costs per litre of absolute alcohol consumed as wine are less than for other forms of alcohol.

Empirical studies of alcohol consumption by age, sex, socio-economic groupings, and occasions, included in the Australian Bureau of Statistics 1994 Population Survey Monitor (May, August and November surveys aggregated) indicate the following.

- Some 74.5 per cent of wine is consumed mainly with a meal. (An AGB McNair survey of 1048 consumers, commissioned by the WFA, found 77 per cent of wine was consumed with food compared to 11 per cent of beer and 7 per cent of spirits.)
- Wine is consumed in abusive sessions (more than four standarddrinks per session) at a much lower frequency than other alcohol beverages, except light beer. (See Table 11.8 below.)

Table 11.8:		beverages, drinl ard drinks per s	•	ns greater tha
Gender	Alcoholic beverage			
	Wine	Full strength beer	Spirits	Light beer
Male	24.4	57.2	30.7	15.4
Female	19.2	41.8	21.3	8.4

- Young consumers (18–24) prefer wine least as their alcohol intake (beer 33.5 per cent, spirits 20.1 per cent and wine 11.3 per cent). Their propensity to consume wine relative to other alcohol beverages has been declining (21 per cent 1977, 18 per cent 1989–90) against a background of increasing wine consumption by the total population. These, along with the socially disadvantaged, are the most at risk group to alcohol abuse of the population.
- The preferred alcoholic beverage of the 45 and older age group is wine. Of those surveyed, 33.5 per cent of people between 45 and 64 drank wine versus 29.3 per cent for beer and 11.6 per cent for spirits. Australia's greying population implies a shift of weighted wine consumption from young age groups to older age groups with time. The older age groups are the least at risk to the damage and cost of alcohol consumption but the most at risk from cardiovascular disease.

In the words of the editorial of the September 1994AMA, "the relative number of deaths attributable to alcohol abuse versus abstinence varies markedly with age, with an excess of alcohol related deaths in the 15 to 44 year range and a reduction in coronary heart disease deaths in men and women aged 45 years or older". Not only is the cost of alcohol consumption disproportionately skewed away from wine with respect to other alcohol beverages, but the benefits of moderate alcohol consumption (cost reductions) are skewed towards wine.

• In a survey of 381 drinkers admitted to hospital, 76.5 per cent had been consuming beer, 26.7 per cent spirits and 6.9 per cent wine, of those who had consumed alcohol (University of Adelaide and the National Health and Medical Research Council Road Accident Research Unit, 'Drinking Behaviour and Other Characteristics of Injured Drivers and Riders').

It is difficult, if not impossible, to settle on a correct weighting of wine's contribution to alcohol related costs relative to other alcoholic beverages and it is equally difficult to settle on a weighting of wine's contribution to the benefits (reduced costs) of alcohol consumption with respect to other alcoholic beverages. Suffice it to say there is a considerable body of empirical evidence that wine is relatively benign with respect to all alcohol both as a contributor and ameliorator of costs to the community.

Externality treatment — conclusions

Despite the considerable doubt as to its validity, the Tasman Institute's 1988 estimate of the external costs of alcohol consumption to Australia of \$896 million, if used, should be adjusted for the increased contribution of moderate alcohol consumption to diminished mortality and morbidity which has become evident since the Tasman evaluation.

A fraction should be applied to take account of wine's under-contribution to costs relative to other alcoholic beverages and its over contribution to reducing health costs through moderate consumption.

Mr Croser and Professor Freebairn recommend on the basis of the evidence at hand, a volumetric sales tax be imposed on wine in parallel with an ad valorem sales tax, at a level of \$4.00 per litre of alcohol. With the effect of the state franchise fees (10 to 14 per cent) imposed on top of this volumetric tax, this equates to a gross contribution to government of \$4.50 per litre of alcohol to pay for wine's contribution to external costs.

Within the context of an unchanged Commonwealth aggregate taxation regime on wine, this would imply an ad valorem wholesale sales tax contribution to government revenue of approximately 12 per cen??

²⁰ In the draft report, data for 1992–93 had been used to seta tax rate of 10 per cent. If an aggregate increase in wine prices of 15 per cent over the three years is assumed, the tax rate is required to rise to 12 per cent to achieve revenue neutrality for the 1995–96 benchmark.

Revenue tax- competitive neutrality

The highly distorting current indirect tax system with its narrow tax bases (see Section 11.2) means some products are taxed very highly, most are not taxed at all and others are taxed at rates between the extremes. Wine faces an aggregate current indirect tax imposition of 40–44 per cent at the wholesale level (26 per cent WST plus a 10–14 per cent state franchise fee on top).

Luxury cars are taxed at about this rate and only beer, spirits, fuel and tobacco are higher. Given that most potential substitute products for wine are taxed significantly lower than wine, in this second best world, it is not clear that raising the taxation of wine towards the rate on the highly-taxed products results in a net improvement to Australia's resource allocation.

Mr Croser and Professor Freebairn's judgment that there is no evidence that increasing the aggregate taxation of wine will increase the efficiency of allocation of Australia's resources is the basis of their second recommendation that, however imposed, the aggregate level of indirect tax collected from the wine industry by the Commonwealth Government not exceed that from the 26 per cent ruling rate.

Given Mr Croser's and Professor Freebairn's third recommendation for a volumetric component of the aggregate indirect Commonwealth tax of \$4.00 per litre of alcohol, 'a priori' the revenue raising ad valorem component should be set at about 12 per cent.

This rate of ad valorem tax for wine has validity by comparison to the average rate of those indirect taxes which are primarily revenue raising used as a base starting point, and provides for simplicity by corresponding to the lowest general category of the existing WST.

In 1992–93, the latest year of data, all Commonwealth and state/territory indirect taxes on goods and services collected around \$40 billion (see Table 11.1) giving an average tax rate on all private consumption expenditure of 15.1 per cent. By deducting, conservatively, half of the excise and franchise taxes as being for externality or user pays purposes, taxes on motor vehicles for user pays purposes, and taxes on international trade, the purely revenue raising indirect taxes collect about \$24.5 billion— equivalent to a revenue neutral indirect tax on all private consumption expenditure of just under 10 per cent. Given the average retail mark-up on wine of 30 per cent, a 10 per cent retail tax roughly corresponds to a 13 per cent wholesale tax.

Further Mr Croser and Professor Freebairn note that such a 10 per cent flat rate consumption tax is estimated to have slightly less regressive distributional effects than the indirect taxes now imposed. A logical argument might be made to set the general revenue raising tax on wine above the 10 per cent average on efficiency grounds if wine has relatively higher expenditure-weighted cross-elasticities of demand with more heavily taxed products.

Conversely, the tax on wine should be less than the 10 per cent average if wine's substitution in demand is relatively weighted to lower or zero taxed goods and services.

Mr Croser's and Professor Freebairn's judgment is that there are inadequate data of rigour on product substitutability and on crosselasticities of demand to justify a tax rate significantly different from the average figure. Then recognising the \$4 per litre of alcohol (lal) tax for externality purposes, the desire for aggregate revenue neutrality with the current 1995–96 tax take (based on a 26 per cent WST), and that the tax will be imposed at the wholesale level rather than the retail level, and for simplicity to conform with the 12 per cent WST falling on many other goods, they recommend a 12 per cent ad valorem WST on wine for general revenue raising purposes.

Mr Croser and Professor Freebairn consider that this judgment is supported by the evidence outlined below.

- In terms of expenditure, bottled wine represents 70 per cent of the domestic market and bears the greater share of the 12 per cent ad valorem revenue contributing tax. Bottled wine is the least likely wine substitute for other alcoholic beverages and the most substitutable by and for other consumer products.
- Evidence on cross-elasticities of demand with other alcoholic beverages is poor, but in general is consistent with very low levels of substitutability.
- Given that the demand for beverages is influenced by a mix officome effects, taste and social change effects, as well as price effects, simple comparisons of consumption using just one of the explanatory variables is poor analysis. A complete modelling approach, which has been used by Clements and Selvanathan (1991), is the best available. The cross-elasticities of demand for wine with the other alcoholic beverages are very small and not significantly different from zero in their study It is Mr Croser's and Professor Freebairn's judgment that no particular weight should be given to the very high indirect tax burdens on beer and spirits in determining the tax rate on wine as compared with wine and other products.

- Wine has some substitutability with other beverages, including soft drinks (22 per cent WST), and tea, coffee and water (zero indirect tax).
- Most services, except gambling and finance, are exempt from indirect tax and many of these are substitutes for consumer expenditure on wine.
- Clothing and housing are tax exempt and in part are substitutes for wine.

The Ramsey tax efficiency rule, for taxing products highly if they have inelastic demands, does not support high taxation of wine. In this context, the Committee has agreed for reasons of practicality and simplicity that all wine — ultra-premium, premium and non-premium— should be taxed as one by the same tax system.

Thus, the econometric estimates of the price elasticity of wine in aggregate are appropriate measures of the reaction of wine to tax. They give point estimates of -0.4 to -0.8 but generally they are not well defined estimates with wide confidence intervals spanning an elastic demand of -1.0. Wine is in aggregate moderately price responsive. There are many other products with lower demand elasticities which are not taxed at all.

Is wine a luxury?

Some might argue that wine is a luxury characterised by occasional and discretionary purchasing patterns, and having a relatively high income elasticity.

It is probable that a disaggregated analysis of wine consumption would establish that ultra-premium wine demonstrates many of the characteristics of a luxury. However, because of the need for simplicity of tax administration and of tax compliance, Mr Croser and Professor Freebairn have elected to apply their taxation recommendations to all wine in a uniform fashion and therefore it is appropriate to measure wine's behaviour in aggregate fashion.

Wine is consumed uniformly across all age groups with the exception of the very young (18-24 years), both sexes, and comprises approximately the same proportion of household expenditure across all income groups (0.4 to 0.5 per cent), with the exception that it is a higher proportion of the lowest income quintile (0.87 per cent). The generally uniform proportion of income spent on wine shows it is popular across all income groups.

There is no evidence that wine has an income elasticity of greater than one, while there is considerable demographic empirical evidence that wine has become an increasingly significant everyday component of Australian lifestyle. In Mr Croser's and Professor Freebairn's judgment, wine in aggregate does not exhibit the luxury good behaviour of electronic goods, jewellery, leather goods or luxury cars which are taxed for revenue at 32 to 45 per cent WST.

It is also worth noting that many real luxuries such as fashion clothing and gourmet meals are not taxed at all. The WST system is very inconsistent in its treatment of luxury items, demonstrating a lack of determination to target obvious luxury goods.

The taxation treatment of wine inventory

The wine industry is characterised by a heavy investment in inventory relative to other capital requirements including human capital and vineyard and winery infrastructure, and relative to other industries.

The extent of maturing inventory will necessarily increase relative to sales turnover as the domestic market continues in its growth towards bottled premium wine consumption and away from non-premium wine consumption, and as Australia's export markets for premium wine expand.

It can be argued that the current tax treatment of wine inventory provides a bias against investment in maturing inventory relative to other capital investment such as human capital (immediate tax write-off), winery plant and equipment and vines, irrigation equipment and trellising with accelerated depreciation treatment. In these circumstances, Mr Croser and Professor Freebairn believe that the relative importance of stocks in the wine industry investment portfolio when compared with most other industries means that the wine industry currently faces a higher tax burden on its investment portfolio than most alternative industry investment options. (This matter is further discussed in Chapter 12.)

However, on balance, Mr Croser and Professor Freebairn, consistent with their conservative view that there should be no change without rigorous proof of net benefits flowing to the Australian economy, recommend no change to the current tax treatment of inventory for the Australian wine industry.

Mr Croser and Professor Freebairn note that this conservative and consistent judgment adds to other judgments which are detrimental to the short and medium term interests of the winegrape, wine and brandy industry and which, if implemented, will impose adjustment costs.

Effects of recommendations on the non-premium grape and wine sector

The recommendation to lift the excise on brandy from \$29.62 per litre of alcohol to \$34.69 per litre of alcohol (see Part C) will impact on the industry's non-premium grape safety valve. Traditionally, brandy production has been used as a method of mopping up surplus non-premium grapes in times of diminished demand for non-premium wine.

The recommendation to change the style of tax from a total ad valorem to a mixture of volumetric and ad valorem will create much higher equivalent ad valorem tax rates for non-premium wines, especially casks. Because of the volumetric tax application to the 17 per cent alcohol content of fortified wine, the equivalent ad valorem tax rate on cheap fortified wine will be especially punitive.

The non-premium wine sector is recognised as being the most price sensitive of the disaggregated analysis of wine and the recommendations will accumulate to impact as diminished grape prices and surplus production of non-premium grapes.

The impact of taxation increases on the non-premium grape and wine sector was apparent in the slowed growth after the imposition of 10 per cent WST in 1984, despite there being an initial absorption by the industry of price increases. With the imposition of a further 10 per cent in 1986 appearing almost immediately as price increases, non-premium wine ended its thirty year consumption increase and began to diminish in absolute and per capita terms.

The diminished sales and inventory requirements of the brandy industry implicit in the raised excise recommendation mitigates against the displacement of non-premium grapes to this sector.

The expected impact of the cumulative recommendations will be most evident in the non-premium grape growing regions of the MIA, the South Australian Riverland and to a lesser extent, the dual purpose grape growing regions of the New South Wales and Victorian Sunraysia regions.

The timing of implementation of the recommendations and government adjustment assistance must be considered to dissipate the adjustment pain.

Summary of majority recommendations

Longer term taxation target

Commonwealth: 12 per cent ad vabrem plus \$4.00 per litre of alcohol

Mr Croser and Professor Freebairn note that state and territory liquor licence fees (currently between 10-14 per cent) apply in addition to Commonwealth taxes.

Adjustment path

Mr Croser and Professor Freebairn recommend that Commonwealth taxation arrangements for wine be adjusted as follows:

- from 1 July 1997: 19 per cent ad valorem plus \$2.00 per litre of alcohol WST; and
- from 1 July 2000: 12 per cent ad valorem plus \$4.00 per litre of alcohol WST.

Mr Croser and Professor Freebairn recommend that the specific component of the tax be indexed to the CPI from 1 July 1996.

Effects of majority view

It is useful to assess the likely effects of the tax change proposals on wine production and consumption, on prices, and on returns to winemakers and grapegrowers in two steps:

- the initial impact of changes in taxes paid assuming no behavioural responses by wine consumers, winemakers and grapegrowers; and
- the final changes after consumers and producers have adjusted production, consumption and prices in response to changes in the taxation arrangements.

In terms of estimated 1995–96 prices, the*impact effect* of the majority recommendation is to raise the Commonwealth indirect (ad valorem plus volumetric) tax burden on lower priced products and to lower it on medium and higher priced products. Those with a pre-tax wholesale value of \$3.15 per litre are unchanged, those with a lower pre-tax wholesale value face more tax, and those with a pre-tax wholesale value of more than \$3.15 per litre will face less tax. The magnitudes of the relative tax changes increase as the phased implementation of the proposal proceeds. In aggregate, the overall Commonwealth tax collection is about the same.

Table 11.9 below provides some more specific examples of the impact effect of the proposals in terms of tax paid in dollars per unit of product.

While in the first instance the tax change will be felt initially by the winemaker, the forces of a highly competitive industry will lead to price and quantity adjustments by the industry, and these changes will redistribute part

or all of the tax change to wine consumers and to grapegrowers. These second round effects will vary between non-premium and premium wines.

In the case of premium wines, most of the change will be borne by domestic consumers with an adjustment of quantity between the domestic and export markets. Over the longer term, the importance of the export market, together with the high level of price responsiveness (or export demand price elasticity) of export demand, means that export prices have a dominant influence on the setting of pre-tax domestic wholesale prices of premium wines. Winemakers and growers of premium grape varieties will be little affected by the majority recommendation.

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Selected product	Taxation regime			
	Current 26 percent ad valorem tax	\$2 a lal plus 19 per cent ad valorem from July 1997	\$4 a lal plus 12 per cent ad valorem from July 2000	
4-litre cask (current wholesale price of \$5.69 per cask and \$10 retail price)	1.48	1.96	2.44	
Vin ordinaire bottle of wine (current wholesale price of \$2.37 per bottle and \$4.50 retail price)	0.62	0.62	0.62	
Ultra-premium bottle of wine (current wholesale price of \$7.63 per bottle and \$15 retail price)	1.98	1.61	1.25	
Bottle of sherry (current wholesale price of \$2.93 per bottle and retail price of \$5.55)	0.76	0.81	0.86	
Aggregate Commonwealth tax revenue (\$ million per annum)	288	283	279	

The likely effects of the proposed increase in taxation of non-premium wines, primarily the cask market and the fortified wine market, will be different. Here exports are a small share of total sales and the export market price response (or elasticity) also is much lower than for premium wines. Some of the tax increase will be passed forward to consumers as higher retail prices, and some will be passed back to grapegrowers of non-premium varieties as lower prices than otherwise. Also domestic consumption and total production will fall. In all cases, these changes are relative to what would have happened if the 26 per cent WST was continued. The precise magnitude of the split of the extra tax burden between domestic consumers and grapegrowers will depend primarily on the relative values of the price responsiveness (elasticity) of the domestic demand for, and supply of, non-premium products. Unfortunately, the Inquiry was unable to obtain good estimates of these key response variables.

The recommendation to introduce a volumetric tax for externality reasons and to reduce the present ad valorem tax has adverse implications for grapegrowers currently producing non-premium varieties, both in terms of price and quantity. However, the required adjustments should be tolerable for the following reasons. First, the tax changes are to be introduced in two steps. The first step is recommended for July 1997, and the second step three years later for July 2000. Second, the changes should be understood in the context of the slowly growing market due to population growth (of about 1.5 per cent a year) and real income growth. So long as there are no new plantings of nonpremium varieties, the natural market demand growth, together with some attrition and conversion of existing production, will be adequate to accommodate falls in demand. This view does not, however, underestimate the necessity, regardless of the tax recommendations, for significant structural changes in large parts of the grapegrowing regions to occur if the industry is to both continue to be internationally competitive and to generate reasonable returns. Third, the majority recommendation will enhance the returns, and thus also the incentive, for switching from non-premium to premium varieties. Taken over the gradual adjustment period, such changes should have negligible adverse effects on other parts of the regional economies.

Mr Scales' view

In forming my recommendations, I have accepted that Australia, like all other nations, has a range of revenue raising mechanisms which have evolved for historic or pragmatic reasons. I agree with the other members of the Committee that the economy would gain from some reform of the tax system. However, even with significant reform, I think there is unlikely to ever be a perfect system, nor a perfectly consistent system (ie a tax system which meets completely the criteria of simplicity and equity, and is non-distorting between various economic activities). In this context, I consider that Australia is likely for the foreseeable future to have a mix of income taxes, indirect taxes (ie taxes on goods and services such as the WST and excises) and a range of tax concessions. Accordingly, I believe that the most realistic approach for this inquiry to adopt is to work within these existing constraints to improve the current tax system.

An important starting point is my view that the wine industry is one subset of the broader alcoholic beverage industry, with the brewing and spirits industries being the other major elements. I consider that judgments about the extent to which the taxes currently applying to wine and other alcoholic beverages artificially influence consumption choices between these goods (and consequently impact on production and investment decisions), and whether a change to tax structures would reduce the economic costs of raising government revenue, are critically important in this inquiry. It is within this context that I have considered the two key questions: first, what is the most appropriate form of a tax on wine and, second, what is the most appropriate level of tax on wine.

In considering these matters, I have recognised that there are some similarities between the wine industry and the beer and spirits industries and, as would be expected, some significant differences. Some of the similarities which I see are as follows:

- both the wine and beer industries are dominated by a few large firms. In the case of wine, seven firms control around 75 per cent of Australia's total production while, for beer, two firms control over 90 per cent of output;
- at the most general level, the wine, beer and spirits industries all rely on agricultural products as their base input: grapes for wine, hops for beer and a range of agricultural products for spirits, including grapes for brandy;
- for many wine products, the lead time from harvest to dispatch is similar to that of beer. For example, Southcorp explained that, in relation to Queen Adelaide chardonnay, the lead time from harvest to dispatch in 1994 was three and a half weeks. Southcorp (transcript, p. 868) stated:

... we had to move in 94— we moved onto the 94 vintage in the month of March ... it came off the vineyards, was through the winery and in a bottle in about three and a half weeks.

- distribution and marketing arrangements are similar for the different alcoholic beverages, ie hotels, licensed retailers and restaurants all sell both wine and other alcoholic beverages; and
- some of the techniques and equipment used by high volume wine producers are similar to those used by brewers. For example, both use large stainless steel facilities for fermentation and maturation, and both rely heavily on chemical analysis for the maintenance of quality.

The more noticeable differences between wine and the other sectors of the alcoholic beverage industry are that:

- unlike the other parts of the alcohol industry, a large number of small companies produce a tiny proportion of Australia's wine. For example, some 600 of Australia's 800 wineries produce only about 2 per cent of Australia's beverage wine. Many are sole traders or partnerships, established as much for lifestyle purposes as for profit maximisation;
- grape production is also dominated by farmers producing grapes on relatively small holdings of land. For example, the average vineyard size in South Australia is about 11.6 hectares;
- unlike the other sectors of the alcohol industry, grapegrowing and winemaking are geographically dispersed, with the diversity in the composition of soil types and climatic conditions contributing to product uniqueness and wine imaging potential; and
- unlike beer and some spirits, premium wine, particularly red wine, requires maturation, often for periods of two to three years (although some spirits are aged for far longer than this).

In addition to these similarities and differences, I also considered the arguments raised by the winemakers and grapegrowers in relation to: regional significance; substitution with other alcoholic beverages; the effects of taxation on the growth of the wine industry; recent increases in tax revenue raised from the wine industry; and the taxes and subsidies applied by overseas countries to their domestic wine industries.

After weighing up all these factors, I have reached a different conclusion to that formed by the other Committee members about the rate at which the ad valorem (or revenue raising) component of the tax should be set. My conclusion is based primarily on a rejection of the view of Mr Croser and Professor Freebairn that wine is no more substitutable with other alcoholic beverages than it is with all other goods and services.

In essence, I consider that substitution between wine and other alcoholic beverages (in particular, between cask wine and beer, and between some fortified wines — eg port — and liqueurs) in response to relative price

changes is much stronger than substitution between wine and other goods and services. Thus, I believe that consumers see a bottle of wine and a bottle of beer as substitutes for each other much more so than they see a bottle of wine and a pair of socks, or a bottle of wine and an overseas holiday, as substitutes for each other. Underlying this contention is the proposition that households allocate a proportion of their income to necessities such as food, clothing and shelter, and a proportion to leisure/entertainment and other discretionary purchases. In these circumstances, the potential for substitution between wine and other alcoholic beverages is high.

I acknowledge that the limited number of published statistical demand studies have not established a significant relationship between the demand for wine and the demand for other alcoholic beverages. I accept that this could be interpreted to imply that the substitution between wine and other alcoholic beverages is of no greater statistical significance than the substitution between wine and all other goods and services. However, I caution against relying only on these empirical studies for making important policy decisions. Econometric modelling of the determinants of alcohol consumption is complicated and plagued with data deficiencies. Many of the studies are based on aggregated data — ie the data treat each alcoholic beverage as a homogeneous product rather than distinguishing between non-premium, premium and ultra-premium wine, or between different types of beer and spirits. As a result, the data used in the studies mask compositional changes in demand (eg the expansion in the cask market in the 1980s, the more recent shift in demand in favour of bottled wine and the growing preference for light beer). Depending on the underlying assumptions employed in each study, the conclusions reached suggest that alcoholic beverages could be either substitutes or complements for each other. I believe that a finding that alcoholic beverages are complements with each other is counter-intuitive. It would imply that, following an increase in the price of wine, the demand for beer, as well as for wine, would fall.

Furthermore, the failure of the statistical studies to show that strong substitution exists between wine and other alcoholic beverages does not accord with the comments made by several expert inquiry participants. In this context, I note comments made by representatives of winemakers. While, following the draft report, winemakers indicated that they believe that substitution between wine and other alcoholic beverages is no greater than substitution between wine and all other goods and services, their earlier statements reflect considerable concern about substitution between alcoholic beverages as a result of tax induced price changes. Indeed, the prospect of substitution between beer and wine appears to have been a long running concern. For example, in its 1990 Budget submission to the Commonwealth Treasury, the (then) Federation of Australian Winemaker Associations reported that:

...sales of cask, flagon and bulk wine fell 22.3 million litres (11.8%) in 1988–89, due mainly to the reduction on the total taxes on beer in the August 1988 Budget. The sales of beer in 1988–89 increased by 68.4 million litres, or 3.8%.

As reported in Section 11.4, in discussions with the Commonwealth Government leading up to the 1993 Federal Budget, the Winemakers' Federation of Australia stated:

There is evidence from previous significant relative price changes that substantial substitution occurs between the different beverages as relative prices change. Indeed, the wine industry has faced increased competition from low alcohol beer since the tax on such beer was reduced.

Prior to the draft report, the peak industry organisations — the Winemakers' Federation of Australia and the Winegrape Growers' Council of Australia — stressed the discipline which factors such as the high potential for substitution between alcoholic beverages place on the industry. They stated (sub. 30, p. 71):

On the supply side, the industry will need to remain price competitive, remembering the high potential for substitution between alcoholic beverages and the potential cost pressures exerted on the wine industry by export demand and restrictions in grape supply.

Representatives of the brewing industry stated that there is clear substitution between beer and wine (particularly cask wine). They contend that, in the event of a wine price increase, a significant proportion of wine drinkers would switch from wine to beer. Representatives of spirits producers and importers also believe that wine, beer and spirits are directly competing products. For example, the Distilled Sprits Industry Council of Australia (sub. 144, p. 11) stated:

There are, for example, numerous characteristics shared by spirits, beer and wine (and cider and alcoholic soft drinks) which indicate that they are directly competing products. These products can all be obtained conveniently from similar establishments, including hotels, bars, bottleshops and supermarkets and are consumed in similar circumstances including relaxation and entertainment purposes.

Other participants pointed to the potential for substitution between alcoholic beverages to help explain the significance of taxation arrangements to the development of the wine industry. For example, the New South Wales Government (sub. 124, p. v) stated:

Given the importance of the domestic market and the potential for substitution between alcoholic beverages, the efficient taxation of alcoholic products is clearly a central issue to the development of the winegrape and wine industry. I firmly believe that the available evidence confirms the view of these expert industry and government participants that substitution between wine and other alcoholic beverages is stronger than between wine and other goods and services. On this basis, I consider that there will be economic efficiency gains if the taxation regime facing all alcoholic beverages is made less discriminatory. A more neutral tax structure within the alcohol industry would reduce artificial incentives to purchase wine instead of other alcoholic beverages, and to invest in grapegrowing and winemaking at the expense of investment elsewhere in the economy^{2,1} Consequently, a more uniform tax structure, while less advantageous to the wine sector than the current tax arrangements, is likely to provide greater benefits to society as a whole.

Given strong substitution between wine and other alcoholic beverages, there is a case for taxing wine, for revenue raising purposes, at the same level as beer and spirits. Currently, a WST of 22 per cent applies to beer and spirits. However, I consider that the actual revenue raising component of the tax on beer and spirits is much higher when account is taken of the excises which apply to these products. The excises date back to 1901 when they were imposed totally as a revenue raising measure. The WST and excises on beer and spirits, when converted to ad valorem equivalent rates, are of the order of 70 per cent and 187 per cent respectively. Although a portion of the current excises could now be to compensate for external costs, it is reasonable to presume that the revenue raising component of the present Commonwealth taxes on beer and spirits is at least double the 22 per cent levied through the WST.

Setting the appropriate revenue raising tax on wine made from grapes is further complicated because wine, like many products, is not a homogeneous product. As outlined earlier in this report, the wine market comprises several distinct segments (ie non-premium, premium, and ultra-premium). If, as is likely, ultra-premium wine is price inelastic, it would be efficient to tax it at a higher level relative to other goods which are more price sensitive. Indeed, given accurate information about the price elasticities of various grades of wine, it would theoretically be possible to vary the tax on wine to achieve the most efficient tax outcome. For example, for revenue raising purposes, nonpremium wine — which is likely to be less inelastic than ultra-premium wine — could be taxed at close to the general rate, with higher taxes applying to the less price sensitive premium and ultra-premium wine. As an example, for revenue raising purposes, premium wine might be taxed at a level closer to the

²¹ This does not mean that any investment freed from wine will necessarily flow to other parts of the alcoholic beverage industry. It could flow to industries with no link to the alcoholic beverage industry.

beer rate, say, around 45 per cent WST, and ultra-premium wine might be taxed at a rate closer to that applying to spirits, say, around 70 per cent WST. Taxes to address the external cost of alcohol abuse could then be added to this revenue raising component.

While such an approach might be beneficial, it is difficult to determine the points in the price hierarchy which accurately distinguish between the different markets. As such, it would be difficult to implement a hierarchical taxation arrangement. The differences in the tax rates for each segment would also distort price signals near the chosen thresholds. For reasons of practicability, and so as not to further distort the allocation of resources within the wine industry, I have concluded that all wine, whether it be non-premium, premium or ultra-premium, should be taxed at the same level for revenue raising purposes.

While I accept that taxing wine for revenue raising purposes at the same rate as beer would be the most appropriate, I recognise that more than doubling the contribution made by wine to revenue raising would give rise to substantial adjustment costs for both the industry and the community at large. Consequently, I propose that, on balance, the ad valorem component be set at the highest general class WST rate of 32 per cent. Under this arrangement, wine would retain a substantial tax advantage over other alcoholic beverages. However, the tax differential between wine and the other alcoholic beverages — and hence, the potential for disturbing consumption and production patterns— would be significantly reduced.

I accept that it is not practical to adopt a 'clean slate' approach and assume that the current arrangements can be dismantled overnight and my recommended arrangements substituted. Accordingly, I propose that the new tax arrangements be introduced gradually, with the full amount of tax not applying until 1 July 2000.

I propose that, as a first step, the ad valorem component of the tax should be raised to 32 per cent on 1 July 1996. After twelve months, the volumetric component of the composite tax should be applied at an initial rate of \$1 per litre of alcohol, with annual increments of \$1 per litre of alcohol until the target rate of \$4 per litre of alcohol is achieved in the year 2000. The annual increments should be indexed to the Consumer Price Index. When the recommended arrangements are fully in place, the equivalent ad valorem rate of the composite tax would be, on average, 45 per cent—ranging from 37 per cent for ultra-premium wine to 59 per cent for non-premium wine (see Table 11.10).

Retail p			the full eff to consume		tax increas
	\$50 bottle	\$15 bottle	\$10 bottle	\$5 bottle	\$8 four litre cask
Retail price, with tax at 26 per cent (\$)	50	15	10	5	8
Retail price, with tax at 32 per cent plus \$4 per lal (\$)	52.90	16.23	10.97	5.73	10.83
Difference in price (\$)	2.90	1.23	0.97	0.73	2.83
Difference in price (%)	5.8	8.2	9.7	14.6	28.8
Average annual price increase (%)	1.16	1.64	1.94	2.92	5.76
Ad	valorem eq	=	recommen cent)	ided com	posite tax
	Ultra- premium wine	Premium wine	Non-premium wine	Average ad	valorem equivalent
32 per cent plus \$4 per lal	36.7	42.0	58.7		45.4
	-		nue collecte 95–96 pric		0–01
Tax rate	(+	\$ million, 1995–96 price§) Revenue collected			
26 per cent WS	Т		28	88.0	
32 per cent WS	T plus \$4 per lal		46	58.9	

Should the Government decide that a composite tax should not be introduced, I recommend that a wholly ad valorem tax equivalent to the 'average' composite tax of 45per cent be applied to all wine.

I acknowledge, as do Mr Croser and Professor Freebairn in relation to their proposal, that the effects of my recommendation will bear most heavily on non-premium wine and on those areas that concentrate on producing nonpremium grapes (eg the South Australian Riverland and the Sunraysia). However, given the extended adjustment period proposed, I do not believe that my proposals would place an unmanageable burden on the industry. In this regard, I note that many growers are already moving towards the planting of premium rather than multi-purpose grapes.

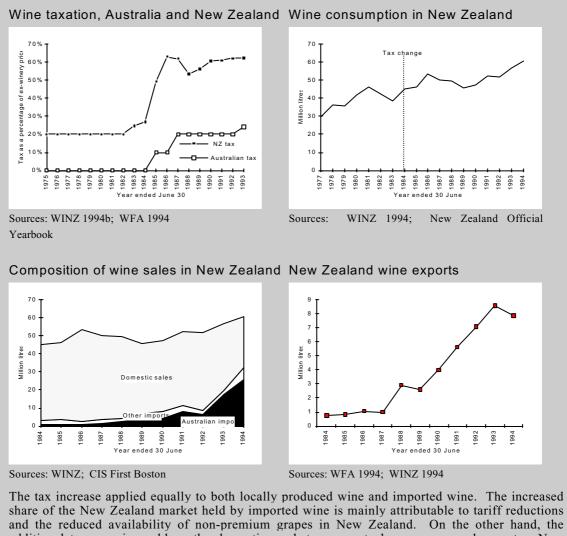
To gain an additional understanding of the effects of my tax proposals, I have looked at the experience in New Zealand (see Box 11.2). Between 1984 and 1986, the ad valorem equivalent of the tax on wine in New Zealand increased by over 130 per cent. Wine is now taxed in New Zealand at the same excise rate as beer. Both products also pay the same goods and services tax (12.per cent).

Despite the substantial tax increase, the market for wine in New Zealand has not collapsed. Indeed, the increase in tax appears to have had relatively little effect. Per capita consumption has been increasing for some decades and, apart from a slump during the recent recession, consumption has continued to increase. Perhaps more importantly, the resolution of the public policy conflict on the varying tax rates on alcoholic beverages has created a significant degree of certainty for investors. Investors in the wine sector have responded accordingly by increasing their commitment to the New Zealand wine industry.

The additional tax burden placed on wine is likely to be shared between producers and consumers. The available information on demand and supply elasticities suggest that, in the case of premium and ultra-premium wine, the major portion will be borne by consumers while, in the case of non-premium wine, most of the adjustment will ultimately be borne by grapegrowers. If, however, it is assumed that all of the tax increase is passed on to consumers, my proposals would translate to annual increases in the retail price of ultra-premium, premium and non-premium wine in the order of 2 per cent, 3 per cent and 6 per cent respectively. The effect of my tax proposals— when fully in place in the year 2000— on the retail price of non-premium, premium and ultra-premium wine is outlined in Table 11.10. The table also shows the ad valorem equivalent rate of my recommended composite tax, and compares the estimated taxation revenue collected under a 26 per cent WST and my composite tax.

Box 11.2: Wine taxwine tax and consumption in New Zealand

The New Zealand Government increased the rate of taxation on wine from an ad valorem equivalent of 25 per cent in 1984 to around 65 per cent in 1986. The same excise is now imposed on wine and beer (currently \$18.023 per litre of alcohol), in addition to the across-the-board 12.5 per cent goods and services tax. Initially, the impact of the tax increase on consumer prices was muted by strong domestic competition following the large harvest in 1985 and, after 1986, by declining levels of import protection which resulted in a significant increase in imports from Australia. However, exwinery prices suggest that these factors only partially offset the effects of the tax increase. Despite the large tax increase, per capita consumption of wine in New Zealand has continued to grow, from 14.0 litres in 1984 to 17.8 litres in 1994.



share of the New Zealand market held by imported wine is mainly attributable to tariff reductions and the reduced availability of non-premium grapes in New Zealand. On the other hand, the additional tax on wine sold on the domestic market appears to have encouraged exports. New Zealand exports increased seven-fold in the last six years. Some 20 per cent by volume of New Zealand's total production in 1994 was exported.

In considering the issue of adjustment, I note that in the two years to December 1994, wine prices increased by more than 10 per cent — over

double the rate of increase in the general consumer price index. Despite this, both domestic and exports sales of wine increased. I also note that two quite significant tax increases in the mid-1980s appeared to have no adverse impact on the overall level of sales of wine. Furthermore, unlike the situation in the mid-1980s, my proposals would give the industry considerable time to plan for the increase in tax. The substantially higher proportion of output which is now exported, and not subject to tax, also places the industry in a better position to accommodate an increase in tax. In addition, there is considerable potential for further increases in exports. Indeed, if exports continue to grow as most expect, and are planning for, the overall effect of my taxation proposals may be, at worst, a modest reduction in the current rate of growth of the industry.

I do not accept the logic of the argument put by the wine sector that an increase in the tax on consumption of wine in Australia will substantially affect Australia's exports of wine. This logic does not hold true for two reasons.

First, a domestic tax increase does not affect the price of Australian wine on world markets, so will not affect the export demand for Australian wine. By changing the price relativities, it will in fact make export sales relatively more attractive for local wine producers.

Second, even if domestic demand (and returns to the industry) were to fall significantly, this should not affect the level of exports in the medium to longer term. Indeed, it could be argued that the Australian wine sector does not require a domestic market to be successful in world markets. In fact, a number of participants in this inquiry have advised that the largest proportion of their bottled wine production is exported, while others have indicated that they could sell all their wine internationally if they wished to do so. It is also a fact that a number of other Australian industries sell by far the largest proportion of their product offshore. Products such as wool, sugar, wheat, iron ore and alumina are essentially internationally traded products, with only a small proportion of total production sold in Australia. Even if production volume was essential for competitiveness, there is no reason why the wine industry could not obtain the sales necessary to generate this volume from offshore.

Importantly, I consider that any disadvantage suffered by the winegrape and wine industry would be outweighed by the economic benefits associated with a less disparate taxation treatment of alcoholic beverages. This would reduce the extent to which the taxation system biases consumer spending and investment decisions in favour of the winegrape and wine industry at the expense of other sectors of the economy. I consider that my taxation proposals will also benefit the community by reducing the conflict apparent between the existing tax treatment of wine — which encourages the availability of a very cheap and a relatively high alcohol content alcoholic beverage in the form of cask wine — and government policies encouraging moderate consumption and low alcohol products for health reasons.

I agree with the other Committee members that wine should be subject to a composite tax levied at the wholesale level comprising an ad valorem component for general revenue raising purposes and a specific rate component to alleviate the external costs of wine consumption. On balance, I also agree with the other Committee members that the specific rate tax should be set at \$4 per litre of alcohol. However, I consider that a very credible case can be made to have the specific rate tax on wine set higher than \$4 per litre of alcohol.

The lowest estimate of the external cost associated with alcohol consumption contained in reliable published studies available to the Committee suggests costs were around \$900 million in 1988. This translates to over \$8 per litre of alcohol after adjustments for inflation, population increases and a drop in per capita alcohol consumption. The estimate includes an allowance for the health enhancing characteristics of alcohol consumption, but not of any specific benefits of wine which may be in addition to those attributed to alcohol consumption generally. It can be argued that the \$8 incorporates some health care costs which could be regarded as internal costs incurred by the alcohol user, and therefore should not be part of any payment to recompense the community as a whole. However, if allowance is made for costs which are not included in the study — such as the costs incurred by industry (eg those associated with absenteeism and higher workplace accident rates, which overseas studies have found to be substantial) and for pain and suffering inflicted on others — I consider it is likely that the total cost figure would be considerably higher than the \$8 per litre of alcohol.

The wine industry maintains that wine is consumed in different circumstances to other alcoholic beverages (eg it is often consumed with food) and, consequently, is less likely to be abused. I accept that there are some differences between the 'average' consumption patterns of wine and other alcoholic drinks. However, I do not accept that this necessarily implies that wine is subject to less abuse than other alcoholic beverages.

A specific rate tax set at a level that would recoup all external costs would impose significant short term costs on parts of the wine industry. As I have discussed earlier, regions which focus on growing non-premium grapes, in particular, would face considerable adjustment costs, some of which would also impact on the wider community. Therefore, on balance, I accept that the component of the tax designed to compensate society for the external costs of wine consumption should be set at a lower rate (ie \$4 per litre of alcohol) than that required to cover all costs.

I agree with Mr Croser and Professor Freebairn that the volumetric component of the tax should be levied at the wholesale level (ie at the same time as the current WST). In addition, any future general increases in the rate of WST should be applied to wine. To maintain the value of the tax over time, the volumetric component of the composite tax should be indexed to the consumer price index. In respect of fortified wine products, I propose that the volumetric component of the tax be applied to the entire alcohol content of the product (ie to both the alcohol contained in the base wine which is fortified and the alcohol introduced by the fortifying spirit).

I observe that Mr Croser and Professor Freebairn also accept that adjustment pressures are likely to be greatest for non-premium wines and in the nonpremium grape growing areas of South Australia, New South Wales and Victoria. I also observe that Mr Croser and Professor Freebairn are recommending what would be equivalent to a WST of 39 per cent on this, the most vulnerable sector. Therefore, I can see few reasons why, if my recommendations are not implemented by the Government, that the industry at large should not be taxed at the minimum rate applied to the most vulnerable sector as proposed by Mr Croser and ProfessorFreebairn. That is, at a WST equivalent of about 40 per cent.

PART C: TAX-RELATED MATTERS ASSED BY THE BRANDY INDUSTRY

While matters relating to the level of Commonwealth excise on brandy were of primary importance for brandy producers, there were several other matters raised — including Australian producers' concerns about imports of subsidised French brandy and about Customs' ability to manage the excise system so that duty paying manufacturers are not disadvantaged by the diversion of non-dutiable brandy and grape spirit— used for fortifying wine — to illegitimate uses.

Excise on brandy

Brandy is currently taxed by the Commonwealth through an excise of \$29.62 per litre of alcohol and WST at 22per cent. Customs duty equivalent to the excise, plus a 7 per cent protective component, and WST are applied to

imported brandy. Where it is used to fortify wine, brandy (and grape spirit) is free of excise.

Currently, the excise on brandy is about 85 per cent of that applying to other potable spirits.²² The concession has applied at different times and rates over the years. It was most recently re-introduced in November 1979 to enhance brandy's ability to compete in the marketplace with other spirits. At that time, the Commonwealth Government was concerned about difficulties facing grapegrowers, particularly in the South Australian Riverland, for whom brandy distillation was an important outlet for surplus grapes.

Domestic consumption of brandy has been declining gradually for many years. The decline has been accompanied by a fall in the market share of Australian brands. The volume of imports— notably from France— has remained steady over recent years and about one-third of sales are currently sourced from imports. Brandy producers nominated increases in excise as the reason for declining sales. For example, Australia's largest producer of brandy, grape spirit, rum and white spirits, Tarac Australia (Tarac) (sub. 81, p. 6) submitted that:

... the massive increases in excise between 1973 and 1978 had a significant adverse effect on sales [and] also established the high excise base upon which indexation has worked to effectively cut Australian brandy sales by a factor of three.

Australian brandy producers sought maintenance of the excise concession for brandy and a halt to the twice yearly indexation.

Participants advanced a number of reasons to support maintenance of the excise concession. The WFWGC argued that the characteristics of brandy, compared to other spirits, justified the concession. It cited a need for greater security for growers because of the three to five year period required for grape vines to come into production, high raw material costs for brandy production compared to other spirits and the fact that brandy is one of only two major spirits distilled in Australia.

The Murray Valley Region Wine Grape Industry Development Committee (MVR) stated that the brandy industry is an important user of doradillo and trebbiano grapes grown in its region and of grape marc. Angove's stated that brandy producers, unlike other spirits producers, have a long term commitment to grape growing. The Australian Democrats considered that the lower excise on brandy was necessary to reflect its importance as a "buffer" market for surplus grapes which might otherwise be discarded.

²² As of 1 February 1995, excise of \$34.69 per litre of alcohol has applied to mosother potable spirits.

Participants also suggested that the removal of the excise differential would have a more detrimental effect on the domestic industry than on overseas brandy producers. For example, the Wine and Brandy Producers Association of South Australia (WBPA) claimed that French brandy producers would find it a lot easier than Australian producers to reduce their price per bottle to remain competitive with other spirits if the excise differential was removed.

The present excise arrangements increase brandy prices and, as a consequence, undoubtedly have an impact on demand. In recent years, however, sales of imported brandy— which is subject to the same excise arrangements plus the protective duty component— have not declined. In addition, demand for other spirits— which are subject to a higher excise than brandy — has not been markedly affected. This suggests that there are factors, other than the excise, contributing to the decline in sales of Australian brandy.

Southcorp, while claiming that high government charges have been the major cause of the decline, identified the ageing of traditional consumers, competition from other spirits and beverages, and poor marketing strategies in the late 1960s and 1970s as contributing factors. Tarac indicated that sales of Australian brandy have been affected by a perception among consumers that it is inferior to French brandy. The Distilled Spirits Industry Council of Australia (DSICA) identified the failure of brandy producers to promote their product, consumers' perception of brandy as a strong alcoholic drink and the increased popularity of other spirits as contributing to the fall in brandy sales.

The Committee considers that the tax structure should not (unless intended) distort the decisions of producers and consumers— ie wherever possible, products which are close substitutes should be taxed at a similar level. In this context, it considers that brandy clearly competes for market share with other spirits. Thus, it considers that there is a strong case on economic efficiency grounds for removing the concessional excise treatment afforded brandy.

While the Committee accepts that there is a lengthy period before vineyards become productive, it notes that many other industries can point to similarly lengthy (or even longer) development times (eg fruit growers generally and producers of plantation timber). More generally, as discussed previously, most industries possess 'unique' characteristics which could form a basis for claiming preferential tax treatment for themselves. Moreover, even if it were accepted that levels of tax should be determined bearing in mind the future viability of grapegrowing, the Committee could not recommend preferential treatment given the strong growth in demand for grapes, both from the Riverland and elsewhere. Given the evidence of strong competition between brandy and other distilled spirits, the Committee recommends that the excise on brandy be set at the same rate as the excise on other distilled spirits.

Competition from French imports

Tarac sought continued protection against the importation of bulk French brandy — which it contended is subsidised by the French Government. Tarac asked the Committee to support the principle that an efficient Australian industry has a right to protection against subsidised imports and to recommend the continuation of effective countervailing duties on imports of French brandy.

Countervailing duties may be imposed where it is judged that a foreign government is providing financial assistance to its own exports and that this is causing or threatening material injury to an Australian industry. In the case of bulk French brandy, the Commonwealth Government's Anti-Dumping Authority has recently extended the countervailing duty on French brandy, imposed in 1990 for five years, for a further five years. The Anti-Dumping Authority (Schacht, 1995) found that substantial subsidies are available to bulk brandy produced in France, that the subsidies are likely to continue for the foreseeable future, and that France's exports of brandy represent a threat of material injury to the Australian brandy industry.

Angove's argued that Australia's goal should be to preserve Australian production, employment and resource use, particularly if the alternative is importation. In this context, Angove's suggested that the non-injurious freeon- board price (the normal value) for subsidised French brandy determined by the Anti-Dumping Authority provided no 'protection' for the Australian brandy industry. Angove's (sub. 148, p. 2) stated:

The ADA, in their calculation of the non-injurious FOB prices applicable to French brandy, remove the benefit of the protective component (of the customs duty). Add to this, the fact that the present NIFOB is below the cost to produce and sell Australian brandy and one has to query the motives of the ADA.

Australia's anti-dumping and countervailing duty legislation is based on the General Agreement on Tariffs and Trade (GATT) Anti-dumping Code which explicitly seeks to constrain the scope for abuse of anti-dumping and countervailing duty actions for protectionist ends. In the case of French brandy, countervailing duties equivalent to the margin between the price of French imports and their assessed normal valuære imposed. The implication of the statement by Angove's is that Australia should seek to preserve domestic industries which have difficulty competing with their overseas counterparts through building in a 'protective component' to the

countervailing duty imposed on subsidised imports. However, this would be tantamount to increasing the level of tariff assistance provided to local brandy producers and would be contrary to the Government's present tariff reduction program. Consequently, the Committee does not support any change to the method of calculating countervailing duties.

As discussed in Section 11.4, a more effective approach to reducing impediments to free trade, such as the subsidisation by Australia's international competitors of their domestic wine and brandy industry, is to address the problem directly through international negotiation. The Committee supports this approach, rather than the Australian Government providing 'compensating' assistance to affected Australian industries.

Administration of the excise system

Both Tarac and the WBPA alleged that alcohol products are being diverted from legitimate non-dutiable (non-excisable) uses to duty-paid consumption without payment of excise, thus disadvantaging legitimate (duty-paying) suppliers and causing revenue loss to the Government. In relation to this, Customs advised the Committee that the Brandy Committee of the WFA has, on a number of occasions, expressed concern over the diversion of concessional spirit (ie spirit used to fortify wine or for industrial- including food — and scientific applications) to the manufacture or extension of spirituous beverages. Users of concessional spirit are required to hold an appropriate permit and are subjected to regular audits by Customs. Irregularities raised by manufacturers are investigated by Customs.

Both Tarac and the WBPA linked the potential diversion of non-dutiable product to delays by the Commonwealth Government in enacting legislation to give Customs the power to effectively prosecute such activity, particularly to delays in adopting the Australian Law Reform Commission's (ALRC) recommended amendments to Customs-related legislation.

The WBPA (sub. 50, pp. 21–2) summarised the position as follows:

Another obstacle to growth in the brandy industry is the fact that the domestic market is regularly distorted by the illicit practices of a small minority which result in price suppression, loss of market share by legitimate producers, damage to brand building and loss of revenue to the Government.

The main reason for the growth in illicit activity, we believe, is ... the lack of effective legislation which would enable the Australian Customs Service to adequately police and prosecute offenders.

The brandy industry spent considerable time over the past three years working with Customs and the Australian Law Reform Commission on reviewing and drafting new legislation which would consolidate and strengthen the four relevant Acts - namely the Spirit Act, the Excise Act, the Distillation Act and the Customs Act. ... The release of the Conroy Report appears to have pushed this matter well down the list of priorities for the Government with regards to Customs.

Customs also advised the Committee that, as several recommendations of the Review of the Australian Customs Service (the Conroy Report) impinge on the ALRC recommendations, there has been some delay in finalising changes to legislation. However, Customs expects legislation incorporating the recommendations of the ALRC to be introduced into Parliament during 1995. The Committee supports the request from Tarac that the Government place high priority on this matter.

Tarac and Angove's sought extension of the seven day period for payment of excise, with Tarac suggesting the ability to defer payment be confined to those companies which achieved standards of best practice in relation to the security of excise revenue. Eligible companies would require, for example, a proven record of performance and compliance with Customs regulations.

Under the present arrangements, manufacturers or owners of all excisable goods must declare the excise liability on goods produced and account to Customs for those goods until they are delivered for home consumption, sold under bond, used in another process, declared as waste or exported. In order to facilitate clients who have large volumes of product continually being delivered into home consumption, Customs has instituted the 'weekly settlement scheme'. This involves Customs permitting a manufacturer or owner to deliver goods into home consumption during a seven day accounting period — Monday to Sunday — and lodging the entry documents and remitting duty on those goods on the first working day after the seven day period. A manufacturer or owner not participating in the weekly settlement scheme must lodge entry documents and pay duty prior to the goods being delivered into home consumption.

Brandy producers' business operations are sometimes structured to allow extended credit to trade buyers and, as a result, receipt of sales proceeds frequently occurs after the payment of the duty relevant to the transaction. However, the current payment arrangements reflect the significance of excise as a source of revenue. They are intended to maintain a regular flow of revenue to the Government²³ Any change solely for brandy producers could have wider implications. Producers of other dutiable products (eg beer, spirits, tobacco products and petroleum products) would be entitled to seek the same concession. Even if a deferred payment scheme along the lines suggested by Tarac could be introduced for brandy producers alone, it would

²³ Because of the amounts of money involved, interest forgone through delays in receiving revenue is a significant cost to the Government.

confer significant benefits (such as reduced working capital costs) on those companies whose business practices are judged to meet the required standard for deferral of excise payments. Such a scheme would potentially place any new entrant to the brandy industry (ie a company without a proven record of performance and compliance with Customs regulations) at a considerable disadvantage.

12 OTHER TAXATION MATTERS

In Chapter 11, the Committee considered the appropriate taxation arrangements for wine, as well as a number of matters concerning the taxation of brandy. In addition to these issues, participants expressed views about several other Commonwealth and state taxation matters. These included Commonwealth issues such as the application of WST to tasting samples, the tax treatment of wine stocks and the Commonwealth's provision of cash grants to winemakers, and state and territory liquor licensing arrangements. The Committee's consideration of these matters is reported in this chapter. The Committee is in agreement on all of these matters.

12.1 Wholesale sales tax treatment of wine used for tasting

The current tax arrangements treat wine provided free of charge for tasting as an 'application to own use'. Accordingly, WST is imposed on wine used for cellar door tastings or provided free of charge in other circumstances (such as exhibitions and wine shows).

The wine industry is unanimous in its view that wine provided free for tasting at the cellar door should be exempt from WST. In addition, some smaller wineries argued that wine*sold* at the cellar door also should be exempt from WST.

The industry sees a WST exemption for tasting samples as being consistent with the decision of state governments to exempt cellar door sales from liquor licence fees. The WFWGC suggested that a WST exemption could be provided at minimal administrative cost by allowing each cellar door outlet a standard WST deduction equivalent to the "industry average" ratio of sample consumption to sales.

The industry submitted that WST should not be imposed on tasting samples under the application to own use provisions because most samples are consumed on winemakers' own premises. It stated that the situation of the wine industry is different from that facing other industries which also depend heavily on samples, such as cosmetics, where samples are consumed away from the manufacturer's premises. The industry also argued that cellar door tastings are akin to general advertising (which does not face WST) by other industries. It stated that, because wine is subject to variations from year to year due to the effects of changes in the climate on grapes and the maturation process, tasting of a vintage is often a pre-requisite for consumer acceptance of price and quality. Tastings are seen as especially important for smaller producers, particularly those linked to tourism. For example, the Great Southern Wine Producers' Association (transcript, p. 219), representing small premium wine producers in Western Australia, stated that:

... because we are so small, the majority of where we can make our money is through cellar door sales. We can sell our wine at a price that is higher than we can sell it to our wholesaler or distributor. Tourists therefore for us are very important people. ... For a lot of the smaller vineyards ... 50 to 60 per cent of their money comes from what they make at cellar door sales. For those of us who are getting into the larger bracket, that percentage will drop slightly.

Furthermore, winemakers believe that applying WST to wine used for tastings or used for other purposes where it is not sold (eg wine shows and exhibitions) means that this wine is taxed twice: once when WST is paid on the tasting sample and a second time when WST is paid on the wine sold— at a price which has to cover the cost (including tax) of wine consumed as samples. The Australian Winemakers' Forum (AWF) (sub. 33, p. 8) stated:

At present, winemakers must bear the cost of providing tasting samples and will incorporate this in the price at which the wine is sold. Thus, tasting wine is taxed twice, once when it is provided free to tasters and the second time when the cost of this is incorporated in the price of other bottles.

Winemakers believe that, because of this 'double taxation', the current arrangements discriminate against them in comparison to other industries. The WFWGC referred to a Board of Review decisioh that a 'give-away' subsidiary product attached to a primary product, when sold by a wholesaler, is not an application to own use as evidence that the ATO is "incorrect in concluding that samples such as cosmetic samples, attaching to other primary products attract sales tax". Furthermore, the AWF stated that, where samples are consumed later in the distribution chain (eg at retail outlets), manufacturers are able to establish contractual arrangements to circumvent paying WST on samples. The AWF submitted (sub. 33, p. 10):

In the few industries that do use samples to a significant extent, the samples are generally provided for use by the consumer at a retail outlet which is removed from the manufacturer's premises. ... Because the samples are provided at a later distribution point, the manufacturer may arrange his contractual dealing with the retailer to ensure that no sales tax is paid on the sample goods. This can be accomplished via contractual arrangements that are generally termed as the provision of bonus goods.

The Commonwealth Treasury argued that it is not appropriate to exempt wine samples from WST. It stated that an exemption would create a precedent causing other industries to seek similar exemptions from WST, and for goods

¹ Case 34, 11 CTBR (NS) 158, (1963).

purchased for use in wine promotional activities generally such as "the furniture used in tasting facilities or displays, or promotional videos". The Treasury argued that, even if an exemption was designed so that it could be restricted to wine provided by winemakers free of charge for tastings at the cellar door, there would be pressure to extend the exemption to wine samples provided by winemakers in other circumstances, such as at wine shows, or to samples provided by wholesalers (which are also currently taxable).

The Treasury also stated that the practice of charging for some wine tastings makes it difficult to identify a genuine free tasting. It also expressed concerns about the equity of a WST exemption for sample wine—because the largest proportional benefit accrues to wineries making most use of cellar door sales — and about potential international trade implications if the exemption was not also available to imported wines.

Assessment

The requirement to pay WST on wine provided for tastings arises out of a provision in the sales tax legislation which imposes a tax liability on all manufacturers for goods manufactured and applied to their own use. In this respect, winemakers are in the same position as manufacturers of many other products — such as cosmetics, detergents, newspapers, magazines, pharmaceutical goods and paint— where samples are commonly used for promotional purposes. The legal basis for the ATO's treatment of samples as an application to own use, and therefore subject to WST, is provided by two High Court decisions?

The Committee accepts that many winemakers — particularly small winemakers — depend heavily on wine tastings as a selling tool and that WST on samples is consequently a significant cost for some. The WST, however, is designed to tax the domestic consumption of all non-exempt goods manufactured or imported into Australia, regardless of how those goods are consumed. Exemption for wine samples would represent a significant departure from this principle. It would undoubtedly encourage similarly affected industries to seek the same concession.

Advice to the Committee from the ATO is that the type of contractual arrangement referred to by the AWF, which allegedly enables payment of

² Deputy Federal Commissioner of Taxation v. Taubmans (NSW) Pty Ltd; 14 ATD 188; (1966) and Max Factor & Co. (Inc in USA) v. Federal Commissioner of Taxation 71 ATC 4136; (1971). The wine industry claimed that Case 34, 11 CTBR (NS) 158; (1963) shows that a 'give-away' subsidiary product attached to a primary product, when sold to wholesalers, is not an application to own use by the manufacturer. However, this case has been superseded by the two High Court cases.

WST to be circumvented in respect of samples used later in the distribution chain, does not remove the tax*liability*. In principle, the sale price used to establish the WST liability should include the value of any discount offered for the 'free' sample— ie WST is payable on the sample. Nonetheless, the Committee acknowledges that it is possible for contracts to be structured so that the provision of samples is not disclosed and the WST paid is reduced. It is clearly difficult for the ATO to detect such practices. However, to the extent that understatement of true taxation liabilities does occur, it is a problem for all non-exempt goods in the WST system— it is not confined to samples or to wine.

The Committee is sympathetic in principle to the concerns of winemakers who feel that the application of WST to samples means that wine which is sold is doubly taxed. While the current arrangement (ie taxing samples) means that WST is appropriately levied on the wholesale sales value of all wine produced (whether that wine is consumed in tastings by customers or sold is immaterial), winemakers have to 'mark-up' the price of wine sold to recover the tax payable on free samples. This mark-up is incorporated in the purchase price of wine sold and is itself subject to tax. Thus, in practice, there is a very small element of double-counting (ie WST is paid on the price inflated by the tax on samples). For example, if it is assumed that one bottle in twenty is used as a sample and that the wholesale price is \$15, the 'double taxation' paid would amount to about 0.2per cent of the total value of sales.

Some winemakers have responded to the requirement to pay WST on tasting samples by applying a small charge for tastings— with the charge being deducted from the price of any purchases— or by offering a meal with a selection of wines for sampling for a specific price. While some participants expressed concern that this might discourage visitors to wineries, it is possible that some wineries could recoup the cost of WST on samples with a minimal tasting charge. However, in some jurisdictions, it is illegal to charge for tastings without obtaining a licence to sell liquor in addition to a vigneron's licence.³

The Committee recommends that state governments which currently do not allow wineries holding a vigneron's licence to charge for tastings (ie Western Australia, South Australia and New South Wales) amend their licensing legislation so that winemakers may charge for tastings without having to obtain a licence to sell liquor. Wineries should be free to charge a fee, but should not be obliged to do so.

³ Known as an off-licence or a producer's licence in some jurisdictions.

12.2 Wholesale sales tax concessions for small business

All manufacturers and wholesalers must be registered with the ATO unless they deal exclusively in exempt goods. Registered taxpayers are required to keep proper records to enable an accurate assessment of their WST liability. Those whose annual WST liability is \$10 000 or more must file a return detailing sales by WST rate categories and pay the tax by the 21st day of the month following the reporting month.

There are two concessions for smaller taxpayers in the WST legislation. The first aims to reduce collection and compliance costs. Small businesses whose annual tax liability is less than \$10 000 can file a return on a quarterly basis within 21 days of the end of the relevant quarter, rather than file returns on a monthly basis.

The second concession provides taxpayers who reasonably expect their annual WST liability to be \$10 000 or less the option of either paying tax on their business inputs while claiming exemption from WST for the goods they produce or, alternatively, obtaining inputs tax free and paying tax on their non-exempt outputs. Once a taxpayer's liability reaches \$10 000, the taxpayer must pay WST on the full value of sales— the option of paying tax on business inputs is not available.

The \$10 000 *tax liability* threshold was established primarily because it represents a convenient point below which collection of tax through the WST starts to become uneconomic rather than to provide a boost for small business. However, the option of paying tax on business inputs rather than on outputs confers a financial benefit on many small businesses— ie tax paid on inputs is generally less than tax on non-exempt outputs. Thus, one consequence of the small business concession is that some businesses whose WST liability just exceeds the threshold can face a very high marginal tax rate. In this context, Rumbalara Vineyards (sub. 82, p. 1) stated:

The present taxation is a positive disincentive to growth and amalgamation and discriminates against small winery establishments with wholesale sales above \$50 000 per annum. Indeed this system actually encourages the proliferation of small winery enterprises.

The WFWGC and several smaller winemakers were concerned that the recent increases in the rate of WST on wine have reduced the threshold sales value of the goods an exempt winemaker can produce, disadvantaging winemakers in relation to other taxpayers and creating an incentive for winemakers to reduce their turnover to retain the small business exemption. The WFWGC (sub. 30, p. 156) stated:

If the sales tax rate is 21 per cent, the value of the goods a taxpayer may deal in before losing exemption status is approximately \$47 620. However, as the sales tax rate increases to 26 per cent, the value of the goods an exempt taxpayer may deal in decreases to \$38 640. This equates to a \$9 160 drop in volume available to a small business taxpayer wishing to avoid the burdens of sales tax compliance.

Participants suggested a number of ways in which these disparities might be addressed, including:

- restoring the previous position of winemakers relative to other taxpayers by returning wine to the WST general rate;
- restoring the previous position of winemakers relative to other taxpayers by increasing the WST liability threshold for the wine industry or providing equivalent cash rebates to winemakers;
- introducing a wholesale*sales* threshold of \$50 000 for all taxpayers (rather than the \$10 000*tax liability*) before a taxpayer becomes liable for WST with WST paid only on the value of sales exceeding \$50 000; or
- rebating tax paid by all business taxpayers (or winemakers only) on the first \$50000 of sales.

As a consequence of the WST's five different rate schedules (in addition to the exempt category), the wholesale sales volume at which the small business concession applies varies considerably among industries. In principle, this variation could be avoided if there was a separate tax liability threshold for each WST rate. However, this would become unduly complicated for businesses producing products which fall into more than one WST category — in practice, it would mean that firms' overall tax liability threshold varied depending on their product mixes. The Committee considers that the added complexity involved in administering a system such as this would clearly outweigh any gains that may accrue to individual firms.

A related approach — which until fairly recently had been available to taxpayers — is to specify a wholesale *sales* threshold in the place of the current \$10 000 *tax* liability threshold. In principle, a sales threshold set at (say) \$50 000 for all taxpayers would still imply different tax liability thresholds for different products in accordance with the applicable WST schedule. However, it would provide access to the small business concession on the basis of a single (sales related) criterion, without undue administrative complexity. From a taxpayer's perspective, it would mean that the definition of a small business is straightforward— essentially, any business with taxable sales of less than \$50000 would be eligible for the small business concession. However, a primary reason for the concession for small businesses is that it is uneconomic for the ATO to collect WST when a taxpayer's liability is small.

From this perspective, the measure which should determine how the exemption applies is the level of tax which becomes worth collecting. In these circumstances, any benefit to small business is incidental.

The introduction of a sales threshold, in the place of a tax liability threshold, would not, however, remove the problem of the high marginal tax rate faced by taxpayers whose level of taxable sales places them just above the threshold. It would not, therefore, remove the incentive for businesses to remain small or structure themselves such that the small business concession could be retained.

Removing this major step in tax liability is fraught with difficulty. For example, a tax-free threshold for small business, whereby the first (say) \$50 000 of wholesale sales are completely free of WST, would have serious ramifications for revenue collection because it would be available irrespective of the size of the business. It would also introduce disparities in the tax treatment of businesses and other taxpayers. A tax 'break' for small business, however defined, or for the wine industry alone, would introduce even greater taxation disparities.

A tax-free threshold would also be costly to administer. If it were provided through a rebate system, tax would have to be paid on all sales prior to being refunded by the ATO. As noted above, the current option of paying tax on business inputs where the tax liability is less than 1000 (instead of WST on sales) is offered because it is uneconomic for the ATO to collect tax on sales where the liability is small. If a variant of the current small business concession were introduced— whereby tax in respect of the first 50000 of wholesale sales is paid on inputs rather than on sales— there would be complexities for taxpayers. For example, a taxpayer would need to identify (and be able to substantiate) the taxable inputs used to produce those sales within the threshold. In view of these practical difficulties, and bearing in mind the need to ensure, as far as possible, that the taxation system treats all taxpayers equitably, there does not appear to be a ready solution.

While acknowledging that the current reliance on the *tax liability* threshold to define a small taxpayer is primarily designed to reduce the ATO's administration costs, the Committee recommends that the ATO consider the reintroduction of a *sales* threshold for determining a taxpayer's access to the small business concession. The *sales* threshold could be set at \$50 000 indexed annually. This arrangement could be introduced for all businesses, not just those in the wine industry. In this regard, the Committee notes that, in comparison to the current *tax liability* arrangement, the application of a *sales* threshold of \$50 000 would benefit businesses whose products are taxed at the general rate

and above, and disadvantage businesses whose products are taxed below the general rate.

Winemakers also expressed concern about the effect on their cash flow of the requirement to pay WST within 21 days of the end of the month following the month in which the transaction attracting the tax takes place. Many winemakers reported that they sometimes receive payment for goods sold 60 or 90 days after the sale. The AWF recommended that this matter be addressed by increasing the statutory time period for payment of WST or by imposing regulations on wine merchants' trading terms.

The 21-day payment requirement means that there is a a minimum of 21 days and a maximum of 51 days before payment of the WST is required— on average a lag of 36 days from the date of sale to the date that taxation revenue must be passed to the ATO. The Committee accepts that, in many cases, winery operations are structured to allow extended credit and that it would not be unusual for winemakers to pay WST on some transactions before they receive cash payments. In this respect, however, wineries are unlikely to be different from other industries which offer extended credit terms.

The Committee has not identified any special reasons applying to the wine industry which would warrant the extension of the current 21-day rule for payment of WST. If the time frame is a problem, it would be appropriate for the industry to seek to modify the current terms under which wine is supplied to the trade. Credit terms, along with other conditions of sale (eg volume discounts, promotional undertakings, etc), are fundamental commercial matters which should be determined through negotiation between buyers and sellers. The Committee does not consider it appropriate for governments to intervene and regulate outcomes.

12.3 Write-off allowance for establishing vineyards

The Commonwealth's 1993 wine industry packag@rovides a four year writeoff period for expenditure incurred after 1 July 1993 in establishing grape vines in Australia for primary production. All expenditure incurred from the time the vines are actually planted can be written-off over four years, except for expenses such as trellising and irrigation costs which are depreciated in accordance with a schedule related to their economic life. The write-off is unaffected by ownership changes.

The new write-off provision represents a significant change from existing law under which most establishment costs are deemed capital in nature and not deductible. It considerably reduces the effective tax rate on new investment in vineyards. The Commonwealth Treasury (sub. 95, p. 23) stated that:

This change has ensured that the write-off regime for investment in Australian vineyards is considerably more generous than that applying in some other countries, such as New Zealand and the United States. The United States allows the costs of planting trees and vines to be depreciated at a rate of 10 per cent on a straight line basis, whilst in New Zealand depreciation is at a rate of 10 per cent on a diminishing value basis.

As with other provisions for the write-off of expenditure, the four year provision for writing-off costs incurred in the establishment of vineyards provides most assistance where a tax entity has a taxable income against which the costs can be written-off. Given that it can take up to five years before a new vineyard produces a flow of income, the four year tax write-off for vineyards provides greater benefit for taxpayers with established vineyards who are increasing their plantings and for large diversified companies entering the industry, than it does for new businesses.

The AWF sought to have costs incurred from the time that land is being prepared for vine planting also able to be written-off over four years. However, this would extend concessions to grapegrowers who are already accorded preferential treatment through the ability to write-off many establishment costs well in advance of the time implied by the (on average) 30 year economic life of vines. The Committee does not support the extension of the current concession.

The WFWGC requested that the concession be extended to lessee owners, stating that capital expenditure on privately leased land is currently not eligible for write-off over four years. The Commonwealth Treasury (sub. 95, p. 23) indicated that the WFWGC request is receiving Government consideration, stating:

On an equity basis it may not appear unreasonable that lessees should receive the same tax write-off as owners. However, the measure was not extended to lessees initially because of concern at the potential for tax benefit transfer to finance companies. Treasury and the ATO are examining the issues further.

Some grapegrower representatives expressed opposition to the extension of the ability to write-off the cost of establishing vineyards over four years beyond owner-operators. Both the SAFF and the MVR contended that the extension of the entitlement would harm the long term development of the wine industry by encouraging the entry of short term investors or corporate operators and risking an oversupply of grapes. For example, the SAFF (sub. 171, p. 14) stated that:

... growers fear that the relaxation ... will seriously harm their futures in the industry due to the incentive for short term investors [to be] part of a huge expansion and [who] subsequently, when the taxation measures cease to give them benefit in their operation, will leave the industry and leave the potential oversupply situation for full time long term growers to have to deal with.

While this possibility cannot be discounted, the Committee does not believe that it is appropriate to use the tax system to discriminate between short term or long term investors or industry participants who choose to own assets (in this case land) and others who opt to lease assets. It also needs to be recognised that there would be some advantage to existing participants in the wine industry if the four year write-off entitlement was available in respect of leased land. It would mean, for example, that growers wishing to increase their involvement could do so with lower initial capital outlays and could devote scarce capital to vineyard development rather than tying it up in the purchase of land.

The Committee recommends that the four year write-off provision be extended to include leased land. In principle, access to the write-off provision should not be restricted to any particular ownership structure.

12.4 Valuation of wine stocks for income tax purposes

Section 28 of the *Income Tax Assessment Act 1936* requires that changes in the value of trading stock be assessed as income. Thus, additions to wine stocks during an accounting year are treated as additional income, although there is a matching deduction for the cost of producing or acquiring the stock. Where the value of trading stock falls over the year, the reduction is an allowable deduction from assessable income.

Subsection 31(1) of the Act gives to business taxpayers an option to value stock at either cost price, market selling value or replacement cost. Winemakers are most likely to value their stocks at cost because this method provides the lowest valuation and defers their tax liability. The ATO takes the view that cost price refers to the full absorption cost, ie it includes costs associated with bringing stock into its existing condition and location. Thus, for manufactured goods, full absorption cost includes the cost of labour and materials plus a proportion of fixed and variable overheads such as power, rent, rates and administration.

Many industry participants commented upon the wine industry's "atypically strong" demand for working capital due to factors such as long production lead times and the maturation requirements of certain types of wine. Industry participants believe that the current tax treatment of stocks— whereby the

ATO requires the wine industry to apply full absorption costing in valuing its stocks — impinges disproportionately on winemakers because of the industry's low rate of stock turnover. The WFWGC (sub. 181, p. 46) stated:

Essentially, the absorption costing of expenses under the wine industry situation of low stock turnover leads to understated expenses for the current year, and subsequent overstated profits. Taxation, therefore, is paid in advance of sale, thereby calling on additional working capital.

Consequently, this tax treatment of its own account generates an unjustifiable need for working capital. In doing so, it creates an impost which inhibits the growth of the wine industry.

The WFWGC stated that the ATO requirement that winemakers apply full absorption costing with respect to valuing their stock for income tax purposes contrasts with the "majority of other classes of primary producers" who are able to use direct costing principles. It also claimed that the very low level of stock turnover in the wine industry relative to other industries means that winemakers receive a lower proportion of eligible deductions in respect of production expenses in the year that the expenses are incurred than does industry generally.

More generally, there was criticism by the industry that the current stock valuation provision does not provide any tax incentive to produce for stocks. A deduction *is* available for the cost of producing additions to stock, but winemakers' taxable income is increased by the same amount. Participants contrasted the current provision with Section 31A of the*Income Tax Assessment Act 1936*, which was repealed in 1973. This provided a tax concession by allowing winemakers to value stocks below cost. The actual cost of making the wine could then be deducted against the artificially low stock value, allowing a tax deduction against profits from sales in that year. In effect, the concession allowed winemakers to bring deductions forward and receive an interest free advance from the Government. When the wine was sold, the low stock value was deducted from the sale price—with higher tax being paid than if the wine had originally been valued at the cost of production. Winemakers could receive a continuing deferral of tax payments while stocks were increasing.

Because tax deductions claimed for the cost of adding to stock are balanced by an increase in taxable income, some winemakers believe that they pay more income tax in the year that the stocks are produced than they otherwise would — in essence, they believe they are paying tax on additions to stock. Many also believe that winemaking has special features— for example, producers of some red wine, fortified wine and brandy commonly hold stocks over long periods, and the timing of the vintage is such that winemakers generally have large stock holdings at June 30 each year. Consequently, many in the industry contend that wine stocks should be treated differently from stocks held by other industries.

Full absorption costing

Stock valuation using the full absorption methodology requires that account be taken of a portion of the cost of overheads and depreciation, unlike direct costing which requires that only direct costs— such as wages, materials and variable overheads— be taken into account. Accordingly, full absorption costing results in additions to stocks being valued more highly for taxation purposes.

The WFWGC and the AWF claimed that the ATO is inconsistent in its application of full absorption costing to stock valuation across different industries, citing livestock, nursery greenstock and the banana industry as evidence of inconsistencies by the ATO.

The Committee investigated each of these examples of "special treatment". It found that, in each case, the tax treatment appears to reflect the commercial environment facing the particular activity. In relation to banana growers, for example, the ATO accepts changes in the valuation of trading stock based on the cost of harvesting and processing the fruit (ie some costs— such as growing costs— are excluded).⁴ It does this recognising that the quantity of stock on hand at any one time is small relative to total production, that some expenses are very difficult to allocate to the value of stock and that the total amounts in question are small. According to the ATO, the application in respect of bananas is simply a reflection of ATO general practice where stock holdings are very small relative to total production and the amounts in question are small. This situation is unlikely to apply to winemakers because the quantity of stock is usually large in absolute terms and large relative to total production.

In the case of nurseries, where greenstock is valued at cost, the ATO permits a discount of up to 25 per cent to allow for likely losses. Where greenstock is valued at market price, and it can be established that the stock has no value, then no value is ascribed to it for tax purposes. The likelihood of stock losses in nurseries is, of course, far greater than in the case of wine. Indeed, unlike nursery greenstock, wine stocks generally appreciate over time.

⁴ In the case of banana growing, the ATO (TD 93/47) states that harvesting and processing expenses include, but are not limited to, material, labour and overheads associated with all work done from picking the crop to loading it for transport. This includes pickers' wages, depreciation of picking plant, fuel for machinery used in the harvesting process, packing costs, sorting costs and the cost of electricity used in the packing shed.

In relation to certain types of livestock— cattle, horses, pigs, deer, goats and sheep — there are prescribed minimum values for natural increases. Producers are required to value natural increases in these types of livestock at the prescribed minimums unless the actual cost— the full absorption cost is lower. Prescribed minimum values do not apply to increases achieved by way of purchase— these must be valued at the cost of purchase. The effect of the taxation ruling in regard to natural increases in livestock is to prevent producers from*undervaluing* natural stock increases. In this sense, it is not a concession as implied by the WFWGC and the AWF.

Slow turnover of stock

Many participants submitted that the wine industry is unique in that the rate at which it sells its stock is very low⁵. They argued that this means that the proportion of stock costs to total production expenses which can be claimed as a tax deduction in the year of manufacture is lower than for other industries. The WFWGC (transcript, p. 1299) stated that:

... a typical average is that only 82 per cent of the expenses that a producer incurs can actually be expensed in the year in which they are incurred.

The WFWGC, while recognising that the matter is a question of timing, argued that the timing difference is important because it reduces the ability of winemakers to finance debt and raise capital, and encourages the production of lower quality wines by pressuring winemakers to reduce stock levels and increase the rate of stock turnover.

The AWF (sub. 33, p. 12) stated that:

... to hold stocks over lengthy periods of time is unique to the wine industry and a concession on stock valuation is therefore necessary to alleviate the liquidity pressures resulting from this high stock requirement. The nature of the legislation provides an incentive for producers to sell off stock before they are adequately matured so as to maintain a satisfactory cash flow, thus compromising wine quality. This obviously has an impact on market development, both domestically and internationally.

Assessment

The Committee acknowledges that the current provision for valuing additions to stock for taxation purposes is a significant concern for many in the wine industry, particularly in terms of cash flow. Some winemakers– particularly

⁵ The WFWGC and AWF cited an analysis by Coopers and Lybrand which indicated that the rate at which the wine industry completely sells its stock (stock turnover)— calculated by dividing the cost of goods sold by the industry's average stock level—ranges between 0.2 and 1.8 times per year.

producers of brandy, fortified wines and some red wines— maintain large stock holdings, which can create liquidity pressures. Indeed, brandy is required to be held for a minimum of two years for maturation. In contrast, for a large portion of the industry, stocks of many products (typically nonpremium wine, some bottled white wine and, to a lesser, extent some bottled red wine) are not held for extended periods. The WFWGC (transcript, pp. 1298–9) stated:

The sort of problem that's identified ... is very much relating to those stocks which are held for a considerable period of time, typically for maturation purposes. ... In the case of cask wines or those white wines that don't require wood treatment, ..., the problem disappears ... because basically they're sold within a shorter time frame ...

The current tax provision does not subsidise the holding of stock in the way that was possible under Section 31A— it does not deliver liquidity benefits previously available to the wine industry vis-a-vis other taxpayers through the ability to claim a tax deduction in the year that the stocks were produced while withholding payment of tax until the wine is sold. The current tax arrangement for valuing stock represents neither an incentive nor a disincentive to change stock levels. In that sense, valuing stocks for tax purposes according to their cost of production has the same effect in cash flow terms as if stock holding was outside the tax system.

The Committee believes that it is appropriate to value trading stock for tax purposes across all Australian industries— including the wine industry— on a common basis and in a way which does not confer an advantage to a particular industry because of its operating characteristics. The Committee considers that full absorption costing is the appropriate methodology because it ensures different industries are treated on an equivalent basis— taking into account *all* costs of production. In contrast, the direct costing method would value stock in industries where labour and material inputs are a higher proportion of production costs more highly than it would in industries where these inputs are less important.

The Committee acknowledges that, in some parts of the wine industry, considerable assets are tied up in the form of stock. However, this is not in itself a reason for special treatment for the wine industry. Different industries face different cost structures. Just as long maturation periods, high stock levels and resulting pressures on cash flows are a normal part of the process of producing some types of wine, so are high capital equipment costs for the steel industry and high labour costs for the hospitality industry, etc. These differences merely reflect variations in production processes and input usage across different industries. They do not warrant 'compensation' through the tax system. Winemakers' decisions to produce longer maturing wine should

be based on commercial judgments that consumers are prepared to pay for such wine, rather than on subsidies to stock holding available through the tax system.

Given the extent of concern about this matter, the Committee believes it is important to clarify that winemakers valuing stocks at cost do not pay tax on additions to stock. Where stocks are valued at their cost of production, the taxable value of stock held at the end of the year equals the actual costs claimed as deductions in that year. The two amounts are offsetting and no additional tax is paid.

One possible rationale for re-introducing a provision similar to the former Section 31A is the importance of stocks relative to other forms of business investment for the wine industry.

Some forms of business investment, such as stock holding, are treated as income. Thus, as stocks accrue, the increase in their value is taxed as income and the expenses incurred in acquiring them are treated as a deductible expense. In contrast, other forms of investment are treated on an 'expenditure incurred' basis (ie they are tax deductible in the year they occur or are written-off over an abbreviated period) even though, in many cases, they generate a stream of income for many years in the future. Thus, business expenditure on repairs and maintenance, research and development, staff training, product promotion and plant and equipment with an economic life of three years or less is written-off as it is incurred. Other plant and equipment (ie with economic lives greater than three years) can be written-off in accordance with accelerated depreciation schedules. As a consequence, business investment in these types of assets receives favourable tax treatment compared to business investment in stock holding.

The net effect of the differences in the treatment of business investment on the wine industry vis-a-vis other industries is unclear. It could be argued that, because of its high level of stock holding, the wine industry is disadvantaged by the current arrangements. On the other hand, provisions such as the four year write-off for investment in establishing vineyards, given that the economic life of a grapevine is at least 30 years, favour the wine industry. If the net effect is considered to disadvantage the wine industry, then a change in the tax treatment of wine stocks to an expenditure incurred basis might improve the efficiency of resource allocation between the wine industry and other industry. This would mean that rather than the value of new stock

⁶ This is not to say that the four year write-off provision for vineyard establishment is, or should be seen as, 'compensation' for the cost of holding stock.

adding to taxable income in the year it is produced— with deductions equivalent to the cost of manufacture— the value of stock would be taxed at the time it is sold.

However, changing the tax treatment of stocks only for the wine industry would distort stock holding decisions for wine in comparison to other products. As a consequence, a change could only be justified if it were assessed that the relationship between stock holding and other forms of investment in the wine industry is more important than the relationship between stock holding in the wine industry and stock holding in other industries. The Committee has been unable to identify a net economic benefit from changing the current arrangements.

12.5 Taxation of 'ready-to-drink' alcoholic beverages

Manufacturers of pre-mixed spirituous beverages— a combination of spirits and mixers sold in single use packages, generally of 375 ml or less expressed a strong view that products competing in the same market should be taxed in the same way. In this context, United Distillers (Australia) Limited (UDA) submitted that the considerable taxation disparities between products in what it called the 'ready-to-drink' alcoholic beverage market should be removed.

As defined by UDA, 'ready-to-drink' beverages comprise a wide range of drinks: including, for example, wine coolers, beer in cans and stubbies, premixed spirits, cider and alcoholic soft drinks. According to UDA, the primary trait of the 'ready to drink' market is the capacity to drink the beverage directly from a single serve container.

There are significant differences in the tax treatment of this category of product: wine coolers and products considered to be similar to wine (such as cider and the recently introduced fermented alcoholic soft drinks) face WST at 26 per cent; beer faces WST at the general rate of 22 per cent and excise of \$14.90 per litre of alcohol? pre-mixed spirits (typically about 6 per cent alcohol by volume) are taxed at the same rate as spirits sold in full strength form — ie WST at the general rate of 22 per cent and excise of \$34.69 per litre of alcohol. Some of the products which UDA considers to comprise the 'ready-to-drink' market, together with their associated taxation arrangements, are listed in Table 12.1.

⁷ The excise on beer applies to alcohol content above 1.15 per cent.

UDA sought immediate Government action to ensure that 'ready-to-drink' alcoholic products are taxed at the same rate in accordance with their alcoholic content. UDA considered that the current disparities in the taxation of these beverages— principally the excise-free status of wine coolers, cider and alcoholic soft drinks and the lower rates of excise on beer and brandy—seriously disadvantage its product. It believes that consumers operating in the 'ready-to-drink' market — generally younger adults — readily switch between 'ready-to-drink' alcoholic beverages in response to price. UDA quantified the competitive disadvantage it believes is suffered by pre-mixed spirits compared to other alcoholic products containing similar amounts of alcohol, stating (sub.62, p. 1 and p. 4):

The excise duty component on a 375 ml can or bottle of beer of standard strength (ie 5 per cent alcohol by volume) is approximately 21 cents. ... other alcoholic products such as cider, wine coolers, alcoholic lemonade etc are free of excise. ... a similar sized can of pre-mix, containing a similar amount of alcohol, is subject to excise of around 66 cents.

Beverage	Main ingredients	Alcohol content (per cent)	WST rate (per cent)	Excise rate (\$ per lal)
Tropicana Fizz	wine	3.5	26	0
West Coast Cooler	wine, fruit juice	3.5	26	0
JB Reynolds Dry Wine Cooler	wine, fruit juice and mineral water	3.5	26	0
Strongbow Dry, Sweet	apples	4.7	26	0
Strongbow White	apples	8.3	26	0
E 33	apples	8.4	26	0
Two Dogs	lemons	4.2	26	0
Linden's 5.5	brewed fruit juice or soft drink	5.5	26	0
Sub Zero	malt, citrus juice	5.5	26	0
Carlton Diamond Draught	hops (beer)	4.2	22	14.90 ^a
Toohey's Extra Dry	hops (beer)	5.0	22	14.90 ^a
Foster's Light Ice	hops (beer)	2.7	22	14.90 ^a
Brandy, Lime and Soda (pre-mix)	brandy, soda	5.0	22	34.69
Brandy and Dry (pre-mix)	brandy, dry ginger	5.7	22	34.69
Jim Beam and Cola (pre-mix)	bourbon, cola	6.0	22	34.69
Dark and Stormy	rum, ginger beer	6.0	22	34.69
Johnnie Walker and Cola (pre-mix)	whisky, cola	6.0	22	34.69
OP Rum and Cola (pre-mix)	OP rum, cola	8.0	22	34.69
Wild Turkey and Cola (pre-mix)	bourbon, cola	8.0	22	34.69

UDA submitted that, as a general rule, all the beverages it defines as 'readyto-drink' should be taxed in the same way as beer. However, it acknowledged practical difficulties in taxing particular beverages differently on the basis of their packaging. It argued that its preferred taxation outcome could be achieved by introducing a new 'catch all' excise category called "other alcoholic beverages", which would cover all alcoholic beverages not otherwise defined for excise purposes. Thus, the 'catch all' category would cover all (existing and new) beverages which are not grape wine or a grape

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wine product, not a non-grape wine or a non-grape wine product, not beer, not spirits and not a

spirituous beverage of more than 6 per cent alcohol by volume. UDA proposed that beverages in this excise category be taxed in the same way as beer.

Under UDA's proposal, alcoholic beverages fermented from apples, pears and lemons would be explicitly included within the category of "other alcoholic beverages", rather than be defined as a non-grape wine product. Similarly, spirituous beverages of 6 per cent or less alcohol by volume would be categorised within "other alcoholic beverages", rather than be classed as a spirit. Accordingly, most of the beverages which UDA categorises as 'readyto-drink' would fall within the "other alcoholic beverages" classification and be taxed in the same way as beer. However, pre-mixed spirits of alcohol content greater than 6 per cent would continue to be taxed as a spirit, and beverages containing at least 70 per cent grape or non-grape material (including wine based 'imitation' spirits) would be taxed in the same way as grape wine.

UDA's proposal would involve changes to the excise burden currently facing a number of different beverages. Some products— such as wine coolers, cider, and fermented alcoholic soft drinks— would be brought within the excise net, at the same rate as beer. For other beverages which UDA considers to be part of the 'ready-to-drink' market— such as pre-mixed spirits of 6 per cent or less alcohol by volume— the excise burden would be reduced.

DSICA supported the thrust of the submissions from UDA. It argued in favour of equalising the taxation of all alcoholic beverages, and particularly 'ready-to-drink' beverages. DSICA considered that the latter could be satisfactorily achieved by taxing all such beverages (including alcoholic soft drinks and pre-mixed spirits) in the same manner as beer.

Assessment

The Committee's recommendations in relation to the appropriate taxation of wine discussed earlier in this chapter indicate the extent of its concerns about the distorting effect of disparities in taxation arrangements in general. In this sense, the Committee sees some merit in the rationale underlying the

⁸ For the purpose of its proposals, UDA would define grape wine products, non-grape wine and non-grape wine products as: grape wine products— beverages comprising more than 70 per cent grape wine (such as would be covered by the current Food Standard P6): non-grape wine— beverages made entirely from the fermentation of material other than 100 per cent grapes (such as wine produced entirely from fermenting fruit, vegetables or honey) and; non-grape wine products— beverages comprising less than 70 per cent grape wine (such as some fortified grape wine based products proposed for the Australian market) or products based on fruit or vegetable wine without any grape wine content (such as alcoholic lemonade).

arguments raised by UDA — in principle, highly substitutable products competing in the same market should be taxed at the same rate. A reduction in the rate of excise applying to pre-mixed spirits (which would result from UDA's proposal) could also encourage the production and consumption of spirituous beverages in a relatively low alcohol form, which could lead to a reduction in the costs to the community associated with excessive alcohol consumption. This would be consistent with the differential treatment currently accorded regular strength and low alcohol beer.

However, the Committee considers that the 'ready-to-drink' market concept by itself does not provide an appropriate basis for delineating between alcoholic beverages for taxation purposes. For example, it is difficult to see how wine cooler sold in casks or cider sold in draught or 750 ml bottle form could be seen as part of the 'ready-to-drink' market segment. It would clearly be inappropriate to tax wine cooler or cider differently according to its packaging. In addition, consumers may see similarities between spirits sold in pre-mixed form with an alcohol content of 6 per cent or less, in pre-mixed form with an alcohol content greater than 6 per cent and in full strength form (ie many users buy full strength spirits to mix with soft drinks and other mixers as an alternative to pre-mixed spirits). To the extent that this is the case, the current tax arrangements— which tax all spirits beverages in the same way— may be more appropriate than the UDA proposal.

The Committee also questions the appropriateness of applying one tax regime to non-grape wine products made from apples, pears or lemons, and a different (in UDA's case, a less severe) tax regime to non-grape wine products made from any other fruit, vegetable or substance. Differentiating between similar products for taxation purposes in the way suggested by UDA will encourage certain products at the expense of others. For example, while the UDA proposal will result in the same taxation arrangements for beer, cider, perry and alcoholic lemonade, it would tax similar non-grape products which might become available in the future— such as fermented lime juice— at a much lower level. The Committee reiterates its view that, ideally, taxation arrangements should not distinguish between products which are close substitutes.

The Committee has interpreted the terms of reference for this inquiry to restrict its recommendation to wine and wine products made from grapes. Under this definition, products included in Food Standard P4 and Food Standard P6, together with grape based products in Food Standard P5 (ie wine coolers), would meet the Committee's definition. However, the Committee notes that there are a number of other products which are currently taxed in the same way as grape wine— eg 'wine' made from fruit other than grapes,

cider, perry, mead, sake and the new alcoholic soft drinks. Many of these products have some of the characteristics of the 'ready-to-drink' beverages defined by UDA and, according to UDA's analysis, would compete with the more heavily taxed beer and pre-mixed spirits sold in single serve containers.

The Committee outlined its views on the appropriate taxation of wine and wine products made from grapes in Chapter 11. Given the Committee's view that the inquiry's terms of reference constrain it to consideration of the tax arrangements for grape wine and grape wine products (and not spirits, cider, beer or fermented soft drinks), the Committee is not recommending any change to the tax system to overcome the problems identified by UDA. However, the Committee draws to the Government's attention the matter of the considerable contradictions in the taxation arrangements applying to alcoholic beverages generally.

12.6 Taxation of flavoured bevearges with a fortified wine base

Under the *Excise Tariff Act 1921*, grape spirit or brandy (but not spirit from any other fruit) used to fortify Australian wine is free from excise. This provides excise-free status to the fortifying spirit used to produce sherries, ports and other fortified wine products such as vermouth which have been sold in Australia as 'wine' for many years.

It is now possible, through technological advances, to manufacture fortified wine products so that they have characteristics quite different from the wine base from which they are derived. Representatives of the spirits industry suggested that these fortified wine products closely resemble spirits and liqueurs in appearance and flavour. Further, the products are packaged in a very similar way to the spirituous beverage they seek to 'imitate', although they are generally of a moderately lower alcohol content. Typically, they are not sold with other wine products, but alongside the spirituous beverage for which they are intended to 'substitute'.

DSICA expressed concern that these wine based 'imitations' enjoy a considerable price advantage because they are free of excise. It provided information which showed that flavoured wine products retailed at between one-third and one-half of the price of the corresponding spirit. For example, it indicated that for one product alone— Bailey's Irish Cream retailing for

⁹ Wine based imitation spirits are at least 70 per cent wine and considered under the National Food Standards Code to be a type of wine.

26.61 — there are six wine based imitations retailing between \$7.95 and \$9.99.10

The National Liquor Company (NLC), which is involved in the sale of products alleged to be 'imitation spirits', advanced a different view. It argued strongly that it had developed a niche market among wine consumers, disputing that its products competed in the spirits market. The NLC argued that the large price differential between 'imitations' and spirit based drinks illustrates that the beverages are not close substitutes and is evidence that consumers clearly distinguish between the two types of beverage. The NLC (sub. 150, p. 4) stated:

NLC would certainly like to have got \$18 to \$20 a bottle for our products. We would have been mad if we didn't but the trade and the consumer would not allow us. The reason we can't get these prices is because these products are wine.

DSICA has previously called on the Commonwealth Government to use the imitation and substitution provisions of the Excise Tariff Act to treat imitation wine based beverages in the same way as the spirits they seek to imitate. In terms of the neutrality of the taxation system, there is some attraction in this approach. However, there are significant practical difficulties. For example, there would need to be some test to distinguish between fortified wine which does not imitate spirits (such as ports and sherries) and fortified wine based imitations of excisable products. The Commonwealth Treasury expressed caution about such a test, stating (sub. 95, p. 21) that:

Even if the Government were to draw some distinction for taxation purposes between 'wine' and 'imitations of excisable products', it would need to develop a clear basis for the identification of the 'imitation or substitute' such that the legitimate range of fortified wines remained free of excise. It could prove difficult to develop a satisfactory test that could not be manipulated or challenged by the manufacturers of 'imitations' whilst still being able to position their product in the same market as spirituous beverages.

DSICA has raised its concerns about fortified wine products which 'imitate' spirit based liqueurs with the National Food Authority (NFA). DSICA sought a change to the Food Standards Code in relation to the labelling and contents requirements of wine based cocktails, flavoured wine products and wine aperitifs so these products are clearly distinguished from products in Food Standard P3— spirits and liqueurs. The WFA had made an earlier application to amend the Food Standards Code to separate wine and wine products. In response to these applications, the NFA recommended that Food Standard P4 (wine and wine products) be varied to separate products traditionally regarded

¹⁰ Father O'Leary's, Kilkenny Cream, Erin Cream, Mother Machree, Tudor Cream ad Devonshire Cream.

as wine (and free from additives or modifications) and products predominantly based on wine but containing additives or modified by processes to reduce alcohol (Food Standard P6). Wine based cocktails and flavoured wine products are now included in Food Standard P6.

The NFA's original assessment in relation to DSICA's concerns was that existing legislation in the area of food law and trade practices law provided sufficient power to take action against manufacturers who misrepresent products and that it was not necessary to strengthen the Food Standards Code. DSICA has since reached agreement with the NFA on amendments to the Food Standards Code. These require that all products in Food Standard P6 (except marsala and vermouth) be labelled as a wine product and that a wine product must not by any pictorial representation, design, wording or packaging represent itself as a product in Food Standard P3.

Assessment

There are severe practical difficulties associated with using the imitation and substitution provisions of the Excise Tariff Act to apply an excise to fortified wine based beverages judged to be imitations of excisable spirits. It would require that individual products (including new or altered products) be examined to determine whether they are imitations. This necessarily would be subjective and likely to lead to much dispute. For example, as outlined above, the NLC argues that the evidence of substantially different retail prices indicates that fortified wine based cocktails are a distinct market segment and not substitutes for, or imitations of, liqueurs and spirits.

Notwithstanding the case put forward by the NLC, there are strong similarities between some characteristics of several wine based cocktails and liqueurs, for example, in relation to appearance and marketing methods. Given that there are up to five or six companies manufacturing some wine based cocktails and liqueurs, the lower prices reported by the NLC for its products may not imply that flavoured wine products constitute a different segment of the alcohol market. They could simply reflect competition between producers of wine based cocktails and liqueurs (ie producers cannot lift prices up to the level of spirits and liqueurs). On the other hand, if the products are close substitutes, it is unlikely that consumers would be prepared to outlay the quite substantial additional amounts required to buy 'genuine' spirits and liqueurs. Nonetheless, in the event that wine based cocktails and liqueurs*are* competing in the same market as genuine spirits, the Committee would be concerned about the substantial disparity in the tax treatment of the different products.

The Committee's recommendations for the taxation of wine outlined in Chapter 11 would apply to flavoured wine based beverages which fall into Food Standard P6. However, substantial disparities in the taxation treatment of spirits and their alleged wine based imitations would continue to exist. The Committee draws the Government's attention to the significant differences in the taxation arrangements for spirits and their alleged wine based imitations.

In its draft report, the Committee canvassed an 'in principle' approach, whereby these taxation disparities might be addressed by reintroducing the excise on grape spirit used to fortify wine (ie removing the excise concession now available for grape spirit and brandy used to fortify wine). An excise on fortifying spirit (at less than the rate applying to spirits) applied between 1901 and 1970, and again between August 1983 and June 1984. When reintroduced in August 1983, the excise on fortifying spirit was about one-seventh of the level of the excise applying to spirits. The Committee also canvassed an alternative approach—levying excise on fortifying spirit only where it is used to fortify those products which fall into Food Standard P θ .

In practice, there are difficulties with these approaches. Levying excise on the fortifying spirit used in all fortified wines would mean that fortified wine is taxed more heavily than table wine. Levying excise on the fortifying spirit used to fortify only Food Standard P6 products would affect some products traditionally regarded as wine and accorded the taxation status of wine (such as vermouth and marsala). Moreover, it would require that manufacturers of spirit eventually used in the fortification of P6 products had knowledge of the end use of that spirit. However, in some cases, manufacturers of spirit would be unaware of the end use of the fortifying spirit they sell, ie it could be used to fortify traditional P4 products (in which case it would be exempt from excise) or P6 products (in which case it would be excisable). These difficulties suggest that, if the Government were to address the taxation disparities identified above, the most feasible approach would be to directly excise those wine products judged to be 'spirit imitations', at the rate of excise applied to spirits.

¹¹ The standard separates traditional wine products free from non-grape additives and those products which contain non-grape additives or are modified. As flavoured fortified wines typically contain non-grape additives, they would fall into Food Standard P6. Food Standard P6 also includes low alcohol wine but, as this is not fortified, it would appropriately escape the excise on fortifying spirit.

12.7 The Fringe Benefits Tax

Since 1 April 1994, fringe benefits tax (FBT) has been levied on expenditure incurred by taxpayers in providing entertainment to their employees (and their employees' associates) in the course of business. Entertainment is defined to include any meal accompanied by alcohol. Light refreshments— such as morning and afternoon teas and light lunches— are not classed as entertainment and are not subject to FBT, provided they are not accompanied by alcohol. The underlying rationale for the tax is that, as far as practicable, non-cash benefits should be subject to taxation on the same basis as remuneration in the form of wages and salaries.

The WFWGC claimed there are two aspects relating to the tax treatment of entertainment which impinge unfairly on the wine industry. First, it claimed that the current requirement to pay FBT where alcohol accompanies light refreshments provided in the course of business arbitrarily penalises the wine industry. Moreover, the WFWGC alleged that the ATO's handling of this matter is inconsistent— the WFWGC stated that it is aware of at least one private tax ruling which allows limited amounts of alcohol to be consumed with hot food, yet not be deemed to constitute entertainment.

The second matter raised by the WFWGC relates to the income tax treatment of expenditure by wineries on promotional activities such as product launches. Such activities, being heavily reliant on tastings, typically also involve food. However, the WFWGC alleged that the ATO does not treat wineries for taxation purposes as companies involved in the business of providing food and wine. As a consequence, the WFWGC understood that expenditure by wineries on food provided at wine tastings and other promotional activities is not allowed as a deductible expense. Moreover, the WFWGC stated that, if a wine company supplies food at a product launch at which its employees are present, expenditure relating to the company's employees becomes subject to FBT.

Several other participants also commented on the FBT– generally to criticise the complexity of associated administrative requirements. An example of the administrative demands facing wine companies in relation to the FBT is illustrated in Box 12.1.

Assessment

Generally speaking, it is difficult to argue that food accompanied by alcohol provided to employees in the course of business should not constitute a fringe benefit. Indeed, were this not the case there would be the potential for wineries and manufacturers of beer and spirits to partly recompense their employees in kind rather than by wages and salaries. On the other hand, it is difficult to justify the presence of alcohol being used as the sole means of distinguishing between meals which are, or are not, subject to FBT. This is particularly the case for firms whose business is producing and/or selling alcohol and which commonly serve food with alcohol as a marketing tool.

Box 12.1: Wine companies and compliance with the FBT

Most wine companies typically promote their products directly to store owners and journalists at functions where the wine is provided in conjunction with food. This case study outlines the procedure facing a wine company, Company A, in complying with FBT requirements arising from a typical promotional exercise. In this case, a meal at a restaurant was provided at a cost of \$600 to 17 invited guests and 3 employees to introduce a new vintage. Company A advised the Committee that it undertakes this type of function about once a month.

Company A must establish if any invited guests are ex-employees or if they are present at the request of employees as this may affect the deductibility of costs and the extent of FBT. For employees and invited guests present as a result of a link with an employee or ex-employee, the per person cost of the function is a deductible expense and subject to FBT. For invited guests who are not employees or who have no link with employees, the cost is a non-deductible expense. In the above example, the deductible cost was \$90. FBT payable on this is \$84.42.

In addition, Company A provided a taxi fare home for each person present at the lunch, irrespective of how much wine that person had consumed. The component of the taxi cost relating to employees may be subject to FBT. The component relating to invited guests is a non-deductible expense.

Company A also hosts meals with distributors, export agents, government ministers, journalists, other winemakers, restaurateurs and shop owners, on average, once a day. These meals are not elaborate, but wine is normally an important part of the meal since it is the product manufactured by Company A.

In relation to each of these functions, Company A spends about 10 to 15 minutes verifying matters such as the restaurant account, the connection of guests at the meal to Company A, whether alcohol was served and whether anyone paid for their own meal.

One solution to the 'anomaly' raised by the WFWGC would be to categorise all non-wage benefits provided by employers as entertainment (and therefore subject to FBT) without exception, irrespective of whether alcohol is also provided. This approach, however, would place little weight on existing judgments about collection and compliance costs— judgments which are inherent in the current exclusion of light refreshments from entertainment. Another way of dealing with the 'anomaly' would be to exclude expenditure on light refreshments accompanied by alcohol from the definition of entertainment for firms involved in producing and/or selling alcohol. Inherent in this approach is a view that classifying refreshments as entertainment should not depend solely on whether or not alcohol is provided— ie it could be argued that the current system impinges more heavily on firms which produce or sell alcoholic beverages. This second approach would, however, require specification of the amount of alcohol which could be consumed with light refreshments (to avoid, for example, salary payments to staff in the form of alcohol) and would be likely to increase collection and compliance costs. Hence, in practice it may offer little benefit to eligible companies.

Expenses incurred in providing entertainment are not normally treated as a deductible expense for income tax purposes for any taxpayer. However, where entertainment is provided as a means of promoting or advertising a product or service and access by the public to that entertainment is not restricted, current taxation law treats entertainment as a deductible expense for income tax purposes. In such circumstances— which would encompass wine tastings open to the public— all costs of entertainment (ie food, drink and anything else) are treated as deductible expense items. Consequently, the current taxation arrangements appear to accommodate the WFWGC's concerns with respect to general wine tastings, although they do not accommodate the WFWGC's concerns about the tax treatment of product promotions where participation is by invitation.

Concerns about the complexity of the FBT legislation, the high costs of compliance and the inclusion within the FBT framework of many items which are primarily for business use rather than employee remuneration are not confined to the wine industry. Several of these matters were examined in the Commonwealth Government's review (Willis, 1995) of FBT compliance costs. This considered how the costs of compliance might be minimised whilst protecting the tax base and the overall equity of the tax system. For example, in relation to the administration of entertainment expenses— a matter important in the wine industry— employers will now be able to treat 50 per cent of expenditure on entertainment (food and drink) as subject to FBT, with the balance being a non-deductible cost to the employet? There will also be an FBT exemption available for some employer-provided taxi travel directly

¹² Alternatively, employers will be able to keep a record of actual expenditure on entertainment, or keep records for a representative twelve week period which can then be used for up to five years.

between home and work (ie where an employee arrives at, or leaves work before, 6.00 am, arrives at, or leaves work after, 8.00 pm, or is sent home sick). However, the recent changes did not modify the use of alcohol as the factor determining whether refreshments provided to employees are subject to FBT or address matters such as the industry's concern about it being required to pay FBT in respect of employees present at product launches.

On balance, the Committee does not consider that a change to the tax definition of entertainment so that food accompanied by alcohol does not attract FBT is warranted. Such a change could presumably apply only in relation to light refreshments as the provision of more substantial meals already attracts FBT regardless of the presence of alcohol. Removing the requirement to pay FBT in relation to light refreshments accompanied by alcohol may reduce the amount of FBT paid by some wineries, but could also increase compliance costs due to the requirement to account for the alcohol consumed.

While the Committee agrees that the requirement to pay FBT in respect *afll* food and alcohol consumed by wine company employees at the company's product launch is likely to affect wineries more heavily than most other business taxpayers, the Committee cannot identify a satisfactory low cost course of action. The issues raised by wine companies concerning the payment of FBT in relation to employees present at wine product launches apply equally to a range of other business taxpayers, including wholesalers and retailers of other alcoholic beverages, and restaurants and department stores involved in promoting alcoholic beverages. All these taxpayers could legitimately claim eligibility for an FBT concession for their employees.

12.8 The Income Equalisation Deposits scheme

The Income Equalisation Deposits (IED) scheme was introduced to allow primary producers to avoid the higher tax that Australia's progressive tax system levies on fluctuating incomes compared with incomes which are more stable on a year-to-year basis!³

The scheme provides for non-corporate primary producers (with non-farm incomes of less than \$50000) to make tax deductible deposits to the scheme when surplus funds are available and to withdraw money in less successful years (then paying tax). Deposits in any one year are limited to the amount of

¹³ As an example of growers' income fluctuations, the WGMB stated that, in aggregate, MIA grapegrowers received income of \$37.4 million in 1989 compared to \$16.4 million in 1991.

net taxable primary production income in that year (a maximum deposit of \$80 000 is permitted and there is an absolute limit of \$30000 which can be accumulated in deposits). Deposits must be lodged with the Department of Primary Industries and Energy by 30 June to be deductible in that tax year. The amount allowed a depositor as an income tax deduction in any year is limited to an amount equivalent to the net taxable income from primary production in that year. Interest is paid on the 'investment component' of the deposit, which is the deposit less the amount which would otherwise be payable as tax.

Farm management bonds are a particular form of IED. Unlike IEDs, interest is earned on the full amount of the deposit. However, this benefit is only available if funds are withdrawn when the farm business is facing financial difficulty because of climatic events or market downturn. If funds are withdrawn when these conditions do not exist, the amount withdrawn is treated as if it were an IED (ie interest is paid only on the investment component of the deposit).

The WFWGC stated that the IED concept does not adequately meet the needs of grapegrowers - primarily because it is not structured to take account of the nature of grape supply contracts between independent grapegrowers and winemakers. The WFWGC explained that, as a general rule, grape supply contracts provide for payment in three parts: the first payment by the 15th day of the month following the month of delivery, the second payment at the end of June and the third payment at the end of September. Because the IED scheme operates on a financial year basis, the WFWGC claimed that delays in receipt of some of the contract income to the following financial year mean that growers often have insufficient cash to make effective use of the scheme. The WFWGC contrasted the operation of the IED scheme with the income tax system — ie income arising from contracts for grape supply in any one year (including that received in September) is assessed as being earned in the tax year finishing on June 30. However, monies received in the September of one financial year would be able to be used as a basis for a grower's deposits into the IED scheme in the following financial year.

The WFWGC proposed the following alternatives:

- grapegrowers who supply on contract be permitted to recognise inome for income tax purposes when that money is actually received rather than on an accrual basis; or
- the IED scheme be operated on an accrual basis so that monies received after June 30 in any one year can be taken into account in determining payments to the IED scheme in that year.

Contracts for grape supply are usually structured so that growers are paid in three instalments. In a good season, each instalment would typically be high and in a bad season each typically would be low, thus generating the income fluctuations common in many agricultural activities. However, an IED scheme based on a financial year will, for grapegrowers, pick up two payments from one season and one from another. As payments vary between seasons, this will tend to understate the year-to-year variability in grapegrower incomes, which the IED scheme is intended to alleviate. This is particularly of concern given that the income tax system, which operates on an accrual basis rather than on the basis of money actually received, picks up the full variability in actual income.

The Committee considers that there is merit in assessing grapegrowers' taxable incomes and IED purchases on a consistent basis. However, it would not be appropriate to change the basic nature of the income tax system, as suggested by the WFWGC, in order to achieve this consistency.

The Income Equalisation Deposits scheme should be managed on an accrual basis — ie in determining a grower's payments to the scheme, account should be taken of monies received by growers after the end of a financial year, where those monies pertain to a supply contract operating in the previous financial year.

12.9 Assistance to develop export markets

Some smaller winemakers expressed concern that the Export Market Development Grants (EMDG) scheme unfairly discriminated against small producers. For example, the WIAWA (sub. 40, p. 18) stated:

The scheme presently requires a substantial up front investment by the producer/exporter before rebated assistance is available. The present scheme requires \$30 000 of investment by the producer/exporter before a \$15 000 rebate is available — this may be further exacerbated by time delays in payment.

The EMDG is designed to encourage small to medium sized Australian firms in all industries to develop export markets. It provides for exporters to claim a rebate of eligible expenditure, provided that expenditure is at least \$30 000⁴. In principle, the Committee considers that the conditions governing access to the scheme should not discriminate in favour of any size of operation. However, there would appear to be a need for some minimum level of

¹⁴ Exporting companies can claim a rebate equivalent to half of their eligible expenditure less \$15 000. That is, a company with eligible expenditure of \$30 000 could claim \$7500.

spending in order to contain the cost of administering the scheme. For example, if there were no minimum, it is possible there would be a large number of claims for relatively small amounts, and that the processing costs would exceed the grants provided to small claimants. However, the Committee is not in a position to assess whether the present expenditure minimum— $\$30\ 000$ — is appropriate.

Also in relation to the development of overseas markets, the WIAWA expressed the view that the ATO should treat a business's 'first trip' marketing visit as a deductible expense as it does other outlays associated with operating a business, and not as a capital outlay.

In general, the ATO does not allow a tax deduction for travel expenses associated with a drive to establish new agencies or assets or to otherwise expand a business structure, ie where travel expenses are in the nature of capital expenditure. In contrast, travel expenses aimed at seeking information about new markets or manufacturing trends (ie in keeping up to date) or in expanding existing (ie revenue earning) markets are tax deductible. In this sense, the ATO treats overseas travel undertaken to establish a new market in the same way as other investment aimed at*reating* a business.

12.10 Cash grants for winemakers

The system of cash grants for winemakers— introduced as part of the 1993 agreement between the Commonwealth Government and the WFA– provides for grants to all eligible winemakers of:

- \$1 500 in respect of 1993–94 to be paid during 1994–95;
- \$4 500 in respect of 1994–95 to be paid during 1995–96; and
- \$6 000 in respect of 1995–96 to be paid during 1996–97.

The cash grants are intended to provide transitional relief to winemakers to assist adjustment to the higher levels of WST up to 1995–96. According to the Commonwealth Treasury, the agreement with the wine industry does not extend beyond $1996-97!^5$

Participants in general expressed dissatisfaction with the concept of the cash grants, saying that winemakers preferred to be treated fairly with respect to taxation matters rather than receive "charity", and noting the extent of the

¹⁵ The Commonwealth has provided Budget funding of \$1 million in 1994–95, \$2.8 million in 1995–96 and \$3.7 million in each of 1996–97 and 1997–98. The provision of Budget funds for the operation of the scheme in 1997–98 was made subject to the Government's consideration of this Inquiry's recommendations.

paperwork required to obtain the grants. Typical of the response from the wine industry was the statement by the Vignerons Associations of the Grampians and Pyrenees Regions of Victoria (transcript, p. 69) that:

We don't want cash grants. We want a stable policy environment where we can plan ahead. We don't want handouts. We are not a charity.

While the industry generally opposed the concept of cash grants, there was support for their continuation on the basis that they represented some recompense for the application of WST to cellar door tasting stock. For example, both the AWF and the VWIA agreed that the cash grants should be discontinued after 1996–97*provided* the industry receives a WST exemption for cellar door tastings and sample stock.

As for any industry, it is not clear that cash handouts will contribute to the long term development goals of the wine industry. The grants provide no encouragement to winemakers to improve their performance— there are no conditions placed on winemakers or objectives set for the receipt of the grants. Assistance provided by the grants is not equitable across the wine industry. As the grants are set at the same level for all winemakers, they provide the greatest benefit to small producers.

The original purpose of the cash grants was to assist the industry following the increase in the rate of WST from 22 per cent to 26 per cent. It follows that once a consistent longer term tax arrangement for the wine industry is implemented (particularly where implementation of the taxation structure is phased), the rationale for continuing the grants is weakened.

The Committee does not see the continued application of WST to wine used for tastings at the cellar door as a reason to continue cash grants to wineries. As outlined above, all industries are required to pay WST in respect of goods applied to their own use.

Even if it were decided that some offsetting benefit should be provided to compensate for the application of WST to tasting samples, it would not be appropriate to do so by means of the current system of cash grants. Under the present arrangements, all wineries receive the same payment. Thus, a winery which uses a large quantity of wine for cellar door tastings would receive the same grant as a winery which uses relatively little wine for this purpose. Clearly, this would not be an equitable way to 'compensate' for the requirement to pay WST on tasting samples.

The Committee does not support the extension of cash grants beyond 1996–97.

12.11 State and territory liquor licence fees

All states and territories levy fees on a primarily ad valorem basis on the trade of alcoholic beverages within their borders. To avoid Constitutional problems, fees are specified as a fixed charge and a percentage of purchases in a nominated previous period. The percentage fee varies among states and territories — ranging from 10 per cent (retail) in Queensland,⁶ to 11 per cent in Victoria, South Australia, Western Australia, Tasmania and the Northern Territory, to 13 per cent in New South Wales and the Australian Capital Territory. Fixed charges applying to vignerons also vary across States— it is highest in New South Wales at \$500 per annum. All states and territories, however, provide exemptions from fees for cellar door sales, usually on the basis that the exemptions assist tourism and regional development. A comparison of state fees is provided in Table 12.2.

The licence fee is paid either at the wholesale or the retail level. When paid at the retail level, it is applied on a price which is inclusive of the Commonwealth's taxes on alcoholic beverages. That is, it is applied to the product price incorporating excise (where relevant) and WST. When paid at the wholesale level, the licence fee is applied inclusive of excise only. (The WST is then applied on the basis of the product price incorporating the excise (where relevant) and the liquor licence fee.) The impact on retail prices is similar because of the ad valorem nature of both the WST and the sales related component of the liquor licence fee. Hence, an increase in Commonwealth taxation increases state and territory revenues and amplifies the impact of state charges on the final retail price of the product.

Apart from the licence fee, there other differences in licensing arrangements across states and territories. For example, low alcohol beverages are taxed at varying concessional rates— ranging from nil to 10 per cent!⁷ The level at which the low alcohol threshold is set also varies, with low alcohol beer considered to be less than 3 per cent alcohol by volume in the Northern Territory, but less than 3.8 per cent in most other states? Wine with an alcohol content of less than 6.1 per cent is classified as low alcohol in Western Australia, but in South Australia the threshold is 6.8 per cent alcohol by volume. There are other points of difference among jurisdictions in their

¹⁶ In Queensland, producers/wholesalers pay a fee of 14 per cent of sales to unlicensed persons (ie for sales which are not to licence holders).

¹⁷ Rates for low alcohol beverages range from nil in South Australia, Victoria, New South Wales and the Australian Capital Territory to 10 per cent in Queensland.

¹⁸ In New South Wales and the Australian Capital Territory, low alcohol beer is defined as being less than 3.5 per cent alcohol by volume.

treatment of vignerons. For example, in New South Wales, the amount which can be sold at the cellar door is limited to 45 litres per transaction.

The industry argued that there would be benefit from greater consistency in state and territory licensing arrangements, although concerns were expressed that licence fees across jurisdictions reflect the minimum rather than the maximum arrangement. For example, the AWF (sub. 182, p. 16) stated that it would support uniformity:

 \dots under the proviso that the new national rate be reduced to the lowest state licence fee.

The Committee agrees that the wine industry as a whole would gain from greater uniformity in the conditions applying to liquor licensing— including the level of the fee, the basis for levying charges, the frequency of payments and the range and definition of exemptions. State and territory governments have, in recent times, moved to achieve greater uniformity in licensing conditions and most states have reviewed their liquor acts. The Tasmanian Government explained that the review process, and regular meetings of Australasian liquor licensing authorities, have enabled states and territories (and New Zealand) to achieve uniformity in many licensing requirements.

However, the concerns expressed by the wine industry suggest that there are some remaining disparities — principally the licence fee — which would benefit from the continuing attention of state and territory governments.

The Committee recommends that state and territory governments jointly negotiate with a view to removing remaining inconsistencies in liquor licensing requirements that exist between jurisdictions.

Licence fee exemption for cellar door sales

In principle, it is difficult to justify the licence fee exemption applying to cellar door sales. The exemption provides wineries with a clear cost advantage over other liquor outlets and, in this sense, is not consistent with the Committee's concerns about disparities in taxation arrangements. Indeed, the Committee considers that the exemption for cellar door sales is likely to amplify any adverse efficiency effects of taxation generally as the revenue forgone by state and territory governments— through the erosion of their tax bases — causes them to impose higher taxation elsewhere on a relatively narrow tax base. In practice, however, the exemption is unlikely to mean significant revenue loss for state and territory governments as, at most, only about 5 per cent of wine is sold at the cellar door. In addition, given the large number of small wineries compared to potential revenue, in some states it may be uneconomic to collect licence fees on cellar door sales.

A common justification for the exemption is that it is vital to the viability of small wineries which are major contributors to tourism and regional development. For example, the AWF (sub. 182, p. 16) stated that:

Small winemakers generate regional tourism and subsequent benefits to other local industries without receiving an equitable financial return. The State licence fee exemption provides an incentive to invest in enhancing cellar door operations which creates greater tourism appeal. State licence fee exemption for cellar door outlets is a most direct measure to enhance regional development.

Those state governments which made submissions to the inquiry generally supported the continuation of the fee exemption for vignerons in respect of cellar door sales to unlicensed persons. For example, the Tasmanian Government submitted that the exemption is a means of supporting investment in the industry generally and in cellar door facilities- which it considered to be an integral part of Tasmania's tourism industry— as well as increasing the returns to premium producers operating with low yields and margins. The Victorian Government listed a number of reasons for continuing the exemption including: the availability of the exemption in other states and territories; the contribution of the wine industry to tourism in Victoria; investment by vignerons in product research and development; long periods of stock holding; the effect of climatic conditions on product range and quality; high winery start- up costs; the time required for a new vineyard to reach the production stage; and the difficulty in selling a wine business. Slightly different views were expressed by the Governments of Queensland and New South Wales. The Queensland Department of Tourism, Sport and Racing advised that the issue of licence fees was recently reviewed in that State, with a decision taken to continue the exemption (with review after five years) because of the availability of fee exemptions in other states. The New South Wales Government noted that the exemption available in its state reflects the categorisation of vignerons as primary producers, rather than liquor retailers. It expressed support for the draft report suggestion that state and territory governments review licence fee arrangements in order to assess whether they are the best means of achieving regional development objectives.

The Committee agrees that, in many cases, wineries contribute significantly to regional development. Notwithstanding this, many other activities also contribute to growth in a region: ie in some areas the wine industry is a major factor, in other regions it might be other forms of business activity or particular natural phenomena. Moreover, the focus of a region may change over time— ie it may be that a particular activity such as wine is the catalyst for growth but other industries subsequently develop as major contributors. Accordingly, the Committee is not convinced that regional development is

best promoted by providing a tax benefit to wine producers— and, more particularly, to those producers with significant cellar door sales— while not providing a similar concession to other industries. A better use of state and territory taxes, if regional development is the primary goal, would be to collect the licence fee and to direct funds collected to identified regional priorities determined on the basis of the characteristics and needs of each individual region.

The Committee also accepts that many of the factors identified by the Victorian Government do apply to the wine industry. However, as outlined earlier, many industries— apart from the wine industry— could legitimately claim that the same factors are relevant to them, and many could point to unique characteristics of their own operating environment. Accordingly, while the Committee accepts that the wine industry has characteristics such as long lead times on investment and substantial stock holding, it does not believe that these warrant 'special treatment' in the form of state and territory licence fee exemptions for cellar door sales.

The Committee recommends that state and territory governments examine their rationale for providing a licence fee exemption for cellar door sales, and that states and territories consider whether the exemption is the best means of achieving objectives such as regional development.

Mail order sales

Many vignerons now sell wine— usually their own product— directly to consumers through mail order arrangements. For some winemakers, the mail order arrangement is their primary marketing tool. In addition to vignerons, a number of mail order companies, which sell large amounts of wine made by other winemakers as well as their own wine, have developed in recent years.

State and territory licensing arrangements generally provide a licence fee exemption for vignerons selling their own product by mail order where the sale is to an unlicensed person!⁹ In most states and territories, the licence fee applies to wine sold interstate, with the fee revenue accruing to the state or territory in which the mail order sale originates. An important exception is South Australia, which provides a fee exemption in respect of wine sold interstate, including wine which is not produced by the mail order seller. However, South Australia imposes a restriction on the quantity of wine which can be sold by a wholesaler to an unlicensed person (ie 10 per cent of total

¹⁹ The Committee notes that there are considerable differences between states and territories in relation to the definition of a wine producer and in the definition of own production.

sales). Thus, in practice, the South Australian arrangement is unlikely to offer a significant tax loophole for companies which sell interstate by mail order.

However, the availability of the fee exemption for vignerons selling their own product by mail order provides them with a significant advantage over other retailers of alcoholic beverages. For example, the Australian Liquor Stores Association (sub. 115, p. 4) stated:

The price advantage for producers varies between 11 per cent and 13 per cent depending on the licence fee in the State in which the wine is sold. This makes it difficult for retailers to compete with mail order options given by producers.

In effect, these exemptions allow winemakers to compete directly in the retail market. It is the view of the Australian Liquor Stores Association that the exemptions should apply only to cellar door sales where the wine is physically collected by the purchaser at the cellar door and that the quantity purchased by an individual under this exemption should be limited. Mail order sales should not be eligible for the exemption.

The reason most commonly advanced to support the fee exemption in respect of cellar door sales is the promotion of regional development through the attraction of tourists to regional wineries. However, it is difficult to see how mail order sales contribute to regional development. Such sales do not require that the consumer visit the winery (or the region) and, accordingly, do not contribute to regional development other than to assist the sales of wineries which may themselves promote regional development goals. However, if mail order sales attract business away from cellar door sales, the tax exemption available in respect of such sales could retard, rather than promote, regional development.

The Committee recommends that state and territory governments remove the licence fee exemption for all wine sold by mail order.

min - \$1000 min - \$150 min - \$169 min - \$265 14% ^b of p	13% 500 plus
$\min - 1000 \min - 150 \min - 169 \min - 265 14\%^{b}$ of p	500 plus
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Lowexemptexemptexempt 7% $10\%^{c}$ 5.0% 4% alcohol(beer<3.5\%, (beer<3.8\%, (beer<3.8\%, (beer<3.8\%, (beer<3.8\%, wine<6.5\%))	exemp <3.5 %)

APPENDIX A: PARTICIPATION IN THE INQUIRY

A.1 Written submissions

Organisations and individuals who made submissions to the inquiry are listed below. Participants marked * presented submissions at public forums/hearings. The remainder made written submissions only.

Participant:	Submission No.
A & G Engineering Pty Ltd	6
ACI Glass Packaging	107
Albany Regional Alcohol and Drug Advisory Committee	e Inc. 133
Alcohol Advisory Council of Western Australia Inc*	110, 152
Alcohol and Other Drugs Council of Australia*	49, 186
Alexanders Corporation*	verbal
Amberley Estate*	28
Andrew, Mr Neil	4
Angove's Pty Ltd	70, 148
Appellation Wines & Spirits Pty Ltd*	156
Australian Associated Brewers Inc*	75, 129, 168, 198
Australian Conservation Foundation	204
Australian Council of Viticulture Inc	92
Australian Customs Service*	64, 194
Australian Democrats*	178
Australian Dried Fruits Association*	verbal
Australian Fare Pty Ltd	53
Australian Liquor Stores Association*	115, 189
Australian Medical Association Ltd	37, 193
Australian Society of Wine Education	69, 88
Australian Trade Commission (Austrade)	93
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Australian Wine and Brandy Corporation*	29, 159
Australian Winemakers' Forum Inc*	33, 90, 182, 192
Australian Wine Research Institute*	72, 153
Baldivis Estate Wines	111

Barossa Grape Growers Council*

verbal

Participant:	Submission No.]
Bassetts Romavilla Winery Pty Ltd	113	
Bowen Mr J V S	126	
Brown Brothers Milawa Vineyard Pty Ltd, De Bortoli Wir McWilliams Wines, S Smith and Son Pty Ltd and Tyrrell	's	
Vineyard Pty Ltd	96	
C. C. W. Co-Operative Limited	172	
Camden Sydney Wines*	24	
Cassegrain Vineyards*	51	
Central Highlands Grape Growers Association, Peter Hed and Associates, Orange City Council, Cabonne Shire Cou	uncil	
and Blayney Shire Council	106	
Chateau Remy*		verbal
Chateau Xanadu	54	
Coldstream Hills	86, 174	
Colin Gaetjens & Company Pty Ltd*	verbal	
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Commonwealth Treasury	95, 195	
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Harvest Products Pty Ltd	5
Health Department of Western Australia	162
Hunt's Foxhaven Estate	32
Hunter Valley Vineyard Association*	58
Independent Wineries Association Inc*	61, 122, 170
Irrigation Association of Australia*	188, 205
Katnook Pty Ltd*	verbal
King Valley Grapegrowers Association*	7, 143, 173
Koppamurra Wines Pty Ltd	38
Langton's Fine Wine Auctions in association with Christ	ie's 78,85
Leeuwin Estate*	42, 177
Little River Winery*	154
Macedon Region Vignerons Association	103
Main Ridge Estate	131
Margaret River Wine Industry Association Inc*	14, 44, 123
McLaren Vale Winemakers Inc*	109, 179
McWilliams Wines Pty Ltd*	63, 132
M.I.A. Business Enterprise Centre Ltd*	134
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New South Wales Wine Industry Association*	65, 112, 167
Norrie, Dr Phillip	79
North East Victorian Winegrowers Association*	11, 97, 176
Orlando Wyndham Group Pty Ltd*	87
Pemberton Wine Region Association Inc*	39, 56
Penman Mr A.*	verbal

Participant:	Submission No.
Perth Hills Vignerons Association Inc*	15
Pieter van Gent, Winery and Vineyard	77
Plantagenet Wines	16
Queensland Department of Tourism, Sport and Racing	183
Queensland Fruit and Vegetable Growers	116
Queensland Government	101
Redgate Wines*	verbal
Reid, Mr Michael	27
Relationship Research Resource*	71
Riverina Wine Industry and Interested Organisations	47
Riverina Regional Development Board	196
Riverland Development Corporation Inc*	76, 180
Riverland Winegrape Growers Council*	verbal
Robinvale Wine Grape Grower's Association*	25
Rumbalara Vineyards Pty Ltd	82
S Smith and Son Pty Ltd	74
Simeon Wines Ltd	102
Smithbrook Wines Pty Ltd	57
South Australian Farmers Federation*	45, 171
South Australian Government*	41, 169
Southcorp Wines Pty Ltd*	59, 149
Southern Downs Regional Development Group	108
Sunraysia Development Corporation	67, 157
Tarac Australia Pty Ltd	81
Tasmanian Government*	80, 138, 197
Taylors Wines Pty Ltd*	19
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United Distillers (Aust) Ltd* 62, 11	9, 121, 161, 200, 203
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Victorian Government	128, 184
Victorian Wine Industry Association*	12, 114, 141
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Pyrenees Regions of Victoria Inc*	8
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Voyager Estate - Margaret River*	23,163
Ward, Mr Bill	35
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Williams, Mr David M	34
Wine and Brandy Producers' Association of South Australia* 50,	, 127, 190
Wine Grapes Marketing Board*	46, 136
Wine Industry Association of WA Inc*	40, 147
Wine Industry Council of Queensland	83
Wine Service Group*	164
Winemakers' Federation of Australia Inc and	
Winegrape Growers' Council of Australia Inc* 30,	, 125, 181
Woodstock Winery	52
Yarra Valley Wine Growers Association	98
Yarra Yering Pty Ltd*	2

A.2 Visits and discussions

The Committee has had informal discussions with individuals and organisations in all states.

Location	Individual, Company or Organisation
New South Wales	A&G Engineering
	Australian Associated Brewers Inc
	Australian Wine Grape Growers Council/Winegrape
	Marketing Board
	Brokenwood Wines
	Calais Estate
	Centre for Grape and Wine Research, Charles Sturt University
	Cowra Region Winegrape Growers
	De Bortoli Wines
	Helm's Wines
	Lark Hill
	McWilliam's Wines
	NSW Wine Industry Association
	Orlando Wines
	Retail Liquor Store Association
	Rothbury Wines
	Southcorp Wines
	Tyrrell Vineyards
Victoria	ACI Glass Packaging
	Alambie Wines
	Cofield Wines
	Coldstream Hills
	Department of Conservation & Natural Resources
	Diamond Valley Vineyards
	Distilled Spirits Industry Council of Australia
	Domaine Chandon
	King Valley Grape Growers
	Lusatia Park Vineyard
	Mildara-Blass Winery
	Mornington Peninsula Vignerons Association
	Murray Valley Grape Growers
	Oakridge Estate Penfolds Karadoc Winery

	Rutherglen Winemakers Stoniers Winery Tanglewood Downs Estate
	Victorian Wine Industry Association Yarra Yering
South Australia	Antony Smith & Associates Australian Grape and Wine Research Development Corporation Australian Wine and Brandy Corporation Australian Wine Grape Council Australian Wine Research Institute
	Australian Winemakers' Federation
	Balnaves of Coonawarra
	Bowen Estate PPL Hardy Wing Company
	BRL-Hardy Wine Company Coonawarra Vignerons Association
	Drug and Alcohol Services Council
	Economic Development Board of SA
	Hollick Wines
	Loxton Winery
	Majella Wines
	Mildara Wines, Coonawarra
	Orlando Winery
	Penola District Council
	Petaluma
	Redman Winery
	Riverland Winegrape Growers' Association
	Riverland Winemakers' Association
	SA Department of Primary Industry
	SA Economic Development Authority
TT	Southcorp Wines— Wynns/Lindemans Rouge
Homme	Telley
	Tolley Tourism Southeast Viticultural Council of South East SA Wine and Brandy Producers Association of SA Yalumba (Smith & Son) Winery Zema Estate

Western Australia	Alcohol Advisory Council of WA
	Augusta-Margaret River Tourist Bureau
	Evans & Tate
	Leeuwin Estate
	Lenton Brae Estate
	Moss Wood Winery
	Olive Farm Wines
	Perth Hills Vignerons Association
	Redgate Wines
	Sandalford Wines
	Swan Valley & Regional Winemakers Association
	WA Government
	Wine Industry Association of WA
Queensland	Bald Mountain Vineyards
	Ballandean Estate Winery
	Felsberg Vineyards Winery
	Kominos Wines
	Queensland Department of Tourism, Sport & Racing
	Queensland Fruit & Vegetable Group
	Robinsons Winery
	Rumbalara Vineyards
	Southern Downs Regional Development Group
	Southern Downs Tourist Association
	Stone Ridge Vineyards
Tasmania	Meadowbank Wines
	Pipers Brook Vineyard
	State Liquor Commission
	Tasmanian Department of Development and
Resources	
	Tasmanian Department of Premier and Cabinet
	Vineyards Association of Tasmana

APPENDIX B: KEY ELEMENTS OF THE AWBC ACT AND REGULATIONS

The following boxes outline key elements of the AWBC Act and the associated Regulations.

Object of the Act and functions of the AWBC

Box B.1 outlines the object of the Act and the functions of the Corporation as specified in the Act.

Box B.1: Objects of the AWBC Act

- 3 (1) The objects of this Act are:
 - (a) to promote and control the export of grape products from Australia;
 - (b) to promote and control the sale and distribution, after export, of Australian grape products;
 - (c) to promote trade and commerce in grape products among the States and between States and Territories and within the Territories; and
 - (d) to improve the production of grape products, and encourage the consumption of grape products, in the Territories.

Functions of the Corporation

- 7. The functions of the Corporation are:
 - (a) to promote and control the export of grape products from Australia;
 - (b) to encourage and promote the consumption and sale of grape products both in Australia and overseas;
 - (c) to improve the production of grape products in Australia;
 - (d) to conduct, arrange for, and assist in, research relating to the marketing of grape products; and
 - (e) such other functions in connection with grape products as are conferred on the Corporation by this Act or the regulations.

A fundamental problem is that one of the key objects of the Act, and thus one of the key functions of the Corporation, is to control exports, with no particular objective of that control being specified. The objects of the Act also specify the control of the sale and distribution of grape products after export.

Implementation of the Committee's proposals outlined in Chapter 7 would require the modification of the objects of the Act (Section 3) to remove reference to the control of exports, and its replacement with an objective which would refer to the need to ensure that exports of grape products meet, as appropriate, Australian food standards and labelling requirements, or the requirements of the destination country, and is not spoiled.

The functions of the Corporation would need to be modified accordingly.

Powers of the Corporation

Box B.2 outlines the powers of the Corporation as specified in the Act. Clauses (aa) through to (ae) were added in December 1993. The most significant of the new clauses is:

(ae) — the power to determine what varieties of grapes may be used to make wine.

Other key clauses are:

- (a) the power to control exports; and
- (d) the power of the AWBC to trade in its own right.

Box B.2: Powers of the Corporation

- 8. (1) Subject to this Act, the Corporation has power t o do all things necessary or convenient to be done for, or in connection with, the performance of its functions.
 - (2) Without limiting the generality of subsection (1), the powers of the Corporation referred to in that section include power:
 - (aa) to determine any conditions that are to be applicable to registered geographical indications in relation to wines manufactured in Australia or an agreement country; and

Box B.2: Powers of the Corporation continued

- (ab) to determine any conditions that are to be applicable to registered traditional expressions in relation to wines manufactured in Australia or in an agreement country; and
- (ac) to determine any conditions that are to be applicable to registered ancillary protected expressions in relation to wines manufactured in Australia or an agreement country; and
- (ad) to determine any geographical indications or traditional expressions that are to be applicable to those indications or expressions; and
- (ae) to determine the varieties of grapes from which wine may be manufactured in Australia and to determine any conditions that are to be applicable to the description and presentation of wine manufactured from grapes of those varieties; and
- (a) to control the export of grape products from Australia by determining the persons, other than the Corporation, who shall be permitted to export grape products and the conditions under which such exports will be permitted; and
- (b) at the request of a person engaging, or proposing to engage, in the export of grape product, to co-ordinate activities relating to the promotion of the export of the grape product; and
- (c) where a grape product proposed to be exported from Australia to a foreign country meets the requirements of that country for importation into that country, issue certificates that the product meets those requirements; and
- (d) to the extent required to promote the export of grape products from Australia, or the sale of grape products overseas, by persons other than the Corporation, to buy, sell or otherwise engage in trade in grape products and do all things necessary or convenient for engaging in that trade; and
- (e) to engage, or make arrangements with, persons, organisations or companies to perform work, or act as agent for the Corporation, whether in Australia or overseas; and

Box B.2: Powers of the Corporation continued

- (f) to charge such fees as are fair and proper to enable the Corporation to meet costs incurred by the Corporation in administering licensing arrangements relating to the export of grape products (including costs in relation to the grant or renewal of licenses) and in ensuring that persons who are licensed to export grape products comply with the conditions under which the export of the grape product is permitted; and
- (g) to charge for the provision of services, or the performance of work, by, or on behalf of, the Corporation; and
- (h) to waive the payment of fees and charges payable to the Corporation.

The Committee's recommendations in Chapter 7 would require amendments to Section 8 of the Act relating to the powers of the Corporation:

- Clause 8 (2) (ae) would need to be modified to remove the power to determine the varieties of grapes from which wine can be made in Australia, while retaining the power to determine any conditions that are to be applicable to the description and presentation of the varieties of grapes used to manufacture grape products.
- Clause 8 (2) (a) would need to be retained so as to provide the basis for the export licensing and permit provisions necessary to enforce compliance with food standards and labelling requirements. The clause could be modified to specify the conditions under which the Corporation has the power to control the export of grape products, for example by referring to the power necessary to ensure compliance with relevant food standards and labelling requirements.
- Clause 8 (2) (d) which gives the Corporation the pwer to trade in grape products would need to be deleted.

Contracts for carriage of grape products

Box B.3 outlines powers to determine wine shipping contracts.

Box B.3: Contracts for carriage of grape products

- 9. (1) The Corporation may, by notice published in the Gazette, approve a person as a carrier for the purposes of the carriage of a specified grape product to a specified place outside Australia.
 - (2) The Corporation may, by notice published in the Gazette, determine that a contract, or a contract included in a class of contracts, for the carriage of a specified grape product to a specified place outside Australia shall not be entered into except with the approval of the Corporation.

An approval under subsection (2) may be given subject to such conditions (if any) as the Corporation determines.

This is followed by subsections (4) to (8) which elaborate on the earlier subsections.

The proposals included in Chapter 7 would lead to the abolition of Section 9 of the Act.

Regulations associated with the Act

Boxes B.4, B.5 and B.6 outline some of the key regulations associated with the AWBC Act. Notable areas are: Clause 5(3)— prescribed matters; Section 6— the conditions of export— general; and Clause 6(A)— the conditions of export— food standards.

Box B.4: Part 2— General Export Controls

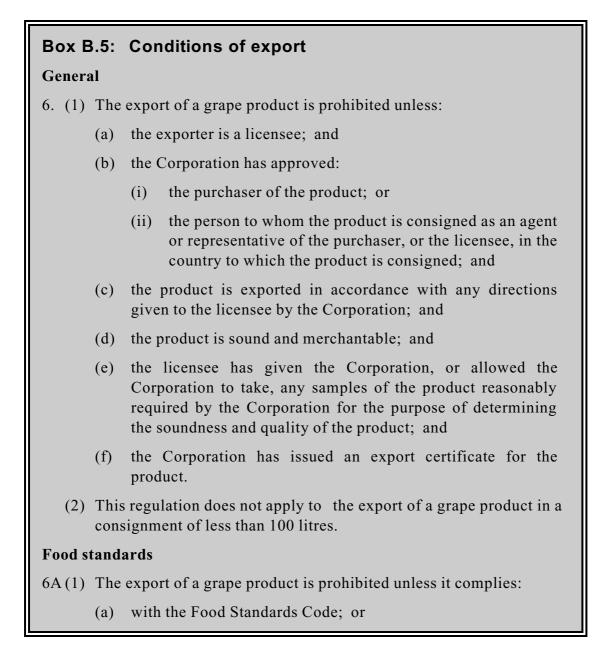
Grant of licences

- 5. (1) The Corporation may, on the application of a person and after taking into consideration the prescribed matters in relation to the person, grant to the person a licence to export grape products from Australia.
 - (2) A licence granted under this regulation
 - (a) shall be in accordance with an approved form; and
 - (b) remains in force for such period, not exceeding 3 years, as is specified in the licence, and may be renewed.
 - (3) For the purposes of sub-regulation (1), the **prescribed matters** are
 - (a) the financial standing of the applicant; and
 - (b) [omitted 1993]
 - (c) the applicant's ability to obtain grape products from Australian suppliers; and
 - (d) matters applicable to the person that relate to the promotion of the export of grape products, including matters that may affect adversely the export trade in grape products; and
 - (e) any other matters relating to the promotion of the export of grape products; and
 - (f) whether the Corporation has cancelled a licence held by the applicant; and
 - (g) if the applicant is an individual whether the Corporation has cancelled a licence held by a corporation of which the applicant was a director or a shareholder who held a controlling interest.

The changes proposed in Chapter 7 would result in the following clauses being deleted.

- 5. (3) (a) relating to the financial standing of the applicant;
- 5. (3) (c) relating to the ability to access grape product;
- 5. (3) (d) relating to the any matter that may affect adversely the export trade; and
- 5. (3) (e) relating to the any other matter.

These provisions are not related to the proposed object of the Act, namely the meeting of food or labelling standards.



Box B.5: Conditions of export-continued

- (b) if subregulation (2) or (3) applies to the product with that subregulation.
- (2) If the grape product is to be exported to a country that imposes requirements for grape products that conflict with the Food Standards Code, the product must:
 - (a) comply with the requirements of the other country that conflict with the Code; and
 - (b) comply with the Code in any other respect.
- (3) If:
 - (a) the grape product is to be exported to a country that imposes no requirements for grape products; and
 - (b) the Corporation has approved in writing standards for the export of the product that differ from the requirement of the Food Standards Code;

the products must:

- (c) comply with the standards to the extent that they differ from the Code; and
- (d) comply with the Code in any other respect.

The proposals outlined in Chapter 7 would require the retention of Section 6(A) — **Conditions of export - food standards** — as this would be the key activity of the revised regulatory agency in relation to exports. Powers covering compliance with various labelling conditions are covered in other sections of the Act and its regulations and are not changed by the Committee's proposed changes.

Most of Section 6. (1) — Conditions of export — general — would be abolished. In particular: clause 6. (1) (b) relating to the right to approve the buyer; and clause 6 (1) (c) relating to the power of the Corporation to give unspecified directions. Clause 6 (1) (d) relating to the power to determine whether the product is sound and merchantable, would be modified, removing reference to sound and merchantable, and replacing this with a clear reference to export being prohibited if the wine is 'spoilt'. The clauses identified for abolition are not related to compliance with the suggested objective of meeting appropriate food standard and labelling requirements.

The remaining clauses in Section 6 (1) would be retained.

Box B.6: Power to set export prices and quantities

- 8. The Corporation, or a person authorised by it, may, from time to time
 - (a) determine, or determine the manner of calculation of, minimum prices for the sale of grape products to be exported or for the sale outside Australia of exported grape products, either generally or in relation to a particular country;
 - (b) give to a licensee directions, in writing, with respect to the quantities of the grape product to which an export certificate relates that may be exported by the licensee either generally, to the countries specified in the directions or to the persons, agents or representatives specified in the directions.

Regulation 8 would need to be modified to limit the power of the Corporation to set minimum prices, and to control quantities only in conditions where this was required by the destination country.

APPENDIX C: TRANSFERABILITY OF WATER

This appendix outlines conditions applied to the transfer of water in New South Wales, Victoria and South Australia.

New South Wales

New South Wales introduced limited trade in water allocations in 1983. Prior to this, the right to access water had been linked to ownership of land and the granting of a water licence. Transfers of water licences were, at that time, prohibited.

In response to increasing water scarcity, New South Wales first implemented a volumetric allocation scheme in which the quantity of water able to be taken from any irrigation source was restricted to a set number of megalitres. Previously, a licence had allowed an irrigator 'enough' water to irrigate a set amount of land, with few restrictions on the actual quantity taken. Growing demand for irrigation licences subsequently prompted the Government to introduce embargoes on the issuance of new licences on the grounds that allocations from existing sources were fully appropriated (Sturgess and Wright 1993).

In 1983, short term 'leasing' of water entitlements was introduced in New South Wales, with permanent transfers remaining prohibited. Over time this restriction was eased, allowing multiple year leases of up to five years, with tenure restrictions substantially eliminated by 1989 (Sturgess and Wright 1993).

However, despite growing acceptance of the benefits of permanent transfers, there is still continued resistance to the introduction of permanent transferability between irrigation areas and districts. This is reflected in the pattern of New South Wales water transfers in 1991–92–1074 temporary transfers of between 1 to 3 seasons with only 86 permanent transfers (New South Wales Department of Water Resources 1992). Further information regarding water transfers in New South Wales is contained in Table C.1.

In some irrigation areas and districts, water transfers are restricted by zonal boundaries which map out limits beyond which transfers are not permitted. In part, these restrictions reflect previous technological constraints on the movement of water, although the implicit objective of preventing water movement away from its original location is commonly a primary goal for these spatial restrictions (Sturgess and Wright 1993). Developments in the last two years have seen the trial of inter-valley transfers, although transfers generally remain restricted to within the boundaries of each regulated river system.

Table C.1: Water transfers in New South Wales					
Region	Tempora	y transfers	Permanent	transfers	
	Volu	ne (value -	Volume (val	ue - \$/ML)	
		\$/ML)			
	1991-	1992-	1991-92	1992-	
	92	93		93	
Border	8 271	8 489	4 974	1 692	
			(220-450)		
Gywdir	26 545	1 560	3 645	0	
Namoi	31 290	30 683	10 350	3 7 5 0	
Macquarie	23 155	12 896	1 1 1 8	1 1 5 4	pasture/unused to
		(10-15)	(71-250)	(130-	cotton
				145)	
Lachlan	6 3 2 3	6 929	497	3 869	pasture to orchards
		(3.5)	(120-150)	(70-80)	and grapes
Murrum-	48 826	11 203	2 166	4 3 5 7	pasture to rice
bidgee			(nom-	(100-	downstream of
			416)	250)	Darlington Point
Murray ^a	83 017	26 659	0	0	
Murray ^b	12 388	17814	372	1 728	pasture to pasture
		(2-3.5)		(100-	
				300)	
Lower	1 792	5 437	526	2 892	
Murray-		(7.5)	(187-320)	(175-	
Darling				200)	
Hunter	0	180	0	602	no significant change
				(175-	in patterns of use.
				200)	
Total	241 772	129 939	23 732	20 044	
a Districts	_ 11 // 2	12/ /0/		20017	
^b Pumpers					
i unipers	lumes are in	megalitres Fi	oures in brackets	represent the	approximate value
		-	-	-	o not sum to totals
		of some region		c. commis u	o not sum to totals
		•	f Water Resource	s	
Source. New	South wates	Department 0		0.	

Water allocations in New South Wales are broken down into a two-tiered system of high and normal security entitlements. Except in periods of extreme drought, high security licence holders always receive their full allocation (such entitlements are generally allocated to urban, industrial, stock and permanent horticulture uses). Normal security licence holders receive what

water is available after diversions for high security allocations and 'prudent' water retentions for dry periods are accounted for. In practice, this amounts to normal security entitlement holders receiving around 80 per cent of their nominal entitlement in the Murray and Murrumbidgee valleys, although in some northern areas the proportion received is less than 50 per cent (EDA 1994).

During wetter periods (termed periods of 'unregulated flows'), water users (both high and normal security) may be offered the opportunity to divert increased quantities of water for on-farm storage or other uses. These 'off-allocation flows' must still be paid for. Temporary 'overdrawing', or water loans, are also available to aid irrigation flexibility (Sturgess and Wright 1993).

In some areas, irrigators may be able to exchange a normal security entitlement for a smaller volume high security entitlement (and a higher charge per megalitre). The terms of such transfers vary between different areas in order to ensure that supply reliability for remaining normal security licence holders is maintained. In the Lachlan Valley, a formula of approximately 1000ML of normal security water in return of 700ML of high security water was used, with 6000ML of normal security water upgraded in 1991–92 (New South Wales Department of Water Resources 1992).

The New South Wales Government is moving towards a more comprehensive specification of property rights over water resources, and also has moved to introduce ECAs designed to accommodate environmental requirements within the framework of water transferability. ECAs are volumetric allocations attached to specific water quality or environmental objectives— for example, to dilute effluent loads or support wetland habitats. At present, only a limited number of ECAs have been allocated, but future specifications of ECAs to all river valleys is anticipated to proceed as soon as practicable. New South Wales also has reformed its approach towards unregulated flow management to preserve the important environmental effects pertaining to periods of high flow.

Other conditions applying to the New South Wales water market include:

- for the Lachlan and lower Murray-Darling regions, a transfer factor of 0.7 applies, effectively reducing the volume of water transfers— and taxing the transaction— by 30 per cent. This restriction is aimed at reducing the total commitment of irrigation on water resources and subsequently improving the reliability of water supply;
- a minimum of 4ML of water per hectare must **b** retained for properties within the MIA, ostensibly to guard against de-watering and environmental degradation;

• transfers, the issuance of new licences or normal-high conversions may be prohibited where adverse environmental consequences are anticipated. This restriction has particular relevance for inter-regional transfers (New South Wales Department of Water Resources 1993).

Victoria

Water allocations in Victoria traditionally have been linked to specific parcels of land, with moves towards transferability of water entitlements independent of land only recently becoming prominent. Transferability amongst private diverters and within gravity fed supply systems was introduced in 1987.

In early 1994, a two year program commenced aiming to formalise the property rights pertaining to all bulk water entitlements. This program will focus on formalising existing consumptive allocations (together with the few existing environmental allocations) and will involve the development of a framework under which trading of these entitlements can occur. Importantly, trading is envisaged to occur between all water users, including local water authorities, urban and commercial users as well as farmers.

For irrigators in public irrigation districts, transfers are permitted only within the same delivery system and on the proviso that drainage, channel capacity and salinity levels will not be adversely affected to a significant extent.

Transfers between private diverters are not heavily regulated, with the majority of government controls pertaining to salinity impacts of trading (given the Victorian Government's commitment to the MDBC's salinity reduction strategy outlined in Chapter 8).

Private irrigation areas are broken down into two distinct categories on the basis of the impact additional irrigation would have on river salinity. Low salinity impact zones (LIZs) are those in which each additional megalitre of irrigation would increase salt displacements to the river by no more than 1 tonne. This means that 1 000ML of extra irrigation would increase river salinity at Morgan by up to 0.2EC, resulting in cost increases for downstream users of approximately \$20000 per annum. High salinity impact zones (HIZs) are those areas in which an extra megalitre of irrigation would raise salt displacement to the river by greater than 1 tonne, increasing salinity levels by 0.5 to 0.9 EC for every extra 1000ML of irrigation (Nyah to the South Australian Border Salinity Management Group 1992).

These zones are central to the operation of water trading amongst private diverters in Victoria. Transfers are permitted without restriction between

irrigators in LIZs. However, restrictions are placed on the transfer of water to or within HIZs.

For HIZ allocations deemed to be 'utilised', transfers within the same HIZ will be permitted, and transfers to a LIZ encouraged by way of a government funded \$50 per megalitre payment, on top of the market price received for the water entitlement. Where a HIZ allocation (or a proportion of an allocation) is deemed to be unused or surplus to normal requirements, transfers of this proportion of the allocation will only be permitted to LIZs. Transfers of LIZ water allocations to HIZ locations are prohibited.

An arbitration committee has been established to settle disputes regarding the definition of HIZ/LIZ boundaries and the calculation of the utilised/unused ratio of HIZ allocations. The committee is expected to play a transitional role, with a review over its future to be conducted in 1997 (Government of Victoria 1993).

As outlined previously, all transfer proposals in Victorian must comply with the States' commitment to the MDBC's salinity and drainage management strategy. In conjunction with this, the Victorian Government has established a system of Salinity Disposal Entitlements (SDEs) to gauge the impact of water transfers on river salinity.

SDEs are not transferable assets accruing to individual irrigators, rather they are a measure of how transfers affect river salinity and the extent to which the Victorian Government has to implement additional salinity interception or reduction works to meet its requirements under the MDBC's salinity management strategy. For example, transfers out of a region may lead to a reduction in the overall level of salinity, thereby earning SDEs. These SDEs may only be used to offset the salinity impacts of intraregional trades or the development of presently unused allocations within that region. Any additional salinity reduction measures required to offset such actions will be funded by government capital contributions, with irrigators meeting the necessary operating and management costs of the salinity reduction works.

Where LIZ irrigators wish to import water from other regions or make use of expanded supplies from new dams, they will be required to meet the full capital and operating costs of any salinity abatement work necessary to counter expected salinity increases. In the case of the additional 000ML supplied from the Dartmouth Dam, the Government estimated that the capital costs of required salinity reduction works were approximately \$112.50/ML, with operating costs of \$2.80/ML per annum. These costs were added to the market price of the water allocations when they were auctioned at Swan Hill in February 1994.

Over time, the Victorian Government anticipates expanding the concept of salinity impact zones to further disaggregate between the effects of additional irrigation on river salinity. This reform would enable the charges for salt disposal to more accurately reflect the true costs of necessary salt interception measures.

South Australia

South Australia for some years allowed limited transfer of water entitlements from land unsuitable for further irrigation to other properties, provided the land is commonly owed. This avenue was expanded in 1979 to allow water transfers between any land in common ownership, as long as there were no significant increases in saline flows to the river. Full transfer of water rights between any two parties was introduced in 1983.

Initially the water transfer scheme was applied only to water allocated to irrigation, though by 1984 South Australia had removed impediments to transferability amongst allocations for irrigation, industrial, recreational and environmental uses. Permanent and temporary transfers are permitted. Within this framework, an average of 3GL per year is transferred, making up around 1 per cent of the State's total entitlement of 317GL. These transfers predominantly involve unused 'sleeper' allocations moving to upstream users.

Under the *Water Resources Act 1950* irrigation areas in South Australia are specified as proclaimed or non-proclaimed. Non-proclaimed regions are those with no current constraints to the development of new irrigation. In proclaimed regions, for example the Wilunga Water Management Area, a moratorium exists on further irrigation diversions. In the proclaimed regions in the south east of South Australia, water is allocated by area of existing crop rather than by volume. Once a region is proclaimed, the Minister appoints a Water Resources Committee to monitor use of the water resources within that area and report on relevant areas of water policy.

There are no spatial restrictions on transfers along the Murray, so long as there are no significant adverse effects on river flows or other environmental considerations (private irrigators must supply an appropriate irrigation management plan detailing the anticipated effects of additional irrigation). An agency fee of \$11.50/ML is levied on all surface water transferred in South Australia.

In contrast to Victoria, irrigators in South Australia's public irrigation districts — making up just under half of the total area under irrigation in South Australia — are now able to transfer water externally, as well as within the same delivery system. This reform was introduced in July 1994 as part of wider water industry reforms progressing in South Australia.

Trades into and out of a government irrigation district must be approved by the relevant irrigation board. For instance, an irrigation board may decline to approve a transfer if it considers that the movement of water will unduly increase the operating costs faced by remaining irrigators in that district. Moreover, until the process of formalising water allocation volumes for irrigators in government irrigation areas is completed, some irrigators will not be able to participate in water trading.

Previously, public irrigators were able to transfer water only within the same delivery system and subject to delivery capacity constraints. Consequently, although the actual number of transactions was quite large within government irrigation districts, only 0.3GL of a total allocation of 149GL was transferred annually.

South Australia has also implemented a scheme for the transfer of groundwater allocations in the northern Adelaide Plains, providing there are no adverse hydrogeological consequences resulting from the transfer. Where groundwater allocations are transferred to another irrigator, the original volume is reduced by 10 per cent (this reduction increases to 70 per cent if the transfer is to a sector other than irrigation).

¹ Government irrigation areas are administered through the Irrigation Act, not the Water Resources Act which applies to private diverters. The Irrigation Act previously did not explicitly define water rights for many districts. Subsequently, while trading into, within and out of government irrigation areas is now permitted, it cannot effectively commence until water rights in government irrigation areas are fully specified.

APPENDIX D: ASSISTANCE TO THE WINE INDUSTRY

There are several standard measures used to report on levels of assistance. The principle measures are nominal and effective rates of assistance. The nominal rate of assistance for an activity is the percentage by which government assistance allows the average gross returns per unit of output to increase, relative to the hypothetical situation of no assistance. The effective rate of assistance is the percentage increase in an activity's value addedper unit of output, relative to the hypothetical situation of no assistance. In other words, the effective rate of assistance takes into account both assistance to output and penalties and/or assistance on inputs. This appendix contains estimates of the nominal and effective rates of assistance for the wine and brandy industry² from 1989–90 to 1993–94 and 1996–97. The nominal and effective rates of assistance on different industries within a sector and over time.

The main form of assistance to the wine industry is the tariff. For the wine industry, rates were mainly composite rates from 1989–90 to 1992–93. That is, an ad valorem plus a specific tariff rate. From 1993–94 onwards, most of the tariff assistance is ad valorem.

Tables D.1 and D.2 list significant wine industry 8 digit harmonised tariff items and their tariff rates. Table D.1 describes each of the tariff items. Table D.2 gives the tariff rate that applies to each classification. At the end of 1992–93 some of the classifications were merged and, thus, some categories are not applicable after 1992–93.

Winegrapes also receive assistance. Grape must (crushed grapes), which is considered to be a close substitute for winegrapes, is afforded assistance through tariffs. In 1992–93, which is the latest estimate, the nominal rate on winegrapes was 13 per cent. This assistance adds to the production costs in the manufacturing sector, thus off-setting some of the assistance to outputs, that is, it acts as a tax on materials.

¹ Value added is the return to land, labour and capital from the production process.

² Wine and brandy are classified under the Australian Standard Industrial Classification (ASIC) 2188.

Table D.1: Definitions of the classification of commoditiesused by customs for tariff purposes								
8 digit Harmonised	Description							
Tariff								
Classification								
2204	Wine of fresh grapes, including fortified wines; grape must other than that of 2009 ^a .							
2204.10	Sparkling wine.							
2204.10.10	In which the natural effervescence is produced solely by secondary fermentation in the bottle.							
2204.10.91	Of an alcoholic strength by volume exceeding 1.15% volume.							
2204.10.99	Other.							
2204.2	Other wine; grape must with fermentation prevented or arrested by the addition of alcohol.							
2204.21	In containers holding two litres or less.							
2204.21.1	Wine which, when kept at a temperature of 20°c in closed containers, has an excess pressure of not less that 140 kpa.							
2204.21.11	Of an alcoholic strength by volume exceeding 1.15% volume.							
2204.21.19	Other.							
2204.21.2	Wine, NSA, of an alcoholic strength by volume not exceeding 20% volume.							
2204.21.21	Of an alcoholic strength by volume exceeding 1.15% volume.							
2204.21.29	Other.							
2204.29	Other.							
2204.29.1	Wine which, when kept at a temperature of 20 ^o c in closed containers, has an excess pressure of not less than 140 kpa.							
2204.29.11	Of an alcoholic strength by volume exceeding 1.15% volume.							
2204.29.19	Other.							
2204.29.21	In containers holding less than 5 litres.							
2204.29.3	Wine of an alcoholic strength by volume not exceeding 1.15% volume.							
2204.29.31	In containers less than 5 litres.							
2204.29.39	Other.							
2204.29.40	Wine, NSA.							
2204.29.90	Other.							
-	s (including grape must) and vegetable juices, unfermented and not whether or not containing added sugar or other sweetening matter.							

Other forms of assistance available to grapegrowers and winemakers are cash grants to eligible commercial winemakers, money to convert an AUSTRADE loan into a grant to the Australian Wine and Brandy Corporation for wine promotion, and a write-off of the cost of acquisition and planting of vines over four years. The recent nature of these assistance measures and the consequent lack of data mean these forms of assistance are not included in the assistance estimates provided in this Appendix.

Table D.2: The ad valorem and specific rates that apply to the classification of commodities used by customs for tariff purposes									
8 digit Harmonise	ed 1989	1990	1991	1992	1993	1996			
Tariff	-90	-91	-92	-93	-94	-97			
Classification									
2204.10.10	11% & \$0.16/L	11%	10%	9%	9%	5%			
2204.10.91	13% & \$0.41/L	13% & \$0.29/L	13% & \$0.17/L	11% & \$0.13/L	na	na			
2204.10.90	na	na	na	na	11%	5%			
2204.10.99	\$0.59/L	\$0.56/L	\$0.53/L	\$0.50/L	na	na			
2204.21.11	13% &	13% &	13% &	11% &	na	na			
	\$0.41/L	\$0.29/L	\$0.17/L	\$0.13/L					
2204.21.19	\$0.59/L	\$0.56/L	\$0.53/L	\$0.50/L	na	na			
2204.21.21	11% &	11% &	11% &	11% &	na	na			
	\$0.19/L	\$0.16/L	\$0.13/L	\$0.13/L					
2204.21.29	\$0.25/L	\$0.25/L	\$0.25/L	\$0.25/L	na	na			
2204.21.10	na	na	na	na	11%	5%			
2204.29.11	13% &	13% &	13% &	11% &	10%	5%			
	\$0.41/L	\$0.29/L	\$0.17/L	\$0.13/L					
2204.29.19	\$0.59/L	\$0.56/L	\$0.53/L	\$0.50/L	12%	5%			
2204.29.21	11% &	11% &	11% &	11% &	11%	5%			
	\$0.19/L	\$0.19/L	\$0.16/L	\$0.13/L					
2204.29.29	27%	23%	19%	15%	12%	5%			
2204.29.31	\$0.25/L	\$0.25/L	\$0.25/L	\$0.25/L	na	na			
2204.29.39	\$0.40/L	\$0.40/L	\$0.40/L	\$0.40/L	na	na			
2204.29.30	na	na	na	na	12%	5%			
2204.29.40	11% & \$0.70/L	11% & \$0.70/L	11% & \$0.70/L	11% & \$0.70/L	12%	5%			
	φ υ. / U / L	φ0./0/L	φ0./U/L	φ0./0/L					
2204.29.90	\$0.70/L	\$0.70/L	\$0.70/L	\$0.70/L	10%	5%			
na not applicat	ole								

Tariff assistance for the agricultural sector is presented in Table D.3. The nominal and effective rates of assistance to winegrapes during the period 1990–91 to 1992–93 fell marginally from 15 to 13 per cent and 31 to 29 per cent respectively. In 1992–93, the average nominal and effective rates of assistance for the agricultural sector were at substantially lower levels of 4 and 11 per cent respectively. Winegrapes are a key input to the wine industry, consequently tariff assistance to winegrapes penalises manufacturing.

Table D.3: Average nominal and effective rate of assistance by, activity, for the agricultural sector, 1990–91 to 1992–93 (per cent)								
	Nominal rate of assistance on outputs ^a			Effective rate of assistance ^b				
Description	1990	1991	1992	1990	1991	1992		
<u> </u>	-91	-92	-93	-91	-92	-93		
Winegrapes	15	14	13	31	29	29		
Total agriculture	6	4	4	15	12	11		
 a Average nominal rates on outputs are weighted by the unassisted value of each activity. b Average effective rates of assistance are weighted by the unassisted value added of each activity. 								

Tables D.4 and D.5 contain estimates of nominal and effective rates of assistance for wine and brandy and other selected industries within the ASIC group 218. The assistance estimates for wine and brandy are, however, understated due to the absence of data on forms of assistance other than the tariff.

The effective and nominal rates of assistance fluctuated during the period 1989–90 to 1993–94. For example, over this period the nominal rate of assistance moved within a range of 8 to 18 per cent. The primary sources of this variation are specific rates of assistance. This form of assistance is tied to the unit value of imports. Therefore, as the import value varies, so does the level of assistance.

By June 1994, the majority of specific rate tariffs for wine had been phased out. For example, in 1989–90, sparkling wine assistance (tariff item 2204.10.10) consisted of an ad valorem tariff of 11 per cent and a specific rate of \$0.16 per litre. By 1993–94, this was solely an ad valorem tariff of 9 per cent. This phasing out of specific rates reduces the yearon-year variation in the assistance rates.

Table	Table D.4: Average nomial rates of assistance on outputs for manufacturing industries, 1989–90 to 1993–94 and 1996–97, (per cent)								
ASIC	Description	1989	1990	1991	1992	1993	1996		
code		-90	-91	-92	-93	-94	-97		
2185	Soft drinks, cordials and syrups ^a	9	10	8	7	6	4		
2186	Beer ^a	5	5	5	4	4	2		
2187	Malt) ^{a,b}	1	1	1					
2189	Alcoholic beverages nec)								
2188	Wine and brandy ^a	12	13	8	18	11	3		
218	Beverages and malt ^a	7	7	6	6	5	3		
21	Food, beverages and tobacco ^a	5	7	6	6	5	3		
	Total manufacturing		5	5	4	4	2		
a Est Inc b As	tween 0 per cent and 0.5 per cent. timates for 1991–92 and 1992–93 an lustry Commission projections of ass sistance estimates not calculated so officiential.	sistance to a	agricultur	al commo	odities.				
• • •	Industry Comm ission estimate	s.							

Table D.5: Average effective rates of assistance for manufacturing industries, 1989–90 to 1993–94 and 1996–97, (per cent)								
ASIC	Description	1989	1990	1991	1992	1993	1996	
code		-90	-91	-92	-93	-94	-97	
2185	Soft drinks, cordials and syrups ^a	10	7	8	8	8	5	
2186	Beer ^a	-3	-3	-3	-3	-2	-1	
2187	Malt) ^{a,b}	1	2	2	2	1	1	
2189	Alcoholic beverages nec)							
2188	Wine and brandy ^a	14	16	9	18	14	8	
218	Beverages and malt ^a	4	4	4	4	3	2	
21	Food, beverages and tobacco ^a	4	4	4	4	3	2	
	Total manufacturing	15	14	13	12	10	6	
In b As	stimates for 1991–92 and 1992–93 and dustry Commission estimates of assis ssistance estimates not calculated so onfidential.	tance to ag	ricultural	commod	ities.			

Assistance to wine and brandy is high relative to the ASIC group 218 beverages and malt. In 1993–94, the effective rate of assistance for beer was - 2 per cent, 1 per cent for malt and 8 per cent for soft drinks, cordials and syrups. In comparison, the average effective rate of assistance for wine and

brandy was 14 per cent. This figure of 14 per cent in 1993–94 was higher than the total manufacturing average of 10 per cent.

The current round of tariff reductions concludes in 1996–97. By that time, the average nominal rates of assistance for wine and brandy will have fallen from 12 per cent in 1989–90 to 3 per cent in 1996–97. The average effective rate of assistance will decline from 14 to 8 per cent. However, in 1996–97, the nominal and effective rates of assistance for wine and brandy will still be higher than the averages for total manufacturing of 2 per cent (nominal) and 6 per cent (effective).

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