



Foundation for Alcohol  
Research & Education



## **The Wine Glut:**

An analysis of the oversupply of wine in Australia and  
progress of the voluntary industry restructure

FOUNDATION FOR ALCOHOL RESEARCH AND EDUCATION

OCTOBER 2012

# About the Foundation for Alcohol Research and Education

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- helping communities to prevent and reduce alcohol-related harms;
- building the case for alcohol policy reform; and
- engaging Australians in conversations about our drinking culture.

Over the last ten years FARE has invested more than \$115 million, helped 800 organisations and funded over 1,500 projects addressing the harms caused by alcohol misuse.

FARE is guided by the [World Health Organization's Global Strategy to Reduce the Harmful Use of Alcohol](#)<sup>[i]</sup> for addressing alcohol-related harms through population-based strategies, problem-directed policies, and direct interventions.

If you would like to contribute to FARE's important work, call us on (02) 6122 8600 or email [info@fare.org.au](mailto:info@fare.org.au). All donations to FARE over \$2 are tax deductible.

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<sup>[i]</sup> World Health Organization (2010). *Global strategy to reduce the harmful use of alcohol*. Geneva: World Health Organization.

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## Acronyms

ABARES	Australian Bureau of Agricultural and Resource Economics and Sciences
ABS	Australian Bureau of Statistics
AWBC	Australian Wine and Brandy Corporation
GWRDC	Grape and Wine Research and Development Corporation
WET	Wine Equalisation Tax
WFA	Winemakers Federation of Australia
WGGA	Wine Grape Growers' Australia

## Overview

Over fifteen years, wine production in the Australian wine industry has significantly outstripped demand – with a boom in international demand and generous Government incentives leading to excessive vineyard plantings and wine production. In late 2009, key industry bodies declared that this situation had created a wine glut of such a scale that it was causing serious damage to the industry and announced the *Wine Restructuring Action Agenda* (the Agenda). The Agenda identified an urgent need to reduce wine inventories and production capacity in order to rebalance supply and demand.

The Agenda was a joint undertaking by the Wine Federation of Australia (WFA), Wine Grape Growers Association (WGGA), the then Australian Wine and Brandy Corporation (AWBC) and Wine Grape Research and Development Corporation (GWRDC). The Agenda's first statement indicated that the wine glut had resulted in 20 per cent of bearing vines and 100 million cases of wine were surplus to requirements.

In December 2010 a follow-up statement on the Agenda was released suggesting that there were 'signs of adjustment in the vineyard area and wine stock, but there are by no means sufficient to suggest the oversupply problem has passed'.<sup>1</sup> No further statements have been issued on the wine industry's progress against the Agenda and in addressing the glut.

Understanding the extent of the wine glut is important for decision makers, as the restructure has been relied upon by the Commonwealth Government as a reason for deferring reform to Australia's alcohol taxation system.<sup>2</sup> The Henry Review recommended that the current Wine Equalisation Tax (WET) be reformed and replaced with a volumetric tax rate, as a matter of urgency. This is because the WET 'arrangements are inconsistent with targeting spillover costs'.<sup>3</sup> Unlike other alcohol taxes, the WET is an ad valorem tax, which results in cheaper wines being taxed less, with no consideration given to the alcohol content of the product.

The primary focus of this paper is to analyse the extent of the wine glut in Australia and assess the progress of the current voluntary industry efforts to address the wine glut. As there is no one definition of a wine glut and no one key indicator to measure the extent of a wine glut, six key indicators have been identified to measure the extent of the Australian wine glut. These are:


1. industry and stakeholder commentary - statements made by wine industry bodies and producers on the extent of wine glut;
2. changes in wine inventory levels against restructure targets - data on changes in wine inventories against the Agenda target of a reduction of 100 million cases;
3. changes in vineyard areas against restructure targets - data on changes in vineyard area against the Agenda reduction target of 20 per cent of bearing vineyards;

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<sup>1</sup> See WFA, WGGA, AWBC and GWRDC 'Wine sector must continue to focus on transition (December 2010)

<sup>2</sup> See Rudd K and Swan W: 'Stronger, Fairer, Simpler – A Tax Plan for our Future' (2 May 2010)

<sup>3</sup> See Australia's future tax system report.

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4. stock to forward sales ratios - the actual stock of wine available in a given year, against the actual domestic and exports sales in the following year;
  5. projected stock to forward sales ratios - the actual stock of wine available in a given year, against the domestic and exports sales in the following year, when the sales data is not yet available; and
  6. the market share of bulk wine - the total market share of bulk wine compared to bottled wine.

Each of the six indicators were examined using available data from a range of sources including the Australian Bureau of Statistics (ABS) and the Australian Bureau of Agricultural and Resource Economics and Sciences (ABARES).

Following an assessment of all six indicators, it is concluded that, on balance, the wine industry has stabilised, suggesting that the wine glut is at an end. This is most apparent when examining the stock to forward sales ratios for 2010/11 (1.4), which is at its lowest since 1994/95 and is in line with the industry's desired ratio of 1.36. Furthermore, these ratios are predicted to decline further in coming years.

This finding has significant implications for decision makers, who can no longer use the wine glut as a reason to delay reforming Australia's alcohol taxation system, namely the Wine Equalisation Tax (WET).

# A brief history of the recent wine glut

## The cyclic nature of the Australian wine industry

Growth in the Australian wine industry has typically been cyclical: characterised by a series of booms that have each been followed either by a plateau and a subsequent period of slow growth, or by significant industry decline.

Commentators have identified a total of five such cycles, starting in the mid-1850s (after the gold rush led to rapid increases in Australia's population and, therefore, in domestic demand) and continuing to the oversupply problems being faced in the present day.<sup>4</sup> The end of the last full cycle, during the late 1970s and early-mid 1980s, culminated in 1985 with the Government putting in place a 'vinepull scheme,' which attempted to rebalance production levels by providing financial payments to grape growers that uprooted their vines. This scheme is generally considered to have been unsuccessful: it was not means-tested (and therefore was taken up by many growers who could afford to absorb the cost of restructuring) and it ultimately led to the removal of some of Australia's oldest vines which produced the highest quality grapes.<sup>5</sup>

It was only a few years after the implementation of this scheme that the wine industry began to move into its next boom cycle. The Government intervened again – this time in the opposite direction. Faced with dramatically increasing international demand for Australian wines, incentives were put in place to encourage new vineyard plantings. It is estimated that these incentives drove an additional 16,000 hectares of plantings – more than half of the approximately 31,500 hectares ultimately declared to be in excess by the Agenda some ten years later. Once the oversupply problem began to impact upon the industry, market adjustment through the exit of some uneconomic producers from the industry was inhibited by a number of factors, one of which was the Government's taxation settings that worked to prop up smaller producers.

The WET framework has entrenched a number of perverse effects that are recognised as directly contributing to the recent oversupply problem<sup>6</sup> – in particular through rebate settings that, in the words of the recent 2009 Henry Tax review:

*fosters small-scale production ... supports some small, otherwise uneconomic wineries [and] ... may be acting to prevent an appropriate market response to [the oversupply] by discouraging mergers within the industry.<sup>7</sup>*

A 2006 ABARES report on the challenges facing the wine industry suggested that the most efficient way of dealing with the current oversupply cycle was simply to let the market work.<sup>8</sup> This stands in stark contrast to repeated interventions by Government at the urging of sections of the wine and grape growing industries.

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<sup>4</sup> Anderson K and Osmond R: 'How long will Australia's wine boom last – Lessons from history' (August 1998)

<sup>5</sup> See, for example, Grant B., Gow J. and Dollery B.: 'The Proposed 'Wine Restructuring Action Agenda' and Alternative Policy Options for the Wine Industry' (May 2011), Australian Agribusiness Perspectives, Vol.19 Paper 89; and The Australian: 'Better Red than Dead' (8 March 2010)

<sup>6</sup> *ibid.*

<sup>7</sup> Henry K. et. al.: 'Australia's future tax system: report to the Treasurer (the Henry Tax Review)' (December 2009)

## Causes of the recent wine glut

The most recent boom cycle began in the late 1980s, and differs from previous cycles in that it was driven primarily by export growth. Ultimately, this cycle of growth has led to structural problems within the industry that created periods of wine oversupply.

The Australian wine industry experienced unprecedented growth throughout the 1990s, driven by a massive increase in the value of Australian wine on the international market. Over the period of 1990/91 to 2004/05, the value of Australia's wine export market increased from \$180 million to \$2.7 billion.<sup>9</sup>

Attracted by the skyrocketing value of the export market, the number of notable<sup>10</sup> winemaking businesses in Australia more than doubled over the same period (from 203 to 413).<sup>11</sup> Vineyard plantings in Australia expanded by approximately 100,000 hectares, and the amount of beverage wine being produced each year went up by a factor of four (from 347 million to 1.4 billion litres).<sup>12</sup> This growth was, in part, encouraged by Commonwealth Government interventions and incentives – through tax-driven Managed Investment Schemes that allowed planters to claim generous tax deductions upon the planting of new vineyards. These incentives are estimated to have been responsible for approximately 16,000 hectares of the new plantings.<sup>13</sup>

Although the value of the export market had skyrocketed, total sales over this period increased more moderately (although still substantially). Combined domestic sales and exports increased by a factor of 3.1 (from 350 million litres to 1.1 billion litres) over this fifteen-year period.<sup>14</sup> This discrepancy between supply and demand has compounded over the years, and increasing unsold wine inventories ultimately led to the wine glut that has characterised the Australian wine market in recent years.

A number of other factors have also been identified that compounded the core issue of mass plantings and that have worked to effectively 'lock-in' the oversupply problem.<sup>15</sup>

The problems with excessive supply have been exacerbated by multi-year contracts, government rebates (i.e. the WET rebate) and barriers to exit have been artificially extending the involvement of otherwise unprofitable wine producers that might have otherwise exited the market.<sup>16</sup>

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<sup>8</sup> ABARES: 'Australian Wine Industry – Challenges for the Future' (October 2006)

<sup>9</sup> Australian Bureau of Statistics: 'Australian Wine and Grape Industry, 1994 and 2005'

<sup>10</sup> Defined as a wine business that crushes 50 tonnes or more of grapes in a year.

<sup>11</sup> Australian Bureau of Statistics: 'Australian Wine and Grape Industry, 1994 and 2005'

<sup>12</sup> *ibid.*


<sup>13</sup> This estimate was given by Mr Worland, President of the Riverina Winemakers' Association during the Catanzariti Inquiry: see New South Wales Legislative Council Standing Committee on State Development Committee: 'Wine grape markets and prices (the Catanzariti Inquiry)' (December 2010)

<sup>14</sup> Australian Bureau of Statistics: 'Australian Wine and Grape Industry, 1994 and 2005'

<sup>15</sup> See, for instance, Commonwealth Bank: 'Commodities: Agri Updates: International Wine Industry Review' (June 2011); PricewaterhouseCoopers: 'How can our wine sector grow through becoming less fruitful? – The Australian wine sector 2011' (2010); Taylor Woodings: 'Industry focus – Has the Government given the wine industry a chance to breathe...?' (May 2010); Winemakers' Federation of Australia, Wine Grape Growers' Australia, Australian Wine and Brandy Corporation, and Grape and Wine Research and Development Corporation: 'Wine Restructuring Action Agenda – Supporting Report' (November 2009)

<sup>16</sup> See, for instance, Wine Grape Council of South Australia: 'Background Paper: The Oversupply of Wine Grapes in South Australia' (November 2011); Allen Consulting Group: 'Alcohol Taxation Reform, Starting with the Wine Equalisation Tax' (August 2011); Henry K. et. al.: 'Australia's future tax system: report to the Treasurer (the Henry Tax Review)' (December 2009); and Seyoum E and Chan C: 'A Real-Options Analysis of Wine Grape Farming in North West Victoria' (March 2012), Victorian Department of Primary Industries Research Paper 2012.4





Meanwhile, international rates of wine consumption have stagnated in recent years, while a high Australian dollar, increased competition from overseas producers and a perceived decline in the Australian brand value have combined to prevent Australia from growing its share of the international market.

## The scale of the wine glut

By the end of 2009, the situation had deteriorated to the point that a group of key industry bodies (the WFA, WGGA, the then AWBC and the GWRDC) issued a joint statement declaring that the wine industry needed to take action:

*Structural surpluses of grapes and wine are now so large that they are causing long-term damage to our industry...*

*...at least 20% of bearing vines in Australia are surplus to requirements... Australia is producing 20-40 million cases a year more than it is selling... [The total] surplus already exceeds 100 million cases and at current rates of production and demand this will more than double in two years.<sup>17</sup>*

To put all of this into perspective, a surplus of 100 million cases equates to approximately 900 million litres of wine, or approximately 20 months of Australia's estimated annual total consumption of wine.<sup>18</sup>

Based on these estimates, the scale of the recent glut is significantly greater than that of the preceding one that culminated in the mid-1980s vinepull scheme. The winegrape surplus that resulted in the implementation of that scheme has been estimated at merely eight per cent, compared to the more than 20 per cent surplus.<sup>19</sup>

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<sup>17</sup> Winemakers' Federation of Australia, Wine Grape Growers' Australia, Australian Wine and Brandy Corporation, and Grape and Wine Research and Development Corporation: 'Wine industry must confront the reality of oversupply' (November 2009)

<sup>18</sup> The latest figure (2010) for apparent domestic consumption provided by the ABS is 539 million litres – see Australian Bureau of Statistics: 'Apparent Consumption of Alcohol, Australia, 2009-2010' (6 June 2011 update)

<sup>19</sup> Wine Grape Council of South Australia: 'Background Paper – The Oversupply of Winegrapes in South Australia' (November 2011)

## Industry action: the Wine Restructuring Action Agenda

The industry bodies' 2009 joint statement recognised that the wine oversupply problem was one that required immediate action through industry restructuring to rebalance supply and demand. It proposed four key initiatives, the foundation of what is now commonly referred to as the Agenda. These were intended to drive reductions in vineyard area across Australia through what has been described elsewhere as an "assisted euthanasia"<sup>20</sup> scheme. The initiatives involved:

- providing supply data summaries to regional associations, examining each region in isolation and in relation to the national picture;
- publishing tools to help individual vineyard operators assess their performance and viability;
- holding regional briefings to discuss data and issues, and to offer business stress testing to assist with decision making; and
- holding discussions with Commonwealth and State/Territory Governments about improved exit packages for growers and small wineries seeking to leave the industry, as well as alternative land use options in wine regions.

While the statement demonstrated that the major national industry bodies recognised the need for structural reform of the wine industry, support among smaller industry bodies and individual winemakers for the targets in the Agenda was not as uniform. Furthermore, some wine industry bodies questioned the validity of the Agenda targets. This is demonstrated through commentary by various bodies in a range of media:

- the Victorian Wine Industry Association chairman, Chris Pfeiffer, is quoted as saying (in early 2011) that: "[t]here's two views out there. One is that we can't sell the wine, therefore we don't need to grow as many grapes; the other is we should be working harder to sell the wine."<sup>21</sup>
- the Margaret River Wine Industry Association president, Leah Clearwater, indicated (in early 2010) that she was sceptical about the accuracy of estimates of the oversupply;<sup>22</sup> and
- the Western Australian Wine Industry Association is reported as saying (also in early 2010) that there is only a very small oversupply in Western Australia, and that the key problem is, perhaps, a failure to adequately promote Australian wine products both domestically and abroad.<sup>23</sup>

The variation in the interpretation of the estimates of wine supply and the division in the industry about these estimates, call into question the basis upon which assessment about the glut has been made and ultimately the value of the Agenda.

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<sup>20</sup> Inside Story: 'The Writing on the Wall' (6 January 2010)

<sup>21</sup> Sydney Morning Herald: 'Over a barrel' (10 April 2011)

<sup>22</sup> ABC News Online: 'Ripping out vines not the answer' (24 February 2010)

<sup>23</sup> *ibid.*

# Progress to date in reducing the wine glut

## Indicators of progress

While there is no single definitive measure of the extent to which the wine glut, the Agenda and independent Government indicators provide a convenient touchstone for assessing the extent of the wine glut. Six key indicators have been used to make this assessment, these are:

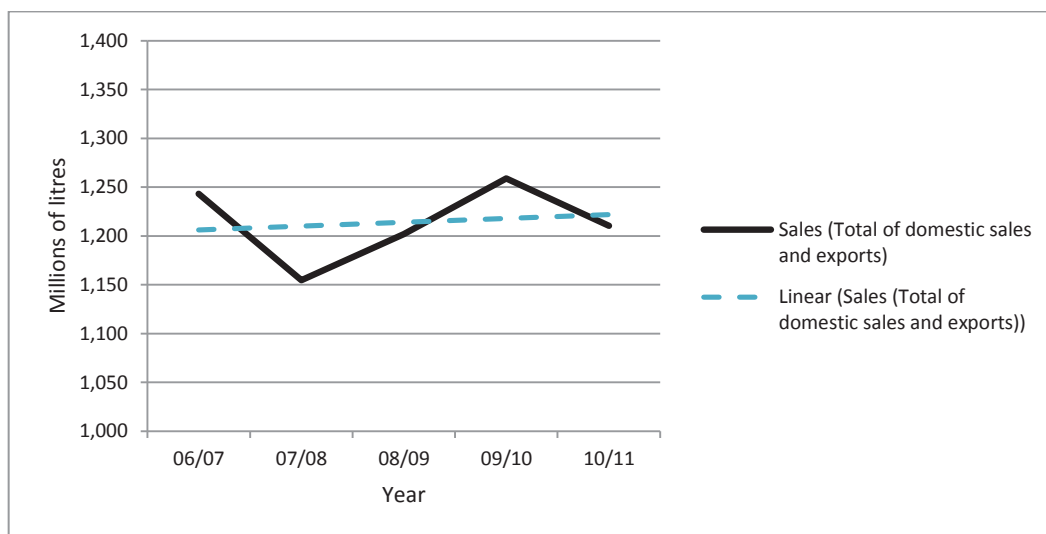
1. industry and stakeholder commentary - statements made by wine industry bodies and producers on the extent of wine glut;
2. changes in wine inventory levels against restructure targets - data on changes in wine inventories against the Agenda target of a reduction of 100 million cases;
3. changes in vineyard areas against restructure targets - data on changes in vineyard area against the Agenda reduction target of 20 per cent of bearing vineyards;
4. stock to forward sales ratios - the actual stock of wine available in a given year, against the actual domestic and exports sales in the following year;
5. projected stock to forward sales ratios - the actual stock of wine available in a given year, against the domestic and exports sales in the following year, when the sales data is not yet available; and
6. the market share of bulk wine - the total market share of bulk wine compared to bottled wine.

Firstly, the wine industry peak bodies responsible for the Agenda have made statements containing self-assessments on the extent of the wine glut and progress of the industry restructure, on a number of occasions. As evidence of progress, these statements are complemented by an array of commentary from other industry stakeholders as well as independent organisations.

Secondly and thirdly, data from the ABS and industry projections from ABARES allows calculation of progress towards the two key targets set out in the Agenda for rebalancing supply – namely a 100 million case reduction in wine inventories and a 20 per cent reduction in vineyard area. It can be reasonably assumed that these targets are still valid, as demand has remained relatively stable over the last five years (as shown in Figure 1). In other words, although demand has increased slightly over that period, it has not increased significantly and certainly not to the point where it would substantially mitigate against the need for reductions. Therefore, the amount of progress that has been made towards these targets should be a good proxy for measuring progress towards ending the glut.

Finally, a review of the available literature suggests three additional measures of the extent of wine oversupply remaining in the market. This provides a fourth, fifth and sixth indicators: a comparison of stock to forward sales ratios; projected forward stock to sales ratios and an analysis of the market share of bulk wine.

Figure 1: Trends in wine sales from 2006/07 to 2010/11



## Indicator 1: industry and stakeholder commentary

The core message from wine industry peak bodies has been that progress against the Agenda, while occurring, has been slower than ideal. For instance, in a joint statement in late 2010, the WFA, WGGA, and the AWBC noted that:

*...despite clear market signals, adjustment is not proceeding at a sufficient pace.<sup>24</sup>*

Similar sentiments are echoed in Wine Australia's current operational plan.<sup>25</sup>

More recently, in the WFA's pre-budget submission for the 2012/13 Budget (dated January 2012), it was stated that:

*...modest progress is being made. An estimated 14,000 hectares<sup>26</sup> of bearing vines have been removed and the average price of Australian wine exports is increasing slowly. However this is not sufficient to suggest the "oversupply problem" has passed.<sup>27</sup>*

Two months later, in April 2012, the Executive Director of the Wine Grape Growers Association further elaborated on the inadequate pace of reform and stated:

*Over a three-year period the national vineyard is reducing, with roughly 4-5 per cent of national vineyard removed in net. Many would believe we need four times as much as that to be removed.<sup>28</sup>*

<sup>24</sup> Winemakers' Federation of Australia, Wine Grape Growers' Australia, and Australian Wine and Brandy Corporation: 'Wine sector must continue to focus on transition (December 2010)

<sup>25</sup> Wine Australia: 'Operational Plan 2011-12' (2011)

<sup>26</sup> This estimate is contestable due to its apparent selection of a baseline year for measurement that ended almost 18 months before the release of the Wine Restructuring Action Agenda, as is detailed later in this paper.

<sup>27</sup> Winemakers' Federation of Australia: 'Pre-budget submission, 2012-13' (January 2012); also see Decanter: 'Australia's grubbing-up programme 'too slow' and 'too little' (10 January 2012) for additional WFA commentary



Moving beyond the peak industry bodies, broader commentary has been more diverse. A number of commentators have expressed views that would appear to align with those of the peak bodies – i.e. that although progress has been made, there is still significant further work to be done to end the oversupply problem. For instance, in a recent report on the Australian wine sector, the United States Department of Agriculture indicated that:

*Australia still maintains very high stock levels that are expected to be an important element of the Australian wine picture for the next 3 to 5 years.*<sup>29</sup>

As a further example, the Wine Grape Council of South Australia reported in late 2011 that, in South Australia alone:

*[u]nless there is a dramatic upswing in demand, up to 20,000 ha of vines, primarily in cool climate regions, may need to be removed ... before supply-demand balance is achieved.*<sup>30</sup>

It should be noted that some commentary has included more optimistic conclusions about when the oversupply of wine and the unsustainable levels of vineyards that are driving it are likely to cease. For example, a short analysis by PricewaterhouseCoopers, released in late 2010, estimated that appropriate levels of vineyard reduction could be achieved in 2015.<sup>31</sup>

In August 2011, the Managing Director of Treasury Wine Estate David Dearie said that “The Australian wine sector is 12 to 24 months away from supply and demand being in balance”.

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<sup>28</sup> Business Day: ‘They may not have turned water into wine but the vintage is good’ (9 April 2012)

<sup>29</sup> United States Department of Agriculture: ‘Global Agricultural Information Network Report – Australia 2012 Wine Annual’ (15 March 2012)

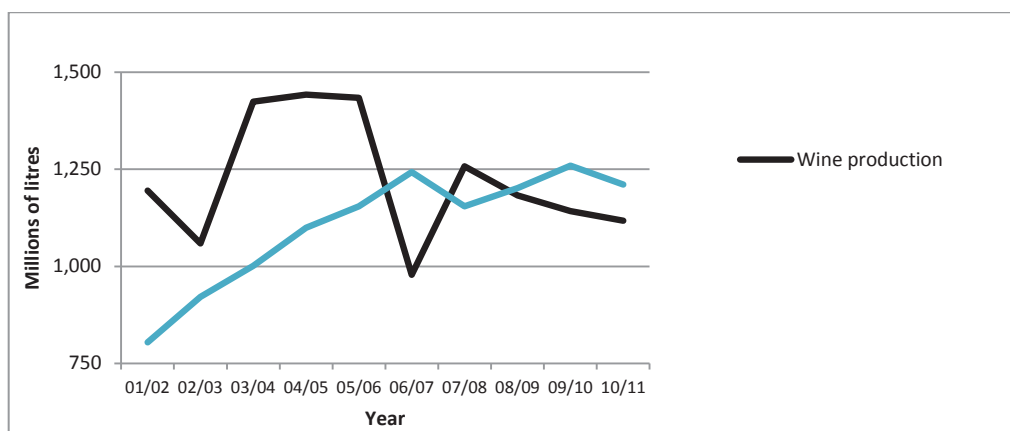
<sup>30</sup> Wine Grape Council of South Australia: ‘Background Paper: The Oversupply of Wine Grapes in South Australia’ (November 2011)

<sup>31</sup> PricewaterhouseCoopers: ‘How can our wine sector grow through becoming less fruitful? – The Australian wine sector 2011’ (2010)

## Indicator 2: changes in wine inventory levels against restructure targets

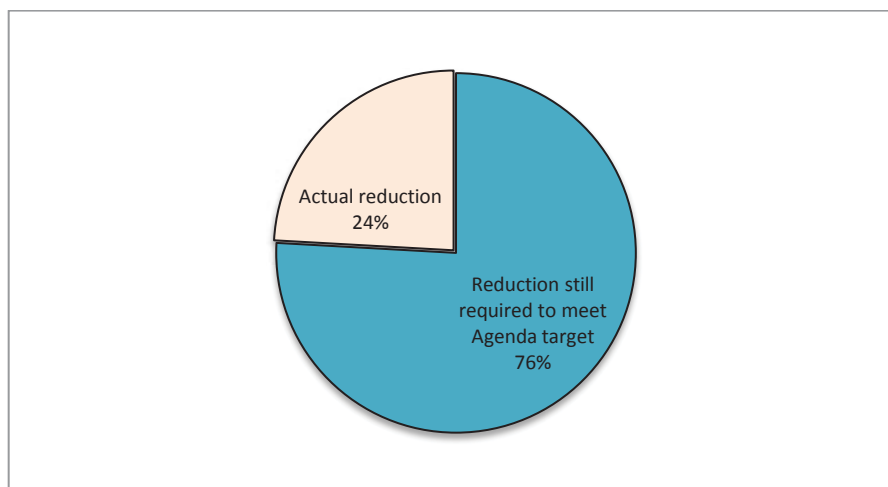
ABS data show that, since the Agenda was put in place, there have been real reductions in the stock of wine held in Australia. In 2006/07, 2008/09, 2009/10 and 2010/11, the wine industry sold more wine than it made, as shown in Figure 2, resulting in inroads having been made into reducing the massive wine inventory built up in the period to 2005/06.

**Figure 2: Wine production surpluses and deficits**



As a result, between 2008/09 (the last full financial year before the Agenda was released) and 2010/11 (the last full financial year for which relevant ABS data exists), Australian wine producers' inventories have declined by 217 million litres.<sup>32</sup> While substantial, this reduction only equates to a quarter of the surplus identified in the Agenda (see Figure 3, below).

**Figure 3: Reductions in wine inventories**

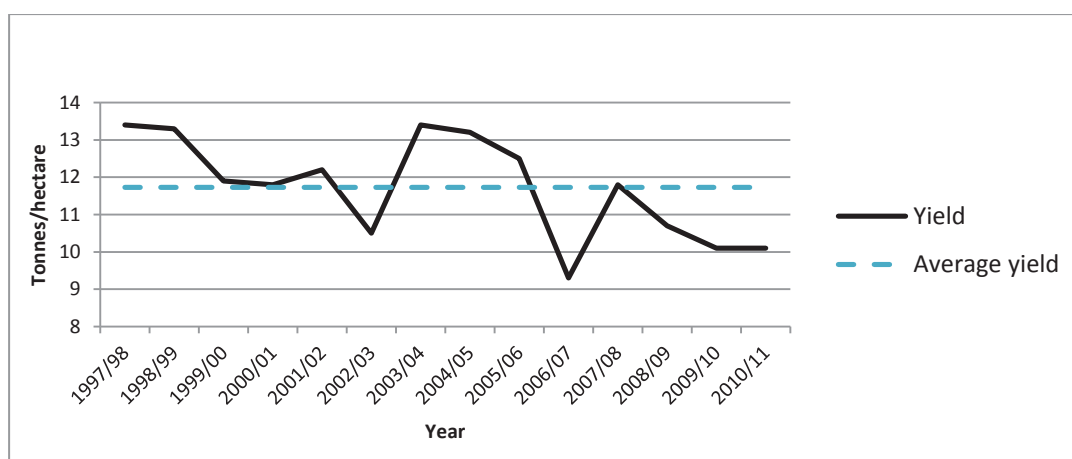


<sup>32</sup> Australian Bureau of Statistics: 'Australian Wine and Grape Industry, 2010-2011' (27 February 2012 update) – note that, for the definition of a wine producer is limited to "wine-making businesses that crush more than 400 tonnes of grapes annually"

Analysing inventory levels in isolation can be misleading. This is because, although reductions in wine inventories are primarily a result of reduced annual production, there are many other possible triggers for reductions in annual production. The most relevant of these is a reduced production capacity through the removal of vineyard area, but lower production might also be due to other factors such as flooding, drought or crop disease.

Data analysis shows that these latter factors are likely to have played a key role in recent years. In half of the recent years in which there has been a production deficit, wine production has decreased despite total vineyard area increasing (2006/07 and 2010/11). The primary driver of reduced production in those years was lower than average wine grape yields; yields in 2006/07 were only 9.3 tonnes per hectare while in 2009/10 and 2010/11 there were 10.1 tonnes per hectare of vineyard, compared to a 15 year average of 11.7 tonnes per hectare (see Figure 4, below).<sup>33</sup> These low yields appear to have been driven largely by climactic factors: with industry reports of significant crop losses in those years due to drought in 2007,<sup>34</sup> and flooding and disease in 2011.<sup>35</sup>

**Figure 4: Annual yields compared to average yield**



The problem with inventory reductions that result from factors other than vineyard reductions is that they may be transient. Production is reduced, but production potential remains high – meaning that once the immediate problem is resolved (e.g. through improved weather conditions or effective combatting of crop disease), production is likely to rebound. This issue has been recognised by at least one industry player, Luke Edwards, Grower Services Manager at Casella Wines, who noted during an interview in early 2011:

*I would suggest (this year's reduced crop) probably won't contribute to the oversupply, which is a positive... We saw similar conditions in 2007 attributed by drought, where we saw greatly reduced vintage. The follow-on from that in 2008-09 and 2010 obviously showed that if you don't remove the underlying problem, which is overplanting, even short-term fixes don't really help anyone.*<sup>36</sup>

<sup>33</sup> Australian Bureau of Statistics: 'Australian Wine and Grape Industry, 2007, 2010 and 2011'

<sup>34</sup> see, for example, The Telegraph: 'Australia's wine industry ravaged by drought' (25 September 2007)

<sup>35</sup> Winemakers' Federation of Australia: 'Pre-budget submission, 2012-13' (January 2012)

<sup>36</sup> Australian Wine News: '2011 vintage to be limited by floods' (20 January 2011)

### Indicator 3: changes in vineyard area against restructure targets

An examination of changes in vineyard area quickly makes it apparent that not only has progress in achieving the Agenda's targets been inadequate, but that momentum has slowed and perhaps reversed over the past 24 months.

The Agenda indicated that at least 20 per cent of Australia's bearing vines were surplus to requirements. At the end of 2008/09 (the year immediately preceding release of the Agenda), there were 157,290 hectares of bearing vineyards in Australia. Achieving a 20 per cent reduction in this would require the removal of approximately 31,500 hectares.

Based on ABS data, Australia's area of grape bearing vines fell by a net 5,500 hectares from 2008/09 to 2009/10. This represents 17.5 per cent of the Agenda's target, meaning that a further reduction of 26,000 hectares was still needed on 2009/10 figures. This analysis broadly corresponds with an independent market analysis undertaken by the Commonwealth Bank, which states that a further 30,000 hectares of removal was needed on 2009/10 levels.<sup>37</sup>

It should be noted that these figures do not match those cited by the WFA earlier in this document, when it stated in its pre-Budget submission that 14,000 hectares of vineyards had been removed. 14,000 hectares is approximately equal to the net reduction in bearing vines over the period of 2007/08–2009/10 according to ABS data (the exact figure is 14,408 hectares). Using 2007/08 figures in order to calculate the total reduction since the release of a late 2009 statement (i.e. the Agenda) could arguably be considered disingenuous – use of 2008/09 figures as a base would appear to be more appropriate. Regardless, in either situation, progress still falls well short of the industry's nominated target.

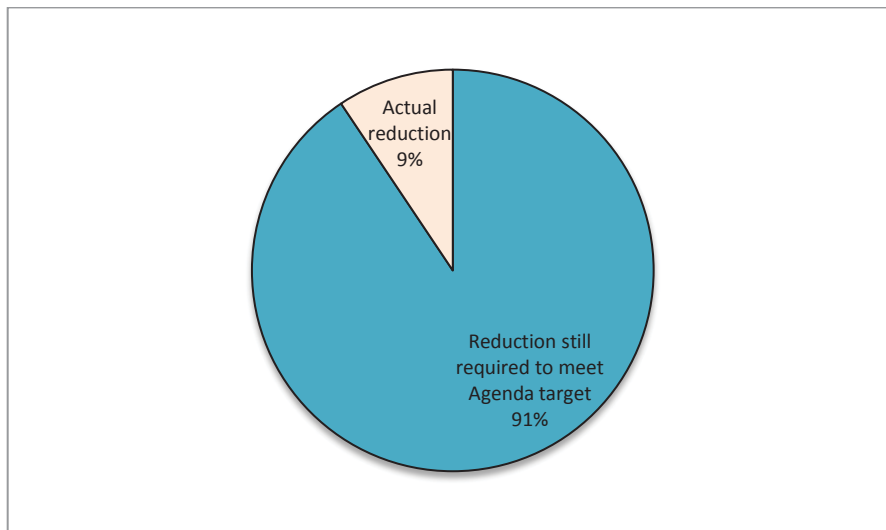
Progress since 2009/10 has reversed. Preliminary ABS data for 2010/11 show a 1.8 per cent increase in the area of bearing vines on 2009/10 levels – bringing the total area back up to 154,030 hectares. This means that reductions in vineyard area to date now represent a mere 10 per cent of the Agenda's target (compared to a 2008/09 baseline), as shown in Figure 5.

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<sup>37</sup> Commonwealth Bank: 'Commodities: Agri Updates: International Wine Industry Review' (June 2011)



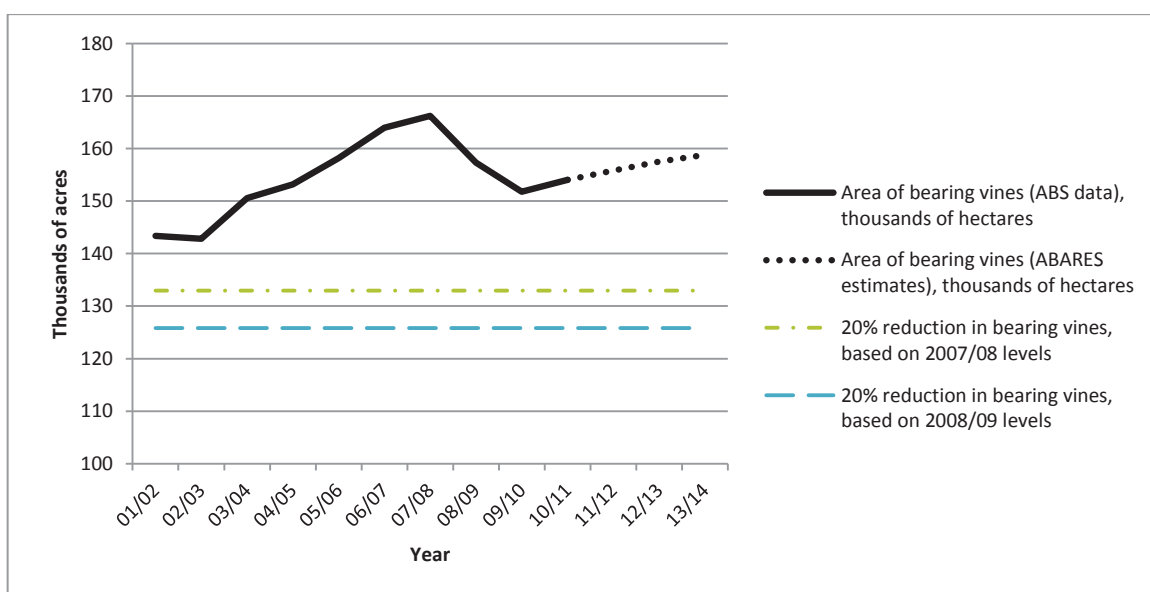
**Figure 5: Reductions in Australia's vineyard area**



Further, the latest ABARES estimates from May 2012 predict similar increases in vineyard area in 2011/12, 2012/13 and 2013/14<sup>38</sup> (see Figure 6) suggesting that this reversal may be sustained. This increased production will inevitably exacerbate the industry's structural oversupply.

If these estimates prove to be accurate, by 2012/13 the Australia's total bearing vineyard area will be approximately 157,530 hectares – which is several hundred hectares more than the total area in the year preceding the announcement of the wine industry's Agenda and will increase to 158,804 hectares in 2013/14. This is a clear sign that the industry has been unable to address the structural factors that have led to the current glut.

**Figure 6: Actual and projected changes in vineyard area**



<sup>38</sup> Australian Bureau of Agricultural and Research Economics and Sciences: 'Australian Wine Grape Production Projections to 2013-14 (May 2012)

## Indicator 4: Stock to forward sales ratios

ABARES calculates stock to forward sales ratios for wine which assess the actual stock available in a given year, against the actual domestic and exports sales in the following year. In 2006, ABARES suggested that the preferred stock to forward sales ratio was: “between 1.5 and 1.6 years of sales for red wines and between 1.2 and 1.3 years of sales for white wines”.<sup>39</sup> A recent presentation from Wine Australia has suggested that the industry’s current preferred stock to forward sales ratio may be as low as 1.36 for all wines.<sup>40</sup>

It is important to note that ideal stock to forward sales ratios change overtime. ABARES stated that:

*[D]uring the past ten to fifteen years, developments in wine making and the changing profile of wine exports have combined to reduce the average length of time wines, particularly red wines, are aged prior to release for sale. These developments mean the industry’s preferred stock to sales ratio has been decreasing at the same time as the stock to sales ratio has been increasing.<sup>41</sup>*

For the most recent year of data (2010/11) the stock to forward sales ratio was 1.4, the lowest since 1994/95. This equates to 1.53 for red table wines and 1.23 for white table wines. The ratios for red and white wines are within the ideal ratios as determined by ABARES and the overall stock to forward sales ratio is very close to the ideal ratio of 1.36 as identified by Wine Australia.

The decline in stock to forward sales ratios has been attributed to production declines, as well as increases in domestic sales and export volumes with the latter being largely due to growth in the lower value bulk wines.

This suggests that the extent of wine inventory reductions still required is less than a simple calculation of progress towards the Agenda targets might otherwise indicate.

## Indicator 5: Projected stock to forward sales ratios

ABARES has published projections of stock to forward sales ratios for wine up to 2013/14. When examining stock to forward sales ratios in subsequent years where sales data is not yet available, the sales figures are based on projections of sales (domestic and export) for the following years. This is a measure used by ABARES to gauge changing market conditions.


Australian wine grape production projections to 2013/14 modelled by ABARES indicate that the stock to forward sales ratio is likely to further decline. By 2013/14, the stocks-to-forward sales ratio for white and red table wine are projected to be 1.08 and 1.36 respectively; below the ideal ratios of between 1.2 and 1.3 years of sales for white wines and between 1.5 and 1.6 years of sales for red wines.

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<sup>39</sup> ABARES: ‘Australian Wine Industry – Challenges for the Future’ (October 2006)

<sup>40</sup> Wine Australia: ‘Australian Wine Industry – State of Play’ (August 2011)

<sup>41</sup> *ibid.*



Although wine grape production is forecast to increase in 2012/13 and 2013/14 based on the assumption of improved seasonal conditions, it is expected that this increase will be offset by growth in exports and domestic sales over this period, with the net result being a reduction in stock to forward sales ratios. This suggests that the market has stabilised and will continue to do so over the coming years.

## Indicator 6: the market share of bulk wine

The market share of bulk wine in a country's wine exports is cited by Professor Kym Anderson from the University of Adelaide's Wine Economics Research Centre as a good indicator of oversupply in the wine market both nationally and internationally.<sup>42</sup> This is because much of the trade in bulk wine is the result of efforts to shift surplus stock. Anderson notes that:

*For Australia since its latest boom began bulk shipments were always below 15 percent, and for New Zealand below 5 percent. In recent years that share has been rising steadily, and by 2004 it was 20 percent for Australia... By 2009 it was ... almost 40 percent for Australia.<sup>43</sup>*

The high market share of bulk wine in Australia is also reflected by data showing that since 2006, the volume of wine exported has only grown for wines priced less than \$2.50 per litre. More recent figures from Wine Australia show that the market share of bulk wine is continuing to increase. By March 2012, bulk wine had displaced bottled wine as the largest section of the Australian export market, with a total market share slightly in excess of 50 per cent.<sup>44</sup> This fits with the preceding inventory analysis that showed that there are significant amounts of stock that still need to be shifted.

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<sup>42</sup> Anderson K: 'Wine Policy Brief No.1 – The Southern Hemisphere and Global Wine Markets to 2030: Case Study of Australia' (June 2010), University of Adelaide Press

<sup>43</sup> *ibid.*

<sup>44</sup> Wine Australia: 'Wine Export Approval Report' (March 2012)

## Overall Assessment

A summary of findings outlined in the preceding section is set out in the table below.

**Table 1: Summary of indicators**

#	Indicator name	Indicator source	Does it show that the glut is ongoing?	Comments
1	Industry and stakeholder commentary	Varied	Inconclusive	Commentary from the wine industry bodies is inconclusive with some commentators suggesting that sufficient progress is not being made against the Agenda's targets, while others suggest that the glut is coming to an end.
2	Inventory reductions	Restructure Agenda target	Yes	Although clear progress has been made in reducing inventories, total reductions to date are only a quarter of the target outlined in the Agenda.
3	Vineyard reductions	Restructure Agenda target	Yes	Vineyard reductions lag substantially behind inventory reductions – total reductions to date are only a tenth of the target outlined in the Agenda. Vineyard area is now increasing and is projected to continue to do so until at least 2012/13.
4	Stock to forward sales ratio	ABARES	No	Stock to forward sales ratios suggest that stock levels are close to equilibrium.
5	Projected stock to forward sales ratios	ABARES	No	Projected stock to forward sales ratios suggest that stock levels will continue to stabilise into 2013/14, with figures being below the preferred ratios.
6	Market share of bulk wine	Wine Economics Research Centre	Yes	The rate of disposal of bulk wine is consistent with the theory that excess inventory levels remain high, although it does not provide insight into how long they could be expected to remain so.

## Discussion


Three of the six indicators (inventory reductions, vineyard reductions and market share of bulk wine) used to analyse the extent of wine oversupply in Australia suggest that the glut is not over. However, two of these measures (inventory reductions and vineyard area reductions) are based on targets established by the wine industry themselves through the Agenda. Both these targets were set in 2009 and have not been reviewed to take into account changing market and environmental conditions since 2009. These measures were also disputed by some industry groups at the time of the announcement of the Agenda. Consequently, it is difficult to reconcile the seemingly abysmal progress against the Agenda's inventory reduction targets with the significant progress made in reducing stock to forward sales ratios in recent years. Also, the reduction in vineyard area is a crude and potentially unreliable indicator of wine oversupply because the yield of vineyards by area may vary considerably depending on a range of factors including environmental and market factors and producers' motivations.

Two of the indicators (stock to forward sales ratios and projected stock to forward sales ratios) suggest that the wine glut is coming to an end in that the previous imbalance between wine stocks and sales is starting to reach equilibrium. Arguably these indicators are more reliable than the two wine industry restructure agenda targets because they are derived from ABS and ABARES data. The recent stock to forward sales ratios provide a snapshot in time of the balance between wine inventories and sales in recent years. It does not provide an assessment of changes in vineyard area, vineyard yield, or wine sales in the future and how these may affect wine oversupply in the longer term.

Similarly the projected stock to forward sales ratio indicates that the balance between wine stocks is likely to stabilise over 2012/13 to 2013/14. However, these projections do not provide an assessment of the impact of the wine oversupply beyond this period.

On balance, the increase in the market share of bulk wine suggests that there is still some degree of wine oversupply. However, it is important to acknowledge that the increase in volume of bulk wine exports is a key factor in reducing the stock to forward sales ratios in recent years, and this reduction suggests that the imbalance in wine stocks and sales is approaching equilibrium. In interpreting the market share of bulk wine indicator, consideration must also be given to the fact that it is a driving factor in reducing the stock to sales ratio and thus in reducing the wine oversupply. Given this, it is likely to peak just prior to the oversupply being corrected, after which time it will either plateau or decline. The peak in the market share of bulk wine will only be apparent after the oversupply has been corrected.

The final indicator, industry commentary on the wine glut, is inconclusive as to whether the wine glut is ongoing as commentators have been divided on this. Of all six indicators, this is arguably the least objective because of the conflicting agendas of some industry commentators. Some may have an interest in perpetuating the perception that the oversupply is ongoing, particularly given that this has been the reason given by the Commonwealth Government for not reforming alcohol taxation, particularly the WET and its associated rebate. Others may benefit more from the perception that the glut is over.



In assessing overall whether the wine oversupply is approaching its conclusion, all six indicators must be taken into account. The targets as determined by the Agenda (inventory reductions and vineyard area reductions) must be considered carefully given the dispute within the industry as to whether these targets are accurate and the crude nature of these targets. More weight must be given to the more objective indicators, that is the stock to sales ratios and projected stock to forward sales ratios. There is no doubt from these ratios that the wine industry is reaching equilibrium.

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