

Submission to Green Paper on Agricultural Competitiveness



Submitted by **Wine Grape Growers Australia**
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Addressed to –
The Agricultural Competitiveness Taskforce
Department of Prime Minister and Cabinet
PO Box 6500
CANBERRA ACT 2600

----- CONFIDENTIAL IN FULL -----

A. WGGA supports the primary tenets of the agricultural competitiveness review –

1. *“The Australian Government’s agricultural policy is driven by one key objective: to achieve a better return at the farm gate to ensure a sustainable and competitive Australian agriculture sector.”*

WGGA strongly supports this objective and a large part of this submission is in support of policy that addresses an imbalance of market power in the wine sector, between winegrape growers and wine companies, that will not only improve the farm gate returns of viable primary producers (winegrape growers) but also returns to whole sector (growers and wine processors).

2. *“It is farmers who need to make business decisions that will make them profitable and competitive.”*

Consistent with the preceding objective, this principle is strongly supported. This support is nevertheless subject to farmers having the professional ability and a facilitating operating environment to make effective decisions.

It is WGGA’s contention that traditional commercial practices in the wine sector distort industry and grower decision-making and need amending to permit effective decision-making.

3. *“The Government’s role is to set the right policy environment to support this outcome [point 2 above] for farmers and across industries, not to make business decisions for farmers who are far better placed to do so.”*

Agreed. Government’s role is to establish efficient markets by identifying market failure and correcting it. WGGA makes a strong appeal to government to assist with good policy in the areas discussed under points 1 and 2 in this section.

WGGA also seeks the assistance of government agencies to act as facilitators of change in the matters raised. Because of the inherent imbalance of market power in the wine sector, WGGA’s advocacy on these matters has largely failed with the wine company representative body, WFA.

B. Introductory comments – context of this submission

Overall principles in WGGA's submission

WGGA believes that the key element of agricultural competitiveness, to provide better farm gate returns, is the **value** provided to the consumer.

Value is a function of **price and quality** and earns customer loyalty at all levels of the quality range by delivering fit-for-purpose **quality** at each **price** point or viewed from the opposite direction, the right **price** for the desired **quality**.

Different levels of the value range will require different **business models**.

Delivering **value** to a targeted consumer segment will define competitiveness at that value level.

These themes are developed further under the following headings.

1. Balancing market power
2. Facilitating business models for profitability

Balancing market power

There is a dual risk to farm gate returns in the emerging structure of Australian agriculture.

- i. Globalisation and consolidation in the processing sector, combined with
- ii. constraints on consolidation in the primary producer/growing sector due to small, family-owned farms which, by virtue of being physically tied to a defined patch of land and with limited resources in terms of both finances and human capital, experience barriers to consolidation.

The consequence of these differential consolidation rates is an imbalance of power between growers and processors, which means that price discovery favours the processor, and risk is inappropriately allocated between the processor and the primary producer. Primary producers are increasingly forced to bear market risk as well as their own production risk.

A direct consequence of this imbalance of power is a failure in whole-of-value chain market signals. In the wine sector, warnings were given as early as 2000 that the sector was in supply-demand imbalance, and the whole of industry conceded this fact by 2005-06. Despite this, supply and demand has failed to correct to this day. *Primaefacae*, market failure exists in the Australian wine sector.

A secondary consequence of the foregoing is an accumulation of stranded assets held by an aging demographic of vineyard operators, who are unable or unwilling to sell due to the depressed market, and who suffer welfare loss by degradation of their saleable asset base as well as the stress of being unable to retire without a source of income that would be generated through the sale of their assets. This also acts as a barrier to generational change, while the depressed market discourages investment by entrants into the sector.

In the last five years, the industry's foundation data sets have seriously deteriorated as its resources in falling markets have declined and commonwealth government resources have been withdrawn from the national statistics data collection agency, the Australian Bureau of Statistics.

Winegrape growers are now reliant on wine companies for information and interpretation and lack the ability to make independent, self-determining decisions.

Priority actions for balancing market power

Through collaboration with government and government agencies -

Innovation in commercial practices within the wine sector, including:

- i. mechanisms to balance the market power of growers and processors,
- ii. systems agreed between growers and wine companies to reward and incentivise quality attributes,
- iii. codified terms of trade that allocate risk appropriately for efficient market operation.

Through government in collaboration with the banking community -

Address the capital requirements of vineyard development with the aim of:

- i. facilitating consolidation in the growing sector,
- ii. removing barriers to generational change.

Through industry in collaboration with government and government agencies -

Higher quality information available to industry

- i. Foundation data – Industry-owned collections with government co-investment for national accounting and policy purposes.
- ii. Advanced industry data collection, together with analysis and interpretation for industry and government policy making, for example –
 - a. Financial benchmarking (whole-of-value chain)
 - b. Profitability
 - c. Measurement of quality attributes
 - d. Consumer-preferences for wine attributes linked back to winegrape attributes,
 - e. Demographics.
- iii. An appropriate mix of scientific, economic and social research conducted by the sector's RD&E function.

Facilitating business models for profitability

Strategy: increasing farm business scale

Increasing scale is the commonly identified solution to lack of competitiveness in the primary production sector. This solution is appropriate for consolidation in the primary producing sector but it is synonymous with commoditisation and antithetical to retention of smaller, family-owned farms.

The driving motivation for increasing scale is price competitiveness, which in turn is a driver for commoditisation of Australian agricultural product. While commodity trade represents a route-to-market opportunity, in a high-cost country like Australia it also has its financial (cost-based) challenges, which need careful evaluation and addressing in order to be achievable.

In the wine sector, a further challenge is that the attitude of the industry decision-makers towards trade in the commodity sector is ambivalent at best. The dominant voice speaking on behalf of the wine sector (that of privately-owned wine brands), speaks on behalf of the premium sector, not commodity wine. As a result, the commodity sector does not get the required attention to initiatives that improve market prospects for this sector. Despite this, achieving profitable sales of commodity wine is a potential "solution" to the oversupply that dogs the wine sector and which drags down its brand asset and profitability.

Strategy: accessing niche markets through point-of-difference

Financial bench-marking of winegrape growing in the Murray Valley has demonstrated that small scale does not preclude profitability. Compared to achieving scale, this business model option emphasizes the quality component of value rather than price, and relies on an individual enterprise's ability to extract a premium through comparative advantage in variety, the consumer's experience, quality attributes, careful targeting and delivery to consumers and so on.

This model is more consistent with retention of smaller, family-owned farm businesses.

Synthesis: accommodating different strategies (scale versus niche)

Whichever route to profitability is chosen - increasing scale or small, differentiated family businesses with a point-of-difference – growers need appropriate business models to support the chosen path taken. This means being able to make an informed decision about which model to follow, having the appropriate attitudes and skill sets within the business operation, and having the knowledge, ability and confidence to restructure the business model and financials to suit.

Priority actions for facilitating business models for profitability

Through industry in collaboration with government and government agencies.

Grower skill development

- i. Research-based identification of relevant skills for competitive business operators and innovation practices.
- ii. Qualifications constituting a 'licence to farm' – based on independent farmer-driven tertiary curriculum as opposed to corporate processor-driven curricula (that dominates the wine sector).
- iii. Personal development of growers to overcome social isolation and the ability to cope with business stress.
- iv. An appropriate definition of industry development in the sector's RD&E legislation governing RDCs.

Specific commentary on the Green Paper's policy ideas under 'Categories for policy ideas' which support WGGA's submission on redressing imbalanced market power between winegrape growers and wine producers and in encouraging business model innovation

This section addresses the request in the Green Paper, for views on those ideas that will make the most difference.

1. Competition and regulation

Policy idea 7 – Improving market competition

This Policy idea has strong parallels with the general thrust of this submission and WGGA considers it to be the highest priority policy priority for the Taskforce to consider.

2. Finance, business structures and taxation

Policy idea 10 – Improving access to finance

This submission has strong affinity with the Statement in the Green Paper that reads “New ways of financing ... to attract additional investors ... while retaining the core role of the family-controlled farm”. This view of WGGA, is not just in support of attracting new funds but also, if the appropriate mechanisms can be discovered, to remove the barrier to exit of stranded vineyard assets in times of downturn. These barriers are created by traditional debt-funding of high establishment costs for a product with lagged returns. The Collaborative Farming Model is an example of an alternative business model for existing capital which could be incentivized by concessional loans where the concession is justified by the improved prospects of viability.

Policy idea 11 – Improving tax system efficiency and equity, Part g. reducing and better targeting the rebate for the Wine Equalisation Tax

WGGA accepts at an intuitive level, that the WET Rebate distorts the wine market and that (i) uneconomic use of the WET Rebate should be eliminated (ii) the WET Rebate should be reformed but subject to a better understanding of the use and dimensions of its use and the materiality and of the distortions that are thought to exist, and finally (iii) that the reforms are indeed, equitable. WGGA notes that the Winemakers’ Federation of Australia’s recommendations in the regard to the WET Rebate reform are not equitable and would discriminate against growers producing wine from their grapes for bulk wine trade. By contrast, WGGA’s recommendation for WET Rebate reform is an across-the-board reduction in the threshold for eligibility which would be effective in reducing the distortion, equitable across all sectors in the industry and by being more market-oriented, would carry less risk of further unintended consequences.

3. Education, skills and training and labour

Policy idea 14 – Strengthening agricultural education

This submission has strong affinity with the Green Paper intent in this area driven by the need for greater business acumen in the industry, new business models, the need for competitiveness on the global stage, the need for generational change, and the existing capture of viticulture curricula by the corporate winery-viticulture sector (see the ‘Facilitating business models for profitability’ and ‘Grower skill development’ sections of this submission).

C. Specific commentary on the Green Paper’s policy ideas under ‘Categories for policy ideas’ which support other matters of importance to the Australian winegrape growing community

This section addresses the request in the Green Paper, for views on those ideas that will make the most difference.

1. Infrastructure

Policy idea 2 – Improving existing infrastructure and transport regulation

The last 20 years has seen growth of the Australian wine sector through a wider geographical spread of production centres. The latter has seen the greater likelihood of winegrape transport to processing centres – sometimes for large distances – particularly by corporate growers who arguably account for 70% of independently grown winegrapes. Improved infrastructure and transport regulations are required to keep pace with the requirements of this evolution in order to (i) create cost savings and (ii) create efficiencies in the national market by introducing competition among processors for a winegrapes that are subject to spoilage and which are prone to uncompetitive capture by local processors.

2. Working with States and Territories

Commonwealth-led harmonization of State regulations through COAG

Consistent with the expansion of a national wine industry over the last 20 years, a number of areas in which harmonization of different state regulations¹ will improve the efficiency of the national industry. For example –

- Terms of payment regulation (illustrated by the Wine Grapes Act of SA)
- Contract dispute legislation eg the South Australian Fair Trading (Farming Industry Dispute Resolution Code) Regulations 2013 under the Fair Trading Act 1987, in SA.
- Legislation to intervene in abandoned vineyards that represent disease risk to surrounding vineyards.
- Protocols governing the interstate transfer of winegrapes (similar to Policy idea 5, part c).
- Initiatives to eliminate spray drift damage to vineyards from broad acre application.
- Initiatives to prevent smoke damage to vineyards from bushfire prevention burn-offs in regional jurisdictions.
- A consistent approach to overcoming sub-optimal resourcing of whole-of-community products and services for winegrape growers through collective funds – such as the Grape Growers Industry Fund in SA.

3. Foreign investment

Policy idea 13 – Improving transparency of foreign investment

Foreign investment is vital to re-capitalising competitiveness in the Australian wine sector subject to the foreign investment being competitive (non-distortionary) and Australia's food security being provided for. Foreign investment by state-owned businesses is not consistent with these principles.

In the light of the preceding view, establishing a register of foreign ownership of agricultural land to improve transparency is vital.

¹ Where for many of these examples, benchmark practices exist in South Australia where the largest part of the industry is located.

4. *Water and natural resource management*

Policy idea 18 – Improving water infrastructure and markets

The most recent drought demonstrated the value of relatively newly-developed water markets in the Murray Darling Basin - in providing drought-resilience to the winegrape growing sector. Recognising the relative infancy of these water markets, their continued refinement is strongly supported.

5. *Research, Development and Extension*

Policy ideas 20 and 21 – Strengthening the RD&E system – and improving rural RDCs

RD&E is vital to future competitiveness of the wine sector. WGGA's interests in Policy ideas 20 and 21 are focused on preserving the existing industry-government arrangements, increasing the flexibility in levy-collection principles to reflect the different levels of political risk in industry consultation requirements and ensuring that the RD&E spend supports grower development defined as follows. Many areas of grower development – including biosecurity preparedness and foundation data collections – are important to the sustainability of grower businesses but are not optimally catered for by grower funding at an individual level. Although there may not be a direct researchable question associated with these activities, the outcomes can be adopted the same way as other research topics and can improve the competitiveness of the Australian grape growing industry. WGGA believes that this is a legitimate use of the Grape Research Levy, subject to the usual tests of pre-competitiveness, market failure, maximising the net benefit of a funding program and contestability in a limited funding pool. The sole national levy that winegrape growers pay is the Grape Research Levy (GRL). As a consequence, it is expected that this is the primary source of funding for grower development projects.

6. *Biosecurity*

As the designated representative body for national biosecurity arrangements in the wine sector, WGGA is greatly interested in policy initiatives in this area. Its comments were contained in the submission to the Agriculture Competitiveness Discussion Paper.

Worthy of noting here, is the issue of the sector's ability to fund the normal commitments of industry - that is, expenditure outside the cost-sharing arrangements with the commonwealth and the benefits derived through PHA membership. Effective industry participation in the collaborative arrangements between government and industry requires greater government flexibility in the principles of levy collections to facilitate levy-funding of industry's capability in this area.

7. *Accessing international markets*

Policies related to the use of agricultural chemicals can have a significant influence on the ability of winegrapes to access the market. WGGA's interests in this area include (i) negotiation of MRLs for cheap, effective vineyard management chemicals with authorities in key markets and (ii) access to proven, safe chemicals available to competitor wine-producing nations but not available in Australia due to market dynamics and regulation.

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