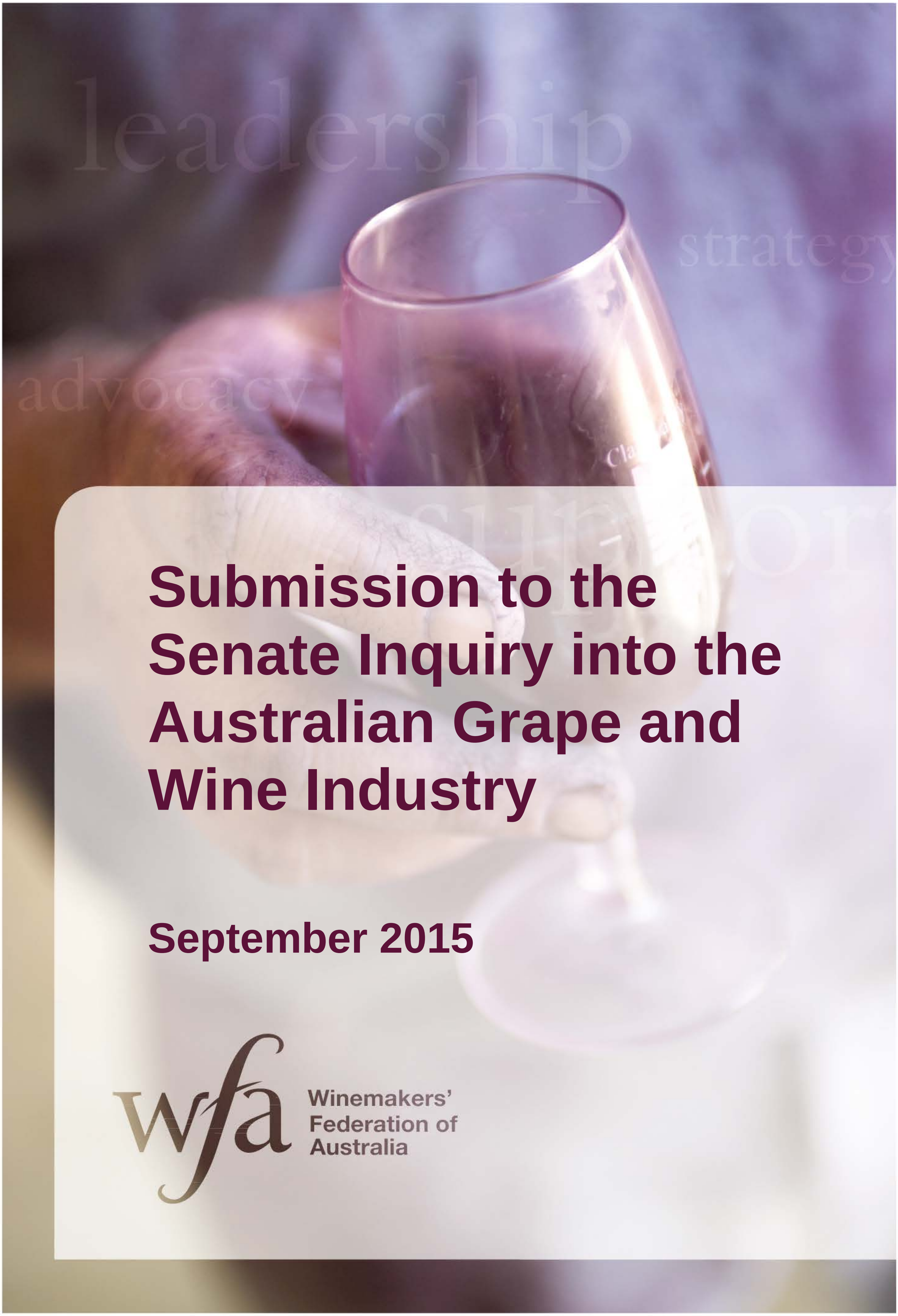

Submission to the Senate Inquiry into the Australian Grape and Wine Industry

September 2015

Winemakers' Federation of Australia

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EXECUTIVE SUMMARY

Over the last 18 months the Australian wine industry has come together in an unprecedented demonstration of unity to ask the Government for one-off funding to help support a demand-led recovery to open global markets and grow demand for Australian wine.

On the back of favourable exchange rate changes, Free Trade Agreements and an upturn in consumer demand – especially in important North American markets - industry has made a request for $43.4m over four years to boost the marketing activities undertaken by its statutory authority. We believe this funding is critical if we are to recapture lost share and margin in traditional markets and to capture the opportunity for growth in emerging markets.

Our industry's export performance is also important to the many smaller wine businesses who sell exclusively on the domestic market as it will help ease the current oversupply of wine in the Australian market. Prices for wine grape growers will also benefit, which will encourage a correction in asset values and reinvestment in innovation and maintaining our global competitiveness.

The proposal for additional funding to grow demand from the Winemakers' Federation of Australia has the backing of Wine Grape Growers Australia, Wines of Western Australia, South Australian Wine Industry Association, Wine Tasmania, Wine Victoria, the New South Wales Wine Association and Queensland Wine Industry Association, as well as wine regions including Riverland, Riverina and Murray Valley.

Together we are saying we need government's urgent help to seize the market opportunity and to help reengage global wine buyers in traditional markets like North America and the UK and to maximise the new export opportunities created by the signing of free trade agreements with China, Korea and Japan.

Government support for wine businesses and the regional communities they operate in must continue while this demand-led recovery is underway. Specifically, the Wine Equalisation Tax (WET) rebate should remain but limited reforms are required to ensure it continues to deliver its original policy intent and can be sustained into the future. These reforms include the abolition of the separate and unfair New Zealand rebate scheme (transferring New Zealand producers to the same access arrangements as Australian and other foreign country claimants) and the phasing out of rebate eligibility for bulk and unbranded wine.

Significantly, WFA has also secured support for these rebate reform measures from all the state wine industry associations and from the national Wine Grape Growers Australia. This support was hard won. It was secured with the mutual acknowledgement that a solution lies in a collective approach that places the future prosperity of the industry as a whole, above the interests of individuals.

The Federal Government has referred these proposals on the WET rebate to a specific discussion paper process which we trust will be expedited at the Mid-Year Economic and Fiscal Outlook (MYEFO) 2015. Our submission to the WET Rebate Discussion Paper process is attached (Appendix G).

We welcome the Senate Inquiry as another opportunity to make our case on behalf of industry for government to urgently support these reforms and the recovery of the sector.

Paul Evans
Chief Executive Officer

SUMMARY OF RECOMMENDATIONS

WFA has made recommendations for most of the specific terms of reference. These appear at the end of each section on the individual terms of reference. A collated summary appears below.

#	Recommendations	Pages
1.	**Government funding of $43.4 million over four years** is needed for the Australian Grape and Wine Authority (AGWA) to develop and implement a targeted and impactful demand-led marketing program. This activity will help set the industry on a course to reclaim and grow its reputation as a producer of quality and premium wines.	**16**
2.	**Use the Government funding of $43.4 million over four years** is to help grow the demand for Australian wine in key overseas markets. The **resulting growth in exports will** importantly help **alleviate the domestic supply/demand imbalance** which impacts grape growers and winemakers.	**21, 31, 52**
3.	**Government reform of the WET rebate** to restore the integrity of the scheme and return it to its original policy intent of supporting wine producers in regional Australia.	**31**
4.	**Maintain** the current system of **government** providing **matching funding for R&D** to AGWA.	**21**
5.	**Expand the Export Market Development Grants** and review the eligibility criteria to ensure the most innovative wine industry leaders who have been past recipients can re-apply and receive the support they need to re-enter markets where demand for our wine has suffered a downturn.	**21**
6.	**Introduce changes to** ensure existing EMDG contracts have provisions that **shield recipients from future policy change**s that alter the terms of the grants.	**21**
7.	**Prioritise inclusion of wine in bilateral agreements** with India and Indonesia and **provide an additional $2m per annum** across a number of government agencies to support this.	**21**
8.	**Prioritise progress on the reduction of trade barriers** for Australian wine in key markets through the upcoming meeting of the World Wine Trade Group and the meeting of the APEC Wine Regulatory Forum.	**21**
9.	**Enable the development of a National Phylloxera Strategy** to ensure consistent protection and management of disease across Australia.	**21**
10.	**Ensure consistency in food regulation** between jurisdictions.	**21**
11.	**Enable FSANZ to provide interpretations of the Food Standards Code at no cost** to producers to help ensure regulatory certainty and alleviate costs pressures on small producers in particular.	**21**
12.	**Develop** either **a single national RSA accreditation scheme or provide for mutual recognition of existing state qualifications**, between all of the states and territories, to facilitate wines reaching new domestic consumers.	**21**

13.	For the Government **not to introduce mandatory Codes of Conduct**.	**31**
14.	Phase out WET rebate eligibility for bulk and unbranded wine at 25% per year starting at 75% of the rebate from implementation. This can be achieved by changing the legislative definition of rebatable wine and will realise savings of $202million over the forward estimates.	**47**
15.	**Abolish the separate NZ scheme** because it affords NZ producers a commercial advantage over Australian and other foreign country claimants whereby they avoid the compliance costs associated with claiming the WET producer rebate. In its place, **NZ producers would still be able to claim the WET rebate <u>but on the same terms as all other claimants</u> – creating a level playing field**.	**47**
16.	**Introduce transitional rebate measures** for merged claimants, phasing out at 25% per year over four years **to encourage industry consolidation** by enabling merged entities to continue to claim the rebates they accessed when separate so that this loss of benefit does not impede consideration of mergers. Will be of particular benefit to small and medium wine businesses.	**47**
17.	**Recognise that support will be required** to grape and wine businesses adversely impacted by WET rebate reform and for the **Government to work with WFA and WGGA on developing assistance**.	**47**
18.	**Industry participation** needs to be encouraged **in setting R&D priorities** and these used to guide the expenditure of government-matched levies.	**21, 52**
19.	That **AGWA take over the collection of the export levy** given they already operate an export licence system and collect FOB export values through the Wine Export Approval System. This reform will deliver a more efficient and effective collection system, with the expected savings of approximately $200k to $250k per annum being available to provide enhanced services for the grape and wine sector.	**53**
20.	That the **Productivity Commission be tasked to conduct analysis** of the domestic wine market and the impact retail consolidation on margins and profitability for wine businesses.	**58**
21.	WFA recommends **the Government require that all brands owned by retailers be clearly labelled** to inform consumer purchasing decisions.	**58**
22.	WFA recommends that **the Government's response to the Harper Review enable a determination** to be made of whether retailer's demands on retrospective pricing support from suppliers, in fact constitutes a **misuse of market power**.	**58**
23.	That **AGWA be the central depository and communicator for foundation data**.	**61**
24.	That **AGWA and ABARE be the provider of information on market dynamics** and for this information to be **released through-out the season.**	**61**

INTRODUCTION

The Winemakers' Federation of Australia (WFA) welcomes this Senate Inquiry into the wine industry. WFA is the peak body for the nation's winemakers. WFA membership represents some 80% of the national wine grape crush, with more than 370 winery members who directly fund the organisation's national and international activities.

WFA represents small, medium and large winemakers from across the country's winemaking regions, with each group having an equal voice at the Board level. WFA works closely with the wine industry organisations in each state and among the 65 plus regions and with the national Wine Grape Growers Australia (WGGA). Our common goal is the health and prosperity of the Australian wine industry and our support for industry and advocacy reflects this.

The wine sector is enthusiastic about its future and highly motivated to resolve issues that threaten enhanced productivity and profitability. Against a backdrop of continuing low profitability and flat domestic demand and a marked decline in exports, WFA has undertaken considerable work in these last few years to better understand the challenging market conditions for Australian wine and to use this work to develop, and to action, proposals which address these challenges. These actions are detailed in this submission and form the basis of our recommendations to government and the Inquiry.

There is the need for urgency in addressing these challenges. The urgency is twofold; firstly the industry has had seven years of flat growth owing to a structural mismatch between demand and supply. Without structural reforms, the mismatch of supply and demand and the resulting low profitability will persist for both winemakers and grape growers.

Secondly, there is currently a unique confluence of factors that together, present an opportunity for a demand-led recovery for our sector. These include 1) a more favourable AUD exchange rate, 2) the fresh opportunities of the recent Asian Free Trade Agreements, and 3) some early signs of renewed interest in Australian wine from key Northern American markets. A concerted category-level marketing effort is needed to capitalise on this demand opportunity trifecta. That is why WFA has asked the Government for $43.4million in marketing funds for the Australian Grape and Wine Authority (AGWA). We continue to pursue this objective.

Resolution of these challenges will also importantly set the future course of the industry. The Australian wine industry is at a crossroads. With structural reform and an impactful, strategic marketing effort, the industry can reclaim and grow its reputation as a producer of quality and premium wines. In the absence of reform, the industry risks a loss of global competitiveness as poor profitability translates into a declining production base and lower levels of reinvestment and innovation.

Central to overcoming some of these challenges, is the importance of putting in place market signals that encourage export growth matched against our market opportunities and reinforced by aligned policy settings. A partnership approach between industry and government is therefore critical. As such, we welcome the Senate taking the time to appreciate the depth and magnitude of the challenges ahead and its consideration of what must be done.

The Australian wine industry

The economic contribution of the wine industry is approximately $1.77 billion, most of which is reinvested in regional Australia. The industry directly employs approximately 16,122 people, again, mostly in regional Australia and at least double that figure indirectly.

The industry is comprised of around 2,500 individual wineries and some 6,300 grape growers over 65 distinct wine-producing regions across Australia.

The wine industry is Australia's fifth largest agricultural exporting sector, with Australian wine now found for sale in over 100 countries around the world. The Australian wine industry is a net exporter, generating around $2 billion in revenue per annum.

Wineries attract significant visitors to our regions each year and the industry contributes $8.2 billion in tourism expenditure.

The 2015 Australian grape crush was 1.67 million tonnes. The 2015 red crush stands at 835,500 tonnes and the white crush at 834,000 tonnes. Compared with the 2014 vintage, the 2015 red crush has decreased by 4% or 30,751 tonnes and the white crush has increased by 5% or 37,524 tonnes. The top three red varieties by crush were Shiraz, Cabernet Sauvignon and Merlot, together accounting for 85% of the total red crush. Shiraz continues to dominate with 47% of the total red crush though with a 6% decrease from 2014. Chardonnay still dominates the white crush at 45% an increase of 28,726 from last year. Sauvignon Blanc remains in second place with 11% followed by Pinot Gris and Pinot Grigio accounting for 9% of total white crush.

The Australian wine category competes for a share of the consumer spending against other wine producers such as France, Italy, Spain, Chile, South Africa, New Zealand and Portugal. For the year ending March 2015, Australia has seen a rise of 3.6 per cent in volume and 3.9 per cent in value of wine exports.

Challenges facing the industry

Before reviewing challenges specific to the current era, it is important to acknowledge the underlying agricultural risks that will always be a part of the sector:

> *Wine producers have only one production opportunity each year. This "one shot" intensifies the pressure to "get it right" but also constrains the ability of winemakers to spread risk, recover from losses and to maximise profits*.
>
> *Winemaking and grape growing are also subject to the seasonal and climatic vagaries inherent to Australian agricultural production and the threat, risks and opportunities these present.*
>
> *Given these underlying challenges, the industry is sensitive to the emergence and presence of additional market pressures.*

It is also important to recap on the recent history of the industry. The Australian wine industry enjoyed considerable success between 1991 and 2007. However, in more recent times, a range of factors have challenged the industry. An independent expert review of industry dynamics commissioned in 2013 by WFA and produced by Centaurus Partners, which can be found in Attachment A, concluded the following:

1. The Australian wine industry has a structural mismatch of supply and demand. As a consequence, seasonal improvements such as the Australian dollar depreciation will not address this imbalance in the long-run. If the industry does not undertake structural reforms, the mismatch of supply and demand will persist.
2. The Australian wine industry tripled in size from 1991 to 2007 and was very successful at building export markets.
3. Since 2007 the profitability of the Australian wine industry has declined significantly.

4. This decline in profitability has intensified:
   - Export returns have declined sharply owing to the high Australian dollar and coupled with a decline in consumer interest in Australian wine in key overseas markets.
   - Domestic margins have been squeezed by retailers, low demand growth, and increased exports.
   - The decline and shift in export demand has created an "oversupply/under-demand of grapes and wine in certain quality segments".
5. Efforts to improve profitability have, in many cases, only reduced the extent of the decline.
6. There are foreseeable circumstances that would put further pressure on profitability.
7. The other side of this 'perfect storm' is that no single level will 'fix' the problem.
8. The industry is not being impacted equally or uniformly – some players/segments are more affected than others and the identity of those affected changes from year to year and by varietal and region; there are a number of success models.
9. Wine tax arrangements remain an issue for the industry.

Adding to these findings, each year WFA produces an annual Vintage Report which is based on a survey of industry (members and non-members), together with published industry data, and tracks the progress of the industry supply-side. 2015 production profitability analysis showed that when compared to 2014, profitable production (profit greater than $300 per tonne) decreased to 6%, low profitability (profit between $100 and $3000 per tonne) and breakeven production between (profit between 0 to $100 per tonne) remained constant. Unprofitable production increased to 85%. Although, the overall production profitability analysis would indicate a higher proportion of unprofitable production, there were some regions which successfully grew their proportion of profitable production.

This era of sustained poor profitability has placed enormous pressure on grape growers and winemakers alike and unsurprisingly has created tensions in the industry – tensions we are committed to resolving through measures that support the restoration of profitability for all.

How the industry is responding

The expert advice we commissioned, together with ongoing industry survey and analysis such as our annual Vintage Report, is critical for developing an evidence-based roadmap for recovery.

In response to the findings of the review and to other industry data, and using their collective industry experience, the WFA Board released draft *Actions* in early 2013 to generate discussion on what was needed to restore profitability to the sector. An extensive consultation was then undertaken including road shows to wine growing regions and written submission from over 70 national, state and regional wine organisation and industry stakeholders. Armed with this feedback and further input, the WFA Board released 43 final "*Actions for Industry Profitability 2014-2016*" in December 2013 and these can be found in Attachment D.

The Actions are grouped under eight headings and in short, address the following:

1. **Continue to engage the Wine and Health debate** - WFA will proactively engage the Wine and Health debate to promote responsible consumption and ensure a balanced regulatory framework for our Industry. These Actions aim to minimise harm to the community, promote the benefits of moderation and to shape the policy debate.

2. **Grow the Demand Opportunity** – With support from the Australian Grape and Wine Authority (AGWA) and the Australian Government, WFA will help wine businesses grow demand for our wine, both domestically and internationally. The outcome from taking these Actions will be an increase in the relative market share of Australian wine in all major markets.

3. **Hasten the Supply Correction** - WFA with the Wine Grape Growers Australia will hasten the correction to the supply base to improve margins throughout the value chain. The outcome will help reduce the oversupply of commercial grade grapes and the pricing distortion it creates throughout the industry.

4. **Maximise Open and Fair Domestic Competition -** WFA will work with the national wine retailers and competition regulator on fairness, transparency and equity in the domestic wine market. These actions aim for a more sustainable domestic marketplace for industry where companies can grow share through quality, innovation and investment.

5. **Retain with changes to the WET rebate -** WFA with the support of Australian Government will retain and make changes to the Wine Equalisation Tax rebate to support regional communities. The outcome will be the retention of the WET rebate to ensure that it is working within its original policy intent, and to seek policy changes to improve the workings of the WET rebate on the wine industry, consistent with its original intent.

6. **Monitor the future of wine tax policy -** WFA will monitor the future of wine tax arrangements in response to changing market conditions. The outcome will be the on-going examination of optimal taxation arrangements for industry to support growth and our licence to operate with the community.

7. **Secure the funding for the Action agenda -** WFA will secure the funding to support the recommended reform agenda in partnership with Industry and Government.

8. **Areas for On-going Work** - WFA will continue and expand its good work in a number of important programmes and policy areas such as promoting innovation and R&D spend and improving market access.

The 43 actions across these 8 areas are the focus of our advocacy work. While progress has been made against some of these 43 actions (and recorded in this submission on pages 23 and 24), others require the support of government, to be realised. These particular actions formed the basis of our submission to the Government for the May 2015 Federal Budget and to our response to the WET Rebate Discussion Paper and were provided to the Government with supporting legal advice and economic modelling, and are summarised in the table overleaf.

What:	Why:
<u>Spending proposal</u>: $43.4million over four years for AGWA to support marketing Australian wine ***(NB:*** *Fully offset by savings generated from the WET Rebate reforms below.)*	▪ To help grow the demand for Australian wine overseas in key export markets; ▪ To capitalise on the three recent Asian Free Trade Agreements; ▪ To capitalise on a more favourable AUD exchange rate; ▪ To build on early signs of consumer recovery in Northern America; ▪ To help alleviate the domestic oversupply of grapes and wine by building demand for exports; and ▪ To help counter the impacts of an expected influx of grapes and wine from the Northern hemisphere.
<u>WET Rebate Reform #1</u> Reduce uncommercial claims on the rebate	▪ Restore integrity; stop the rebate going to unintended recipients. ▪ WFA to continue working with the ATO to assist with understanding and identifying uneconomic practices which are not in keeping with the original intent.
<u>WET Rebate Reform #2</u> Abolish the separate WET Rebate scheme for NZ wine producers and replace with a 'level playing field' for all rebate claimants (including NZ), irrespective of nationality: saving of $45million	▪ To create a level playing field for all WET rebate claimants by removing the clear commercial advantages that the current, separate arrangements afford NZ producers over Australian and other foreign country claimants; and ▪ To avoid other GATT countries requesting separate WET rebate schemes for their producers, further eroding a level playing field for Australian producers and further undermining the integrity of the scheme and its original policy intent of supporting small and medium businesses and cellar doors in regional Australia.
<u>WET Rebate Reform #3</u> Remove eligibility from bulk, unpackaged and unbranded wine, and phased out at 25% over 4 years. Generates savings of $202 million.	▪ Removes a disincentive to export and thus helps alleviate the chronic domestic oversupply issues and the downward pressure this places on grape prices; ▪ Supports those businesses who produce branded wine; who reinvest their profits into their wineries, their regions and whose brands help build the reputation of Australian wine as a quality product.
<u>WET Rebate Reform #4</u> Introduce transitional rebate measures for merged claimants, phasing out at 25% per year over four years. Generates savings of $31 million over four years.	▪ To encourage industry consolidation by enabling merged entities to continue to claim the rebates they accessed when separate so that this loss of benefit does not impede consideration of mergers. Of particular benefit to small and medium wine businesses. Once only or finite entitlement.
<u>WET Rebate Reform #5</u> Industry assistance to be developed	▪ Government to work with WFA and WGGA to develop industry assistance for grape and wine businesses adversely impacted by reform. ▪ May include adjustment programs that facilitate uptake of more suitable business models or which address barriers to vineyard exits.

Collectively, these reforms:

- Generate $278million gross in savings for the Commonwealth;
- Restore the WET rebate scheme to its original policy intent of supporting local Australian wine businesses and the regional communities they support; and
- Return the WET rebate scheme to a more sustainable fiscal basis.

Significantly, WFA has secured support for these measures from all the state wine industry associations and from the national Wine Grape Growers Australia. This support was hard won. It was secured with the mutual acknowledgement that a solution lies in a collective approach that places the future prosperity of the industry as a whole, above the interests of individuals.

Championing these measures, together with arguing for no increase to wine tax and for the retention of wine's differential tax treatment (compared to beer and spirits) are the basis of ongoing dialogue with the Government. Indeed, these measures, which will help achieve a recovery for the wine industry and restore profitability for winemakers and grape growers, formed the basis of our submissions to the Government's Review of Taxation and to the Government's WET Rebate Discussion Paper process.

Through these forums and in our continuing dialogue with government, we seek parliamentary support for our reform agenda. While the extended period of low profitability has generated tensions in the industry, our roadmap for recovery, with supporting independent legal advice and economic modelling, enjoys majority industry support and we are confident that, if adopted, the industry will see a return to profitability. But we cannot action all aspects of our plan alone. It requires the support of government, and to this end, we seek your support for our measures and for the other recommendations we make in this submission, consistent with our '*Actions for Industry Profitability 2014-2016'* analysis and recommendations.

We look forward to addressing a hearing and to answering Senators' questions.

RESPONSE TO THE SPECIFIC TERMS OF REFERENCE

On the following pages we have addressed each of the terms of reference in turn and we welcome the opportunity to speak to each of these at a hearing.

(a) The extent and nature of any market failure in the Australian grape and wine industry supply chain

WFA is well positioned to comment on supply side issues having commissioned expert industry analysis in 2013 and as a result of our yearly survey of industry (members and non-members) and analysis contained within our annual Vintage Reports.

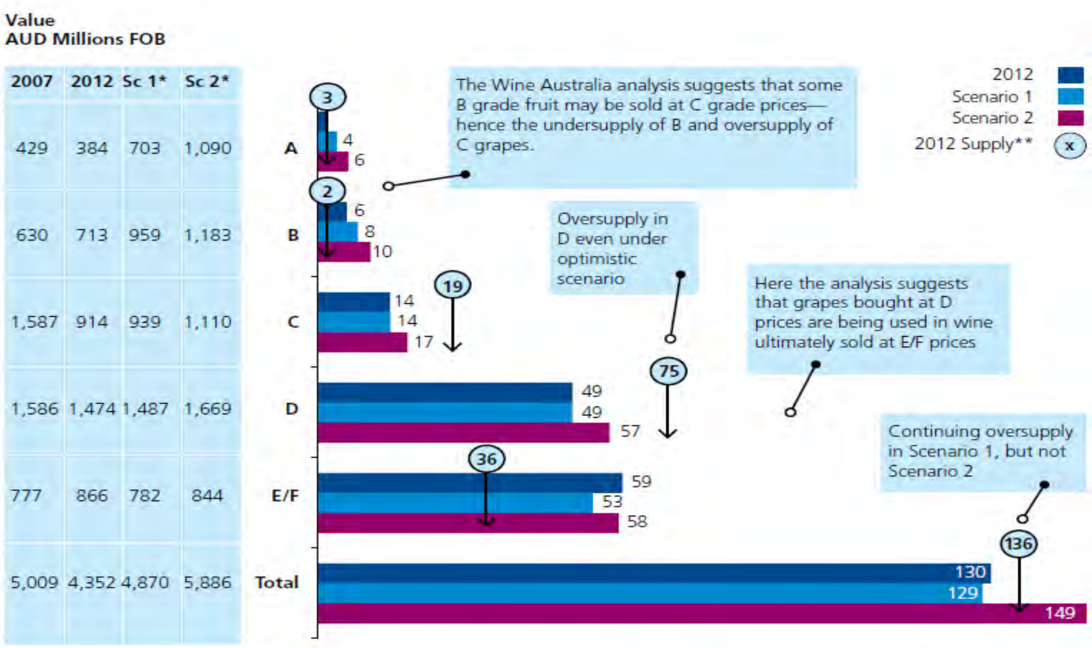
The Australian wine industry enjoyed considerable success from 1991 through to 2007. However, in more recent times, a range of market conditions have challenged the industry and have resulted in a structural mismatch between demand and supply. However, it is not accurate to characterise this imbalance as a “market failure”.

The independent expert review of industry dynamics WFA commissioned in 2013, produced by Centaurus Partners, which can be found in Attachment A, concluded:

1. The Australian wine industry has a structural mismatch of supply and demand. As a consequence, seasonal improvements such as the Australian dollar depreciation will not address the market failure in the long-run. If the industry does not undertake structural reforms, the mismatch of supply and demand will persist. The extract from the expert review below illustrates that if current trends continue, demand will not correct the oversupply in C or D (fob $2.50-$7.49)-- even in the optimistic scenario of growth returning to pre-GFC levels. However, projections indicate a likely growing undersupply of A and B (fob greater than $7.50). See full analysis in Attachment A.

Exhibit 26: Wine Australia volume growth scenarios based on recent demand growth

Millions of 9 litre equivalent cases



* WAC scenarios based on recent demand growth by segment by market. Domestic growth based on Euromonitor data. Scenario 2 assumes decline in AUD, significant marketing investment will bring growth to pre-GFC levels

** Based on grape price dispersion data and yields

Source: Wine Australia; Euromonitor; ABS; analysis

2. The Australian wine industry tripled in size from less than 400 million litres to 1.2 billion litres and achieved total revenues of $5 billion in 2007, and was very successful at building export markets.

3. Since 2007 the profitability of the Australian wine industry has declined significantly:

   - The global financial crisis hit world markets starting in August 2007 and accelerated through 2008—coinciding with a significant fall in Australian wine exports.
   - From 2004 the Australian dollar rose steadily to almost parity in July 2008. A sharp fall to 62 cents in August 2008 preceded a steady climb back to parity in November 2010 and beyond.
   - Domestic demand growth during the same period has been flat and there has been an increase in wine imports.
   - A supply-demand imbalance has ensued resulting from excess planting and wine making capacity given the 'unexpected' fall in export demand and rise in the Australian dollar.

4. This decline in profitability has intensified:

   - Export returns have declined sharply. Export volumes recovered through 2009, only to fall again in 2010 and 2011 including a fall in demand for Australian wine in key markets, especially the US, UK and Canada, from 2007 to 2012. From 2012 to 2013, export volume decreased by 6%, while export value decreased by 5%.
   - Total industry gross margin has declined by 38% to $1,107 million in 2012, from $1,787 million in 2007.This was driven by a $747 million decline in export gross margin. In 2013, using 13 representative companies, average profit margin in the sector was 1.6% compared to -1.4% in 2012.
   - Domestic margins have been squeezed by retailers, low demand growth, and increased imports. Domestic retail consolidation which has resulted in approximately 77% of all off-premise wine sales now being controlled by the two national grocery chains.
   - The decline and shift in export demand has created an "oversupply/under-demand" of grapes and wine in certain quality segments. It is estimated that up to 70% of total 2012 wine grape production may be uneconomic with the most significant profitability issues concentrated in lower grade grapes. For 2014, the estimated unprofitable production is 84% of total production assuming cost of production has increased by 3%.

5. Efforts to improve profitability have, in many cases, only reduced the extent of the decline.

6. There are foreseeable circumstances that would put further pressure on profitability, such as global oversupply that will place further downward pressure on domestic grape and wine prices.

7. The other side of this 'perfect storm' is that no single lever will 'fix' the problem.

   - Australian Grape and Wine Authority's scenarios for global demand growth indicate that even under their optimistic scenario (in which growth returns to pre-GFC levels) the US and the UK will not return to their 2007 value by 2017.

8. The industry is not being impacted equally or uniformly—some players/segments are more affected than others and the identity of those affected changes from year to year and by varietal and region; there are a number of success models.

9. Wine Tax arrangements remain an issue for the industry. While wine remains the cheapest form of alcohol on average per standard drink, other alcohol producers have intensified their proposals to increase wine taxation. Public health activists also believe that an increase in wine taxes will reduce alcohol related harm. Both these arguments are addressed in this submission.

Since these findings of the expert review were released in 2013, industry fundamentals have not changed. The 2015 Vintage Report found an average crush marginally lower than "average" and while average grape prices have strengthened, this is off a low base. The 2015 vintage will continue to distort pricing across the sector and fuel the production of retailer private label wines. In addition, the market supply and demand imbalance will be impacted by sustained high inventory levels (i.e. 1.8 million litres in 2012-13) and historically low average grape prices. Unless action is taken, it is unlikely that the industry will experience a transformational upward shift in pricing and margins for the foreseeable future.

Below is an extract from the 2015 WFA Vintage Report, see Appendix B for full report.

> *The 2015 Australian grape crush is estimated at 1.67 million tonnes, which is marginally lower than the "average" of the last 8 years. Riverina delivered increased yields but this was offset by lower yields in Murray Darling and most cooler temperate regions.*
>
> *The 2012 Expert Review analysis on production profitability has been further expanded to include 2015 data. Increasing 2012 cost of production by 1.5%, profitable production across 15 representative regions decreased from 7% in 2014 to 6% this reporting period. Low profitability and breakeven during this time were unchanged, while unprofitable production increased to 85%.*

In response to the above findings of the Expert Review and Vintage Report, WFA has developed a comprehensive plan to restore profitability to our wine businesses and secure the futures of those regional communities and jobs that depend on their success. This roadmap for recovery entitled *"Actions for Industry Profitability 2014-2016"* (see Appendix D) was developed following extensive industry consultation and has the support of the Australian wine industry (see our response to (c) in the terms of reference for more details).

While implementing the Actions plan for the industry's recovery continues to be led and predominantly financed by industry, it also requires Government support to:

1) Provide finite funding of $43.4m over four years to the Australian Grape and Wine Authority (AGWA) to grow the demand opportunity for our wine and multiply the benefits of recent FTAs; and
2) Make limited legislative changes to the eligibility for the Wine Equalisation Tax (WET) producer rebate to return it to its original policy intent and to ensure it is financially sustainable into the future. This includes the abolition of the separate New Zealand producers' WET rebate scheme (transferring New Zealand producers to the same access arrangements as Australian and other foreign country claimants), and we have legal advice on how this can be done in compliance with our international trade obligations.

These two initiatives stand on their own and were proposed to the Government for the May 2015 Budget. (See Appendix C for an updated one page summary of Budget Impacts.) As a package, they enable the Government to use the significant savings from WET rebate reform to fully offset the $43.4m in proposed new spending to AGWA and to deliver a conservatively estimated net savings to the Commonwealth of at least $234m over the Forward Estimates.

It is WFA's firm view that focusing industry efforts on a demand led recovery and growing demand in export markets will reduce the amount of wine currently competing in the domestic market. This will in turn reduce the market power of local supermarkets while improving the market power of grape growers and winemakers as competition for supply intensifies.

WFA's proposals are underpinned by detailed legal advice by Finlaysons (Appendix E2) on what specific reforms are needed and the basis for those changes. Our recommended saving measures are fully costed with supporting economic modelling provided by PwC (Appendix F).

In response to (d) in the terms of reference, we have provided comment on the role of the WET rebate in the market and supply side impacts but have included reference to this in our summary below.

(a) In summary, the industry is challenged by a **structural mismatch in supply and demand**. The Expert Review WFA commissioned identified the market conditions which have contributed to this demand/supply imbalance, as follows:

- A **marked and prolonged decline in exports** has placed pressure on the supply of grapes and wines in the domestic market;
- The **high AUD** of recent years is **only partly responsible** for this;
- A marked **decline in consumer interest** in key export markets has also contributed to this pressure;
- **Domestic demand growth** has been **flat** and concurrently there has been an **increase in imports**;
- **Domestic margins** have been **squeezed** by retailers and domestic retail consolidation has resulted in approximately **77% of all off-premise wine sales** now being **controlled by** the **two national grocery chains**;
- The decline and shift in export demand has created an "**oversupply/under-demand" of grapes and wine in certain quality segments**, resulting in a high proportion of uneconomic wine grape production, concentrated in lower grape grades.
- **The industry is not impacted equally or uniformly** – some players/segments are more affected than others and the identity of those affected changes from year to year and by varietal and region.
- **The WET rebate for bulk, unbranded and unpackaged wine**, has encouraged the 'home brand' market of the major wine retailers at the cost of branded product and provides a disincentive for wine grapes to go into wine destined for exports.
- A **demand-led marketing effort** will help alleviate the domestic oversupply of grapes and wine and help to set the industry on a **pathway to profitability**.

WFA recommendation:

- **Government funding of $43.4million over four years** is needed for AGWA to undertake a targeted and impactful demand-led marketing program. This activity will also help set the industry on a course to **reclaim and grow its reputation as a producer of quality and premium wines.**

(b) The extent to which federal and state legislative and regulatory regimes inhibit and support the production, processing, supply chain logistics and marketing of Australian wine

The Australian wine industry operates in a complex regulatory environment which while intense and sometimes regarded as onerous by industry, is important and necessary. As such, the industry works in close partnership with a number of federal and state government agencies – agencies that oversee arrangements impacting exports, the regulation of alcohol as a drug, food standards, labelling and liquor licensing, to cite just a few examples.

Chief among these agencies is the Australian Grape and Wine Authority. A strong partnership between industry and AGWA is central to the successful operation and future prosperity of the Australian wine industry.

Australian Grape and Wine Authority (AGWA)

The Australian Grape and Wine Authority (AGWA) supports a competitive wine sector by investing in research, development and extension (RD&E), growing domestic and international markets and protecting the reputation of Australian wine. AGWA brings together the RD&E activities of the former Grape and Wine Research and Development Corporation and the market development and compliance activities of the Wine Australia Corporation into one new entity.

AGWA is funded by grape growers and winemakers through mandatory levies and user-pays charges and the Australian Government, which provides matching funding for R&D investments. AGWA is a Commonwealth statutory authority established under the *Australian Grape and Wine Authority Act 2013* that commenced on 1 July 2014. AGWA has recently developed a five year strategy.

The R&D levy matching funding regime is also important for the industry, particularly to maintain our global competitiveness on cost and quality. Industry participation needs to be encouraged in setting R&D priorities and these used to guide the expenditure of Government-matched levies.

WFA acknowledges that AGWA remains constrained in allocating resources as funding streams are tied to certain activities. WFA believes that AGWA requires an additional $43.4m over four years to deliver a meaningful uplift in demand through targeted marketing and promotion of Australian wine in key export markets. See Appendix C for details on providing finite funding of $43.4m over four years to AGWA. This activity will importantly help set the industry on a course to reclaim and grow its reputation as a producer of quality and premium wines.

WFA does not support an increase in levies for raising the additional funding for marketing. The sustained low profitability being experienced by the industry means it cannot withstand another impost on earnings at this time.

The appointment of a new Board for AGWA is imminent and WFA has been represented on the Selection Committee. The industry looks forward to welcoming a Board with strong industry credentials and experience that include R&D, financial management and marketing.

Export Market Development Grants (EMDG)

The Australian Government can play an important supporting role in strategies to increase the demand opportunity. The multiplier effect of Export Market Development Grants is well known, and the wine industry has had a major presence in the programme, averaging around 250 recipients each year. These grants have enabled many small and medium producers to develop and promote their products effectively, and should be expanded.

Eligibility criteria for EMDG should be reviewed. Present arrangements exclude many of the most innovative wine industry leaders from receiving further grants, which creates an artificial ceiling on the potential impact of the program. These restrictions also come at a time when many of these leading businesses require support to undertake the difficult task of re-entering markets where demand for our wine has suffered as a consequence of external forces such as high exchange rates. Changes should also be made to ensure existing EMDG contracts have provisions that shield recipients from future policy changes that alter the terms of the grants.

Free Trade Agreements (FTAs)

WFA strongly supports the Australian Government commitments to pursue Free Trade Agreements (FTAs) with key markets. We also support the Australian Government support for other key initiatives, including:

- APEC initiatives in the Standards and Conformance Sub Committee and Wine Regulatory Forum aimed at standardising import requirements;
- The reduction in trade barriers caused by differing maximum residue limits for agri-chemicals across key markets; and
- DFAT and DAFF's capabilities to properly incorporate technical and regulatory issues into the development and maintenance of FTAs and regional trade agreements.

The Australian Government must continue to pursue Agreements with emerging Asian markets as an upmost priority. Targeted resourcing to government agencies to accelerate other market access opportunities also remains important such as the inclusion of wine in other bilateral agreements with India and Indonesia.

The funding required to support these measures is estimated to be an additional $2m per annum across a number of government agencies and would need to come from a redirection of existing Government spending.

Australia will be hosting two very important meetings in November 2015 which will have a major impact on the reduction of trade barriers for Australian wine in key markets.

The first of these is a meeting of the World Wine Trade Group. The World Wine Trade Group is a group of industry and government representatives with a mutual interest in facilitating the international trade in wine and avoiding the application of obstacles to international trade in wine. Members are Argentina, Australia, Canada, Chile, Georgia, New Zealand, South Africa, United States of America (with Brazil and Mexico participating as an observer). Key medium term issues are:

- An agreement to combat counterfeiting.
- Consideration of bilateral arrangements between WWTG as a group and a particular market such as China as a means of encouraging deeper engagement on regulatory issues.
- Review and adoption of common principles of good regulatory practice including for methods of analysis.
- Work of a maximum residue limit (MRL) working group to feed into APEC work on harmonising agri-chemical MRLs in the APEC region.
- A watching brief and collective action if required on the EU project to measure the environmental performance of products and organisations using a lifecycle assessment approach.
- Preparation of material to contribute to the debate on ingredient and energy labeling; coordination of positions in the Codex Alimentarius Commission;
- An agreement to facilitate the movement of samples between countries.

The current host of the WWTG is Georgia in 2014-15, followed by Australia in 2015-16.

The second meeting will be of the APEC Wine Regulatory Forum. The APEC Sub-Committee on Standards and Conformance (SCSC) Meeting endorsed the establishment of a Wine Regulatory Forum (WRF) and its Terms of Reference in 2008. There is a critical need for better regulatory coherence in the APEC region. For example, wine-related Non-Tariff Barriers in the region are estimated to cost APEC Member Economies and businesses (mostly Small and Medium Sized Enterprises) a combined total of $1 billion/year.

The WRF held an initial Seminar in in San Francisco, California in September 2011 with a fourth meeting in Beijing in October 2014. This was the second of five meetings to be held under the U.S. sponsored multi-year project which responds to the call by APEC Leaders for improved regulation and continues the work which began in San Francisco in 2011 and in Auckland in 2012. Fourteen of the 21 APEC Economies participated in technical discussions focused on a wide range of wine trade issues such as the following below. The WRF will hold a joint meeting with the World Wine Trade Group (WWTG) at the next meeting and APEC members will be encouraged to consider closer engagement with the WWTG.

- Reduction in Export Certificates:
- Enhanced Risk Controls through establishing risk assessment as the justification for regulatory intervention, and noted there may be a need for enhanced laboratory capabilities and technical exchanges to ensure that regulatory authorities have the capacity to assess risk and to use sound science in regulating wine.
- Continue a dialogue on MRLs for agrochemicals with a view to facilitating trade and encouraging cooperation with relevant international bodies such as Codex and the WWTG. Led by the Working Group on Pesticide MRLs, Members should look to the WWTG and the APEC Food Safety Cooperation Forum's pilot project on MRLs for wine grapes to inform future work in this area.

The importance of biosecurity and need for uniformity on addressing phylloxera

A key area for the industry is biosecurity. Legal and regulatory frameworks at the national, state and territory levels currently provide the mechanism through which biosecurity management programs are delivered. For example, the development of a National Phylloxera Strategy would permit the regulation and legislative controls for phylloxera to be harmonised across Australia. Variations in requirements result in greater costs for industry and reduced competitiveness. The principles that reference the World Trade Organisation Sanitary and Phytosanitary Agreement and the subordinate International Standards on Phytosanitary Measures (ISPM) should underpin the national framework to review and harmonise regulatory approaches.

However, it should be noted there are still concerns about the implementation of the National Fruit Fly Strategy. This should become a priority for the Government and the lessons learned from this process should be applied in the development of the National Phylloxera Strategy.

A National Phylloxera Strategy needs to be developed to enable the regulatory and legislative controls for phylloxera to be harmonised across Australia.

Inconsistency in food regulation between jurisdictions

State, territory and local governments are primarily responsible for implementing and enforcing food standards, although the Australian Government, through the Department of Agriculture, has a role in enforcing the Australia New Zealand Food Standards Code at the border. In 1998, the Blair Review recommended Australia adopt an integrated and coordinated food regulatory system with nationally uniform laws and a co-regulatory approach.

Following this, Australian, state and territory governments agreed to move towards a national system. An Intergovernmental Food Regulation Agreement (FRA), signed by COAG in 2000, included the Model Food Act as a template for developing consistent legislation in each state and territory. The FRA also established the Australia New Zealand Food Regulation Ministerial Council, now known as the Legislative and Governance Forum on Food Regulation. The forum's membership comprises ministers responsible for food regulation from all states and territories, the Australian Government and New Zealand. Its role is to develop Australian food regulation policy using powers to adopt, amend, reject or request the review of food standards.

Despite an overarching national approach, inconsistent regulation remains due to the autonomy of state and territory governments in determining whether to implement national standards and their interpretation. FSANZ will not provide interpretation for the food standards they develop unless they receive payment. Small businesses cannot afford to seek this advice, with costs multiplying where it is necessary to contact regulatory bodies in each jurisdiction to ensure compliance with their interpretation of standards.

This is an untenable situation, as poorly drafted food regulation has differing interpretations between enforcement jurisdictions, increasing costs and raising uncertainty for businesses trying to comply with the law. WFA seeks the Government's commitment to FSANZ providing free interpretations of the Food Standards Code to provide greater regulatory certainty.

Responsible Service of Alcohol (RSA) Accreditation – no uniformity between jurisdictions

The traditional route-to-market for wine in Australia is dominated by the two major chains, which between them control an estimated 77% of the "off premise" sales of wine in Australia.

Many of Australia's small- and medium-sized wine producers do not have either sufficient stock to be ranged by the chains, or they are not in a position to otherwise be stocked in any or all of the chain's stores.

As such, wine producers need to find alternative routes to market – this invariably involves them taking their wines and presenting them (i.e. pouring glasses of it) at many different locations around the country. This may be at trade exhibitions, consumer exhibitions, at retail outlets, at farmers markets, field days, etc.

As these opportunities to expose their product to potential purchasers involves the pouring of wine for the potential purchaser to taste, this in turn usually requires the person doing the pouring to have Responsible Service of Alcohol (RSA) qualifications.

Ideally, there would be a single, nationally recognised RSA accreditation which wine producer's staff could hold, which would allow them to present their wine in any State.

However, liquor licensing is regulated at a State level, and there is unfortunately no such nationally recognised qualification.

The next best option would be for each state to provide for mutual recognition of relevant RSA qualifications held in another State. Unfortunately, there is also no national scheme providing for mutual recognition of RSA qualifications.

A further option would be to allow the relevant training to be undertaken online. But again, some States do not even allow this.

This means that wine producers are having to travel to the interstate destinations in advance, or even on a separate trip, to undertake RSA training – with the timing dictated by when face-to-face training is scheduled in that State.

Alternatively, we had an example recently (in March 2015), when one of our Small Winemakers Membership Committee members paid for a NSW-based trainer to fly to South Australia to conduct NSW RSA training for the South Australian staff, so that when they subsequently travelled to NSW they had the relevant NSW accreditation.

The development of either a single national RSA accreditation scheme or the provision of mutual recognition of existing state qualifications, between all of the states and territories, would help wines to find new consumers. This is particularly important for smaller wineries who can struggle to compete for limited shelf-space in the major retail outlets.

(b) In summary, WFA submit the following recommendations on the role of government in relation to production, processing, supply chain logistics and marketing of Australian wine:

- AGWA's current budget is inadequate for growing the demand for Australian wine overseas and as such needs **additional government funding of $43.4million over 4 years to support the marketing of wine for export.** This spending will maximize the export opportunities afforded by the 3 recent Asian FTAs.
- **Maintain** the current system of **government** providing **matching funding for R&D** to AGWA.
- **Industry participation** needs to be encouraged **in setting AGWA's R&D priorities and** these **used to guide** the **expenditure** of government-matched industry levies.
- **Expand the Export Market Development Grants** and review the eligibility criteria to ensure the most innovative wine industry leaders who have been past recipients can re-apply and receive the support they need to re-enter markets where demand for our wine has suffered a downturn.
- **Introduce changes to** ensure existing EMDG contracts have provisions that **shield recipients from future policy change**s that alter the terms of the grants.
- **Prioritise inclusion of wine in bilateral agreements** with India and Indonesia and **provide an additional $2m per annum** across a number of government agencies to support this.
- **Prioritise progress on the reduction of trade barriers** for Australian wine in key markets through the upcoming meeting of the World Wine Trade Group and the meeting of the APEC Wine Regulatory Forum.
- **Enable the development of a National Phylloxera Strategy** to ensure consistent protection and management of disease across Australia.
- **Ensure consistency in food regulation** between jurisdictions.
- **Enable FSANZ to provide interpretations of the Food Standards Code at no cost** to producers to help ensure regulatory certainty and alleviate costs pressures on small producers in particular.
- **Develop** either **a single national RSA accreditation scheme or provide for mutual recognition of existing state qualifications**, between all of the states and territories, to facilitate wines reaching new domestic consumers.

(c) The profitability of wine grape growers, and the steps industry participants have taken to enhance profitability

Low profitability is an issue for the whole industry – for grape growers and for winemakers alike. Each year, WFA conducts an industry survey (with members and non-members) and provides analysis on production profitability. These annual Vintage Reports are invaluable for not only identifying and tracking the factors that contribute to profitability but for enabling WFA to work with industry to identify and progress, evidence-based actions.

Production profitability analysis (see Appendix B for the full 2015 Vintage Report)

The 2012 Expert Review analysis on production profitability has been further expanded to include 2015 data. Increasing 2012 cost of production by 1.5%, profitable production across 15 representative regions decreased from 7% in 2014 to 6% this reporting period. Low profitability and breakeven during this time were unchanged, while unprofitable production increased to 85%.

Favourable changes in seasonal market conditions and the macro-economic environment will not be enough to restore the Australian wine sector's lost share and margin. We need to take pro-active steps with the support of government to boost demand and our resourcing of promotional activities.

The 2016 vintage will continue to present challenges to the industry since we have not seen significant structural shifts.

Regions were affected by changes in purchase prices and yields differently. Extending the analysis to similar regions discussed in the 2012 and 2014 production profitability analysis[1], Barossa Valley, Riverland and Hunter Valley increased profitable production, while Margaret River increased its unprofitable production.

The production profitability analysis for the Barossa Valley illustrates that the proposition of profitable production increased by 10,335 tonnes. This increase is predominantly from the increase of grapes purchased above $2,000 per tonne. This year's report show the lowest proportion of unprofitable production compared to 2012 and 2014 reports.

The Hunter Valley increased its profitable production to 3% and low profitability to 2% in 2015 compared to 2012 and 2014. Similarly, its 2015 unprofitable production is lower than the previous analyses. Purchases between $1,500-$2,000 per tonne exhibited most improvement where 54% are profitable, while in 2014 this figure was 17%.

The Riverland exhibited 8% breakeven and profitable production in 2015 – a 2$ increase from the 2014 analysis. Unprofitable production of 92% is lower than last year's 94%, but still higher than the 2012 figure of 84%. Purchases between $300-$600 per tonne exhibited most improvement – the proportion of breakeven and profitable production increased from 7% in 2014 to 13% this vintage.

Margaret River maintained its 2014 profitable production at 30% in 2015, but increased its unprofitable production to 50%. Purchases between $600-$1,500 exhibited most change since the proportion of breakeven and profitable purchases within this range decreased from 36% in 2014 to 30% this vintage.

[1] WFA conducted the analysis for 15 regions but in keeping with the Expert Review, discussed only four in the 2015 Vintage Report. Analysis for the remaining regions can be obtained from the WFA website.

‘Actions for Industry Profitability 2014-2016’

In response to the findings of the expert review (Appendix A) and other industry data, and using their collective industry experience, the WFA Board released draft Actions in August 2013 to generate discussion on what was needed to restore profitability to the sector. An extensive consultation was then undertaken including road shows to wine growing regions and written submissions from over 70 national, state and regional wine organisations and industry stakeholders. Armed with this feedback and further input, the WFA Board released 43 final Actions in December which can be found in Appendix D.

The Actions are grouped under eight headings. Progress has been made against each and is recorded below.

1. **Continue to engage the Wine and Health debate** - WFA will proactively engage the Wine and Health debate to promote responsible consumption and ensure a balanced regulatory framework for our Industry. These Actions aim to minimise harm to the community, promote the benefits of moderation and to shape the policy debate.

   Progress: WFA continues to lead industry to ensure responsible consumption is promoted at an industry level and that programmes and tools are provided to individual companies to reduce alcohol related harm. We also undertake significant bodies of research to underpin an evidence based approach to policy development to ensure a balanced regulatory framework is in place.

2. **Grow the demand opportunity** – With support from AGWA and the Australian government, WFA will help wine businesses grow demand for our wine, both domestically and internationally. The outcome from taking these Actions will be an increase in the relative market share of Australian wine in all major markets.

   Progress: WFA continues to advocate strongly for additional marketing funds for AGWA to grow demand. It also plays a key role in advising AGWA on strategic priorities. More broadly, progress has been made with the signing of several Free Trade Agreements and additional funding has been secured for EMDGs.

3. **Hasten the supply correction** - WFA with the Wine Grape Growers Australia will hasten the correction to the supply base to improve margins throughout the value chain. The outcome will help reduce the oversupply of commercial grade grapes and the pricing distortion it creates throughout the industry.

   Progress: On the supply side, WFA continues to work closely with WGGA and AGWA on critical research and data collection to help inform the market on projected demand, market opportunity and the state of the industry. While market forces will continue to drive change, there is a considerable body of work underway to improve market signals.

4. **Maximise open and fair domestic competition -** WFA will work with the national wine retailers and competition regulator on fairness, transparency and equity in the domestic wine market. These actions aim for a more sustainable domestic marketplace for industry where companies can grow share through quality, innovation and investment.

   Progress: A Code of Conduct has been signed with between WFA and the largest wine retailer which outlines an acceptable level of market behavior and a dispute resolution process. Negotiations on a similar agreement with other retailers are underway. The Code between growers and winemakers has also been reviewed and updated but work is on-going to ensure it is widely adopted within industry.

5. **Retain with changes to the WET rebate -** WFA with the support of Australian Government will retain and make changes to the Wine Equalisation Tax rebate to support regional communities. The outcome will be the retention of the WET rebate to ensure that it is working within its original policy intent, and to seek policy changes to improve the workings of the WET rebate on the wine industry, consistent with its original intent.

   Progress: WFA has developed a comprehensive position on the WET rebate which is outlined elsewhere in this submission. It is fully supported by expert legal opinion and independent modelling. It has support from the clear majority of industry as evidenced in this submission. WFA will continue to advocate for these changes in the WET rebate discussion paper process and other policy forums.

6. **Monitor the future of wine tax policy -** WFA will monitor the future of wine tax arrangements in response to changing market conditions. The outcome will be the on-going examination of optimal taxation arrangements for industry to support growth and our licence to operate with the community.

   Progress: WFA will continue to advocate against any increase in wine taxes and proposals from other alcohol sectors and the health lobby. A comprehensive submission has been prepared for the Tax Review.

7. **Secure the funding for the Action agenda -** WFA will secure the funding to support the recommended reform agenda in partnership with Industry and Government.

   Progress: WFA continues to advocate to government reform to the WET rebate which will provide significant savings that will offset the funding required to undertake the marketing activities we believe are critical to grow demand.

8. **Areas for on-going work** - WFA will continue and expand its good work in a number of important programmes and policy areas such as promoting innovation and R&D spend and improving market access.

   Progress: WFA continues to develop, represent and lead industry efforts in important policy areas such as R,D&E strategy and works closely with officials on resolving and removing technical trade barriers.

The full Actions document (Appendix D) should be read together with the expert review of industry dynamics (Appendix A) in support of this submission.

Grape Pricing and Commercial Practices

Many of WFA's members are also vineyard owners and know first-hand the difficulties that high costs and low prices present to growers. For a viable and sustainable wine industry, it is critical that grape prices can deliver sustainable profits to growers. In recent years this has not been the case for many commercial grape growers as is evidenced by our grape production profitability analysis included in our 2015 Vintage Report and discussed above.

The concerns raised by growers also go beyond pricing. Given the on-going oversupply of wine grapes, as grape growers have come off long term contracts they have often struggled to re-sign multi-year agreements and achieve a level of contract security which is 'bankable'. This dynamic is indicative of a market in an oversupply of both grapes and wine and is similar to the situation faced by winemakers struggling to secure profitable long term arrangements with domestic retailers for limited shelf space.

Until a structural uplift in demand is achieved and the supply-demand imbalance addressed, poor wine and grape prices will continue. The sector as a whole is suffering depressed prices and ‘under demand’.

WFA notes that Wine Grape Growers Australia has provided a submission to the Inquiry that suggests that the current commercial practices in the sector are also preventing the industry’s ability to adjust to the supply-demand imbalance.

The issues raised in the WGAG submission (p.5) are:

a. The role of contracts in best-practice commercial arrangements.
b. Price determination mechanisms described in codes of conduct together with those that sit outside such codes due to competition law.
c. Sharing of agricultural and market risk.

Role of contracts in dealing with best-practice commercial arrangements

WGGA reviewed a sample of 20 wine industry contracts and identified a number of concerns with a (unspecified) number of contracts. Clearly there is a role for WGGA and WFA to ensure that their members are aware of their responsibilities around contracts. Importantly, and as noted by WGGA in their submission, through the development of the Australian Wine Industry Code of Conduct (see below) and the work of the Code Management Committee (CMC), the industry has committed to improving the operation of contracts. For example, the CMC is committed to making available contract templates that identify the key issues that need to be present in contracts to ensure a mutual acceptable business relationship. However, it should be noted that different businesses will require different contracts with different requirements and a one –size model does not fit all businesses.

Price determination mechanisms described in codes of conduct together with those that sit outside such codes due to competition law

In their submission (pp. 6-9), WGGA identify price determination as causing a disconnect between supply-demand signals, blunting the incentives for quality and undermining buyer/seller relationships. This interpretation does not recognize that the fundamental determination of price is the price achievable for the final product – wine. In the wine sector, grape prices not only reflect climatic conditions and the inputs used (such as agricultural chemicals, water, pruning, and environmental management), but also the ebb and flow of domestic and international grape supply.

Pricing of grapes in the wine industry is determined by contracts between processers and grape growers. However, the final price will be determined by fruit “grade” and its destined product line. In order to resolve disputes over price, the Wine Industry Code of Conduct (the Code) was established in 2009 by WGGA and the Winemakers' Federation of Australia and is supported by the Australian Government's Department of Agriculture, Fisheries and Forestry.

WGGA and the WFA believe a framework for fair and equitable grape purchase agreements and an impartial, cost effective dispute resolution scheme provided through the Code will help improve relationships between wineries and grape growers. In turn, our industry’s market prospects will be improved by improving the supply chain’s ability to meet consumer demand, as well as demonstrate to both consumers and retailers that the industry has sound and fair commercial practices in place.

A key element in the Code is for the provision of indicative prices in some instances. Indicative prices are not necessarily required as the Code allows a range of variations as long as there are arrangements in place for determining a fair and reasonable price.

This means that growers should know in good time *before* their grapes are handed over, what price they will receive. The contract could provide for any of the following:

- A fixed price/tonne;
- Payment based on weighted district average; and
- Grape price to be paid in line with general market price.

In such a case, then, an indicative price does not need to be offered. However, growers support the provision of an indicative price as it potentially allows them to make business decisions based on what they can expect to receive on sale of the crop. However, in practice, the indicative price has not been able to provide such certainty. Indeed, indicative pricing had been identified as a major disincentive by wineries to sign the Code. It was also identified by the grape grower representatives as a major problem this vintage as it encouraged lower across-the-board prices.

WFA believes the provision of better information relating to supply and demand throughout the season would assist growers make better business decisions and may remove the need for indicative pricing. Such information would best be provided by a well-respected and independent research organisation such as ABARES.

Objective measures of quality

The concept of quality should not be confused with producing grapes to specification, with consumer demand for wines with different attributes. Wine grape purchasers pay for wine grapes according to what they can receive for the final product to the market. The premium priced wine segment which uses higher quality (and higher cost of production) grapes is relatively small. The majority of wine sales occur in the lower price points, which means that the cost of inputs must also be lower.

The ability to use science to understand what are the attributes of the grapes on the vine and how that will translate into the attributes of the wine is one that is being studied intensively. The Australian Grape and Wine Authority have funded a substantial research program into this area. For example, an AGWA-funded project nearing completion at the Australian Wine Research Institute (AWRI) is looking to determine which of the many measurable chemical compounds in grapes can be used, independently or in combination, to determine grape quality and even grape style. The research is building on two decades of work by a number of researchers with a view to identifying those measures that could become standard procedures for wineries. Industry has always said, at a strategic level, that it wants objective measures of quality and it's always been something that AGWA has supported and funded. The next step from this project is to make them available to industry in a way that they can use to benchmark their own fruit. The research will continue to the end of this year, with the final report due by mid-2016.

These objectives measure will be useful in reducing uncertainty between grape growers and winemakers on whether the grape characteristics are as contracted for, but will not provide a silver bullet to pricing and profitability. That will only come from a recovery in demand and through the further reduction in costs.

Appropriate sharing of agricultural and market risk

WGGA states in its submission (page 9) that 'under prevailing contracting arrangements, growers bear a disproportionate share of the risk and they often bear market risk that is more appropriately borne by wine companies'. This statement is not supported by WFA and does not acknowledge the risk taken on by wine producers and that risk is shared across the wine supply chain.

While grape growers are directly ‘exposed to weather and pest/disease problems’, WGGA makes no mention of the currency risk faced by winemakers during the lengthy maturation and inventory processes involved in the wine making process. Winemakers face significant uncertainty due to changing market conditions from the time they purchase and pay for grapes to when the wine is taken to market. That is why deferred payments for grape suppliers is a longstanding industry practice to share the risk with winemakers.

Grape growers have the ability to make investment and vineyard management decisions every Vintage to account to changes in the market. A winemaker may make a decision on his/her product and portfolio many years in advance of that wine eventually going to market. In this respect, both grape grower and winemakers face uncertainty and risk.

With regard to payment risk, it should be noted that the winemaker receives no payment until the wine is sold to the consumer or retailer (although anecdotally consignment payment terms are increasingly being proposed by some retailers).

Most horticultural products have a much shorter turn around period as do most agricultural commodities. In this regard, wine production is unique and the agricultural risk is significant for both grower and producer. This is reflected in the risk ratings and ease-of-access to working and investment capital for winemaking (this is discussed later in the submission).

Pricing risk for growers (and winemakers) is not driven by the absence of objective measures, but more so by the prevailing and anticipated supply-demand balance. Even a price determination system based on quality attributes as suggested by WGGA would ultimately deliver variation in pricing and low returns in an environment of oversupply in the Australian market-based economy. Uncertainty over pricing is an issue that winemakers also confront when dealing with the highly consolidated domestic wine retail sector with its limited self space.

With regard to yield caps and control of harvesting schedules, these matters will continue to reflect market conditions and practices will ebb and flow with the broader context of the supply-demand balance. In an environment of oversupply, growers may be compelled to increase volume to offset the impact of low prices per tonne while the winemaker will continue to focus on managing quality to specification and work towards that end. Until sustainable profitability is restored, these tensions will continue.

WFA does not agree with the WGGA submission and the conclusion that ‘wine companies must assume their fair share of risk’. The agricultural risk presented by grape and wine production is shared. Wine companies do not have the luxury of long term contracts with their customers and consumers, are exposed more directly to the fluctuations of the global market including currency shifts and invest heavily in fixed assets and in building brand equity.

In WFA’s view the problem facing both wine companies and grape growers is demand driven. Greater demand for Australian wine will be reflected in greater demand for wine grapes and better prices.

<u>Conclusion</u>

In conclusion, the structural issues facing the grape and wine sector have arisen due to increased supply and demand imbalance. While there are too many grapes being harvested to supply the market demand there will be increased price pressure on both grape growers and winemakers. Neither group is finding profitability easy. WFA strongly believes that the best way to improve profitability to all parts of the sector is by lifting demand.

This demand driven recovery must come from export markets, although the increased presence of imports (particularly New Zealand wine) must also be addressed through targeted marketing programs. WFA has a clearly thought out and well-articulated strategy to drive this recovery.

More can be done to improve the commercial relationship between growers and winemakers. Clearly, initiatives such as the Code of Conduct need to be supported more broadly. More work needs to be done to educate parties in the role of contracts and both of the peak industry bodies have a role to play.

The role of Codes of Conduct

Poor prices cannot and should not be addressed through codes, either voluntary or mandatory, although WFA believes that voluntary codes can play a part in outlining what should be expected behaviours in commercial relationships throughout the supply chain.

Australian Wine Industry Code of Conduct

The wine sector already has a code of conduct in place to rule on disputes between wineries and grape growers. The Australian Wine Industry Code of Conduct was signed by representatives of the Winemakers' Federation of Australia (WFA) and Wine Grape Growers Australia (WGGA) on 19 December 2008.

The purpose of the voluntary Code is two-fold: firstly to establish a common framework on Australian wine grape supply contracts and secondly, to provide a dispute resolution system to manage disagreements involving price or quality assessment disputes.

The minimum requirements set out in the Code have been agreed to by the lead industry organisations for both grape growers and winemakers.

All elements of the Code apply to new grape supply contracts and major variations of agreements between grape growers and signatory wineries for the sale and purchase of wine grapes from the 2009 vintage and beyond

The Code is overseen and administered by the Wine Industry Code Management Committee (CMC) jointly appointed by the Board of the WFA and Executive Committee of WGGA. It consists of six members, an independent Chair, supported by a Secretariat of two, with the assistance of a minute taker. The Committee's responsibilities include acting as the custodian of the Code, monitoring and assessing the Code's performance, improving the Code, facilitating resolution of disputes over winegrape prices and vineyard downgrades and rejections, and determining alleged breaches of the Code. It is required to produce an annual report to be published by 30 September each year containing:

- a description of the nature and number of disputes received;
- any comments it wishes to make about conduct or trends in the industry;
- a report on the operations of the Code, including the names of any parties removed from the Code; and
- a list all current signatories to the code and new signatories since the previous annual report.

In monitoring the Code, the Committee may recommend amendments to assist the Code's operation. The Code is continually updated to reflect the performance of the Code since its introduction.

Winegrape purchasers who are Signatories to the Code agree to be bound by the principles set out in the Code in their commercial dealings with winegrape growers.

They also undertake to provide a grower with a copy of the Code whenever that grower signs a new Agreement.

With the exception of Part 2 (Winegrape Purchase Agreements), the Code took effect on 1 January 2009. Signatories are required to comply with Part 2 for all new agreements for the supply of winegrapes for the 2010 vintage onward. With existing agreements, each Signatory agrees to offer to its winegrape growers to:

- apply the Code (with the exception of Part 2) with effect from 1 January 2009
- bring existing agreements in line with the provisions of Part 2 of the Code at the time of any material variation to the agreement.

Signatories also commit to promoting the adoption of the Code. The two representative bodies, WFA and WGGA, have agreed to publicize and promote the Code and its dispute resolution procedures, and to work to maximize its adoption within the industry.

A winegrape purchaser can become a signatory to the Code by down loading, completing and returning a Code Signatory Notification form from the web site - www.wineindustrycode.org. A register of signatories is maintained and available on the WFA & WGGA websites. The Code is voluntary and becoming a signatory is not compulsory. There are no joining fees or ongoing annual costs.

The Australian Wine Industry Code of Conduct is specifically written to take into account the particular issues surrounding the sale of wine grapes in Australia. It recognises the differences between region and vintage and is very different in structure to other Codes or dispute management systems.

Extension of the Horticultural Code

WFA would be concerned about the possibility to extend the Horticulture Code to cover transactions between growers and processors. This would of course negate the commodity specific code developed by the wine sector. As the Horticulture Code is drafted for a specific purpose, to cover trades between trades in the wholesale market, any moves to extend the coverage of the Horticulture Code would require substantial redrafting. Horticulture trades are characterised by multiple transactions between growers and wholesale traders over a growing or harvesting season whereas trades in the wine industry occur once, when the grapes reach the required level of maturity for winemaking. In addition, to incorporate the specific requirements of the wine sector would be difficult. We are concerned that such a redrafted Code would not recognise the specific nature of wine grape purchases and would:

- Result in an increased administrative burden;
- Potentially result in the loss of information to grape growers;
- Increase the potential for increased expensive and lengthy legal action resulting from a less targeted dispute settlement process;
- Require substantial change to the current provisions in the Horticulture Code which preclude the payment of bonuses as appropriate; and
- Result in unintended consequences as a one-size-fits-all approach is used across multiple commodities and trading arrangements.

WFA is actively involved in promoting uptake of the Wine Industry Code of Conduct and we believe the extension of the Horticulture Code to disputes where the Wine Industry Code of Conduct could apply will have significant detrimental impacts.

We would also note that in the wine sector, in the main, there are written, contractual obligations that exist between a grower of wine grapes and the winery that may process those grapes.

Within some of those contracts there exist dispute resolution procedures which are required to be undertaken and exercised as part of the obligations which are accepted between the parties.

In addition, many companies include an express contractual dispute resolution term in their contracts for acquiring goods or services relating to the business of primary production.
We would also note that South Australia has introduced the Farming Industry Dispute Resolution Code. The introduction of the Farming Code has resulted in one set of rules and compliance procedures for fruit purchased in South Australia and another for fruit purchased elsewhere. We need less complexity, not more and an expanded Horticulture Code will create uncertainty and complexity.

WFA does not believe that an extension of the Horticulture Code of Conduct to include wine processors is warranted, and believes it would add cost and complexity to growers and winemakers alike. We also believe there is a strong chance that it would result in unintended and undesirable consequences.

Recommendations of the Australian Small Business Commissioner

WFA is aware of the submission to the Inquiry from the Australian Small Business Commissioner which follows a recent Roundtable with Industry. In response to the Australian Small Business Commissioner observations, WFA would make the following observations:

Australian Wine Industry Code of Conduct

The Australian Small Business Commissioner identified that the review and removal of specific clauses from the Australian Wine Industry Code of Conduct may increase uptake. On page 5 of his submission, he refers specifically to the indicative pricing provisions which 'are widely acknowledged to be a deterrent for many winemakers to sign up'. WFA supports this view, but also believes the provision of better information relating to supply and demand throughout the season would assist growers make better business decisions and remove the need for indicative pricing. Such information would best be provided by a well-respected and independent research organisation such as ABARES.

The Australian Small Business Commissioner supports the continued promotion of the code and its benefits to the sector. The Code of Conduct Management Committee strongly supports this recommendation and together with the peak industry bodies WFA and WGGA will seek to increase the number of signatories over the coming year. The original performance targets were 50% of the top 100 Australian wine producers by tonnes processed and 85% of the purchased crush. We currently have around 40% of the crush as signatories and will seek to increase this substantially in 2016.

The Australian Small Business Commissioner also suggests that if we cannot improve participation that consideration should be given to a mandatory Code. The Code Management Committee has looked in detail at this option, but as also noted by the Australian Small Business Commissioner there is no consensus to go down this path and indeed WFA consider that any such mandatory Code would be weaker and would lead to increased regulatory burden and cost on grape growers.

Standardised contracts and contract terms

The Australian Small Business Commissioner calls for the consideration of standardised contracts and contract terms. WFA believes that standardised contracts are not desirable or achievable due to the wide variety of purchase decisions and regulatory frameworks (e.g. differing requirements under State legislation).

However, there is a role in educating growers and winemakers in attributes under contracts and the Code management Committee is active in developing template contracts that can be adapted according to differing circumstances.

Enhanced roles of industry organisations

Australian Small Business Commissioner suggests that industry organisations should assume a responsibility to members to provide them with access to information, education and early market indicators. WFA agrees in principle that provision of these services is a worthwhile ambition, but the reality of funding resources makes it difficult to provide such services. WFA has in the past provided assistance to its members through government grants.

Increased focus on export opportunities

WFA agrees with the Australian Small Business Commissioner that improving the demand prospects for Australian wine through growing the export sector will solve many of the concerns of grapegrowers. WFA in cooperation with AGWA has outlined a detailed recovery plan for the sector that focuses on growing demand for Australian wine on export markets.

Please see below for a summary of recommendations for this section.

(c) In summary, with respect to the profitability of wine grape growers, and the steps industry participants have taken to enhance profitability, WFA reports:

- The industry continues to experience poor profitability across the entire supply chain.
- The industry continues to implement measures to aid industry recovery. We also require government support to make the changes and provide the funding we believe will help deliver a demand-led recovery.

But government as a role to play also, and to this end, WFA recommends:

- **Government** funding of $43.4million over four years for AGWA to undertake targeted and impactful demand-pull marketing programs to help grow the demand for Australian wine in key overseas markets. The resulting growth in exports will importantly help to alleviate the domestic supply/demand imbalance which impacts grape growers and winemakers.
- Government reform of the WET rebate to restore the integrity of the scheme and return it to its original policy intent of supporting small to medium wine businesses in regional Australia.
- That the Government does not pursue mandatory codes of conduct for the industry.

(d) The impact and application of the Wine Equalisation Tax (WET) rebate on grape and wine industry supply chains

In addressing this reference, we have included background and discussion on the evolution of the WET rebate scheme, identified problems with the scheme (including uncommercial claims) and the impacts on Commonwealth revenue, and identified necessary reforms that restore the integrity of the scheme and that will importantly help set the sector on a pathway to restoring the industry's performance and reputation as a producer of quality and premium wines. This reputation and standing is critical to the future prosperity of the industry.

The WET rebate

Taxation arrangements for the Australian wine industry play a critical role in shaping industry structure, performance and competitiveness. The Wine Equalisation Tax (WET) has been in place for well over a decade but has undergone a number of changes particularly in regards to the WET rebate.

The WET at a rate of 29% of the last wholesale sale price came into being in the context of the broader GST changes made in 2000 to replace wholesale sales taxes. In order to obtain the support of the Australian Democrats for its GST reform package in 2000, the Howard Government *'undertook to ensure that arrangements were established which provided a tax exemption for cellar door and mail order sales up to a wholesale value of $300,000 per annum'*.[2]

This rebate was intended to assist small and medium sized winemakers and to promote tourism in regional areas.[3] The Explanatory Memorandum to the relevant legislation that introduced the current producer rebate system in 2004 stated, *"Around 90% of wine producers will be able to fully offset their WET liability by accessing the new rebate. In particular, small wine producers in rural and regional Australia will benefit significantly…."* As summarised by the Australian National Audit Office, the rebate was introduced *"in recognition of the substantial financial hardship being faced by small rural and regional wineries and aimed to support their viability and consequent capacity to generate employment and wealth in local communities."*

The WET arrangements were given statutory force by the *Indirect Tax Legislation Amendment Act 2000*, which in turn amended the *A New Tax System (Wine Equalisation Tax) Act 1999 (WET Act)*. The *Indirect Tax Legislation Amendment Act* provided a 14% WET rebate from 1 July 2000 on cellar door and mail order sales (and applications to own use) up to a maximum of $300,000 of sales per annum.[4] The rebate tapered down to zero for sales between $300,000 and $580,000 per annum.[5] The WET rebate applied in conjunction with the applicable 15% State Government cellar door subsidy. The combination of the 14% WET rebate and the 15% State subsidy meant that cellar door and mail order sales up to $300,000 per annum were effectively WET-free.[6]

To be eligible to claim the WET rebate, the producer was required to hold a license issued under a State law to make retail sales of wine from particular premises as a wine producer or a vigneron (i.e. a producer's license under State liquor licensing laws).[7] Hence, the WET rebate was limited to wine and did not include other products captured under the WET Act such as cider, perry and sake.

[2] Supplementary Explanatory Memorandum, Indirect Tax Legislation Amendment Bill 2000, [2.27]
[3] Supplementary Explanatory Memorandum, Indirect Tax Legislation Amendment Bill 2000, [2.38-2.39].
[4] Ibid [2.29];[2.46]
[5] Ibid
[6] Ibid[2.29]
[7] See sections 19-10 and 33-1 of the WET Act, as inserted by the Indirect Tax Legislation Amendment Act 2000.

The WET rebate was introduced to primarily provide assistance to small and medium sized winemakers and to promote tourism in regional areas through increased incentives to open cellar doors.[8]

First expansion of WET rebate

<u>Cellar Door Scheme Replaced by Producer System</u>

From 1 October 2004, the cellar door WET rebate scheme was replaced by the current system which allows a wine producer, or a group of associated wine producers, to claim an annual WET rebate regardless of whether they make cellar door sales. The maximum rebate payable to a producer, or group of associated producers, was initially limited to $290,000 per annum.[9] The rebate therefore effectively exempted $1million of each producer's, or group of associated producers', domestic wine sales per financial year.[10] The amount of the rebate was calculated as 29% of the 'wholesale value' of the wine.[11]

The Government predicted that these measures would allow around 90% of wine producers to fully offset their WET liability, and that 85% of the benefits of the WET rebate would be received by small wine producers in rural and regional Australia.[12]

<u>Rebate Extended to Cider, Perry and Sake</u>

At the same time, the new WET rebate was extended to allow producers of all products to which WET applied (i.e. cider, perry and sake) to claim a rebate on wholesale sales of those products.[13]

Second expansion of WET rebate

<u>WET Rebate Extended to New Zealand Producers</u>

From 1 July 2005, the WET rebate scheme was extended to include New Zealand producers.[14] This was done to enable Australia to satisfy its obligations under the Australia and New Zealand Closer Economic Relations Trade Agreement of 1983; i.e. so there was no policy differentiation in the tax treatment of Australian and New Zealand wine producers.[15] New Zealand producers became eligible to claim the WET rebate provided: (1) they produced wine in New Zealand; (2) exported that wine to Australia; and (3) Australian WET was paid on that wine.[16] However, the separate WET rebate claiming arrangements instituted for New Zealand, were different when compared to those for Australian and other foreign country claimants. Specifically, unlike Australian and other foreign country claimants, New Zealand claimants did not

<u>WET Rebate Increased to $500,000 p.a.</u>

From 1 July 2006, the WET rebate each producer (or group of associated producers) could claim was increased to a maximum rebatable amount of $500,000 each financial year.[17] This enhanced assistance effectively exempts up to around $1.7 million of domestic wholesale wine sales from WET each year per wine producer (or group of associated producers). See Appendix E1 for Finlaysons paper on *'Wine Equalisation Tax-Back to the Future'.*

[8] Supplementary Explanatory Memorandum, Indirect Tax Legislation Amendment Bill 2000, [2.38-2.39].
[9] Tax Laws Amendment (Wine Producer Rebate and Other Measures) Act 2004, Schedule 1, Item 1.
[10] Revised Explanatory Memorandum, Tax Laws Amendment (Wine Producer Rebate and Other Measures) Bill 2004, [1.3].
[11] Ibid, Comparison of key features of new law and current law.
[12] Ibid, [1.7].
[13] Tax Laws Amendment (Wine Producer Rebate and Other Measures) Act 2004, Schedule 1, Item 6A.
[14] Tax Laws Amendment (2005 Measures No. 4) Act 2005, Schedule 4.
[15] Treasury Executive Minute No. 2010/3468.
[16] Tax Laws Amendment (2005 Measures No. 4) Act 2005, Schedule 4, Item 9.
[17] Tax Laws Amendment (2006 Measures No. 3) Act 2006, Schedule 14.

Recent WET levels

$ millions	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
Total WET (WET payable- IC BAS)	790	832	845	929	957	970	985	1,018	1,058
WET Rebate (WET refundable- ID BAS)	134	199	220	221	237	252	284	291	308
WET Producer Rebate (grape grower or wine manufacturer)			143	147	161	169	189	195	206
NZ WET Rebate		6	12	16	19	21	25	23	25
Total WET Rebate and Refunds	134	205	232	237	256	273	309	314	333
Customs collections (Import tax)	7	12	17	21	19	22	28	39	41
Total Net WET	663	639	631	713	720	719	704	743	766

Source: Australian Taxation Office, Taxation Statistics 2005-2013, Final Budget Outcome 2013-14 and WFA estimates

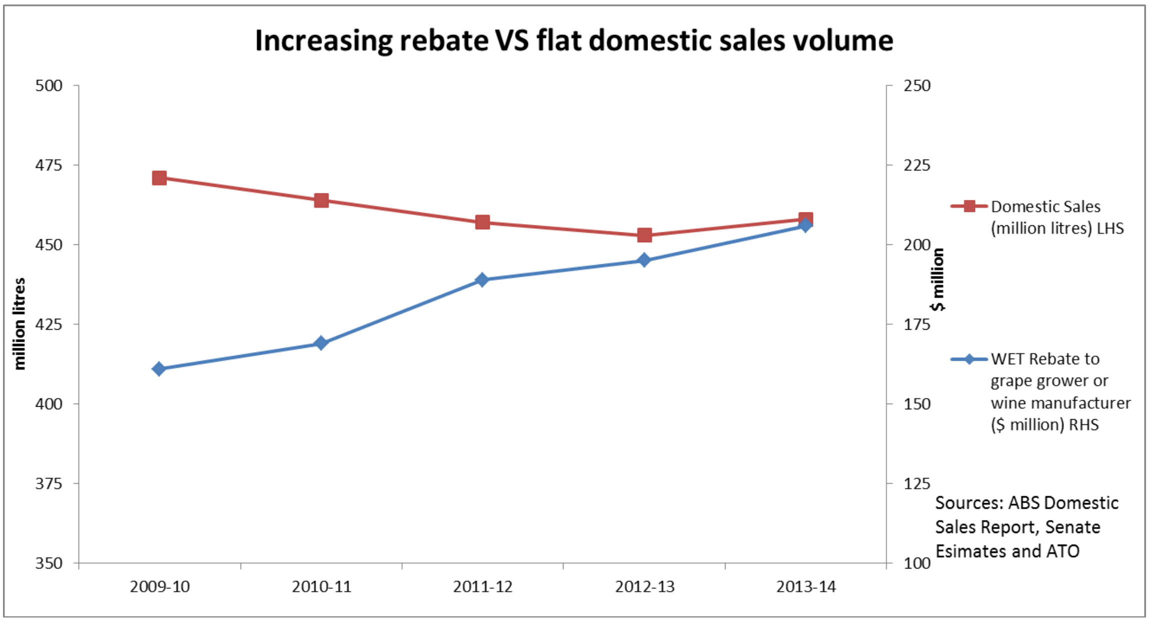
Impacts of the WET rebate and the case for reform

WFA and the majority of the industry believes the WET rebate remains an important revenue source for small and medium winemakers in both the fine wine and commercial segments which are struggling with a decline in export sales and intense competition in the domestic market. It is clear that without the rebate a significant number of wine businesses would be severely impacted financially. Whether originally intended or not, the rebate has been factored into business models and pricing strategies at all points in the supply chain.

However, there are also widespread concerns that the WET rebate has evolved beyond its original intent of supporting local employment and tourism in wine regions, and is being compromised on three fronts: 1) the ability of brokers, intermediaries and uncommercial arrangements to access the entitlement and; 2) the proliferation of retailer home brands supported by the rebate on bulk wine sold domestically and 3) the ability of foreign-based entities to access the entitlement.

WET rebate claimants are increasing despite flat industry growth

These concerns about the integrity of the WET rebate scheme have been fueled by an increase in the amount of claimants on the rebate and of the amounts being claimed at a time when the industry has not grown.



WET rebate is reported on the Business Activity Statement along with at least 12 other refund circumstances for WET including the producer's Rebate. WET rebate claimants who voluntarily reported their ANZSIC code of a grape grower (01310) or a winemaker (12140) have been increasing by an average of 4% per year since 2008. Total ID reporters [18]in total have also been increasing by an average of 4% as detailed in the table below.

Label 1D reporters	**2007-08**	**2008-09**	**2009-10**	**2010-11**	**2011-12**	**2012-13**
Total grape grower and wine manufacturer reporters	1632	1694	1760	1833	1912	1970
Total label 1D reporters	2524	2684	2802	2962	3108	3255
Source: Senate Estimates, ATO correspondence						

The value of the WET Rebate has been increasing for the last five years

The total WET rebate to the industry has been in an upward trend since 2006-07, with an average annual increase of 12%. WET rebate for Australian producers (reflected in WET refundable – BAS 1D) started at $134 million in 2005-06, but have since increased to $308 million in 2013-14.[19] It is estimated that the Total WET Rebate and Refunds will increase to $333 million in 2013-14 and $340 million in 2014-15.[20] When we compare the trend of the WET Rebate to the Total WET over the last 7 years, the evidence of unstainable WET Rebate system is even more apparent.

$ millions	**2005-2006**	**2006-2007**	**2007-2008**	**2008-2009**	**2009-2010**	**2010-2011**	**2011-2012**	**2012-2013**	**2013-2014**
WET refundable - BAS 1D	134	199	220	221	237	252	284	291	308
WET producer rebate (grape grower or wine manufacturer)			143	147	161	169	189	195	206[21]
NZ rebate		6	12	16	19	21	25	23	25
Total WET Rebate and Refunds	134	205	232	237	256	273	309	314	333[22]
Sources: ATO, Taxation Statistics, The Treasury- Final Budget Outcomes, 2005-06 to 2013-14; MYEFO 2014-15**; Tax Expenditure Statements 2013; WFA estimates**									

[18] WET rebate is reported on the Business Activity Statement along with at least 12 other refund circumstances for Wine Equalisation Tax including the producer's Rebate. The following is a list of the circumstances at which a taxpayer can claim a credit at 1D. The grounds are listed in the WET Credit Table in section 17-5 of the WET Act: 1)Tax overpaid; 2) Taxpayer bore WET, even though entitled to quote; 3) Liable to WET because of an ineffective quote; 4) Avoiding double tax on the same wine (e.g. WET was paid previously upon purchase and the current dealing requires that WET be paid); 5) Ensuring exemption where the latest assessable dealing is non-taxable (eg. WET-paid wine is exported); 6) Tax excluded from sale price of tax-paid wine sold to quoting purchaser (e.g. WET-paid wine sold under quote); 7) Ensuring no double tax in respect of containers; 8) Replacement of defective wine; 9) Producer rebate; 10) Wine exported while still assessable wine; 11) WET-paid wine sold as GST-free supply; 12) Refund of customs duty following destruction of imported wine. WETR 2009/1 summarises these 1D credit grounds into the following broad categories: Credits for overpaid WET, Credits to avoid wine being taxed twice, Producer rebate, Export-related credits, Import-related credits, Credits for bad debts.

[19]ATO correspondence

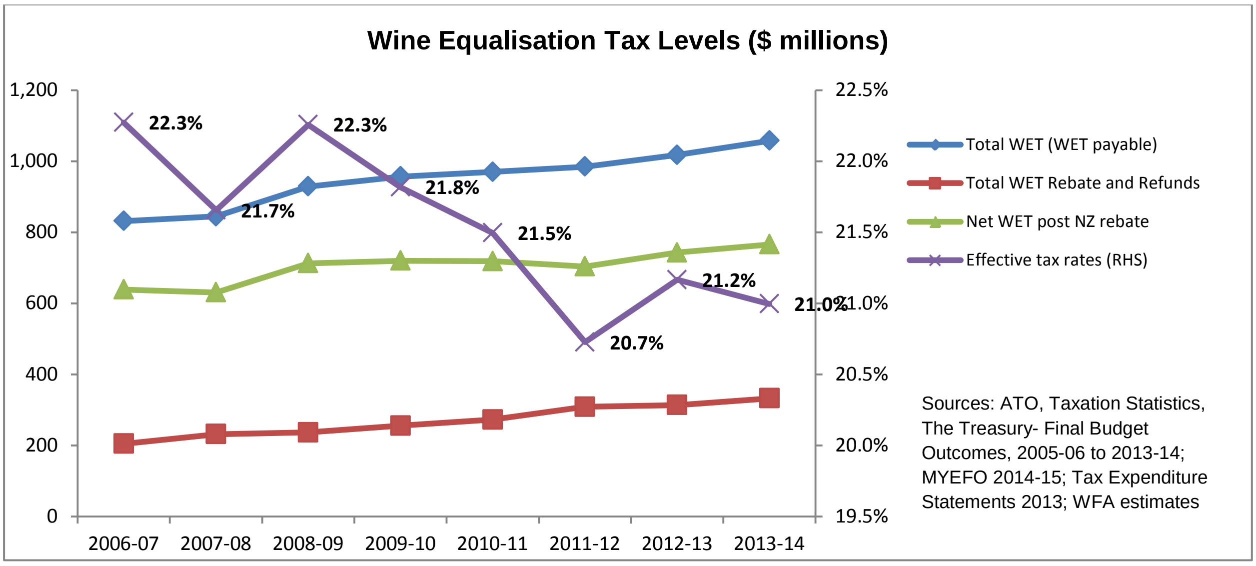
[20] Based on ATO correspondence; The Treasury , 2013. TAX EXPENDITURES STATEMENT, s.l.: The Treasury .

[21] WFA estimate

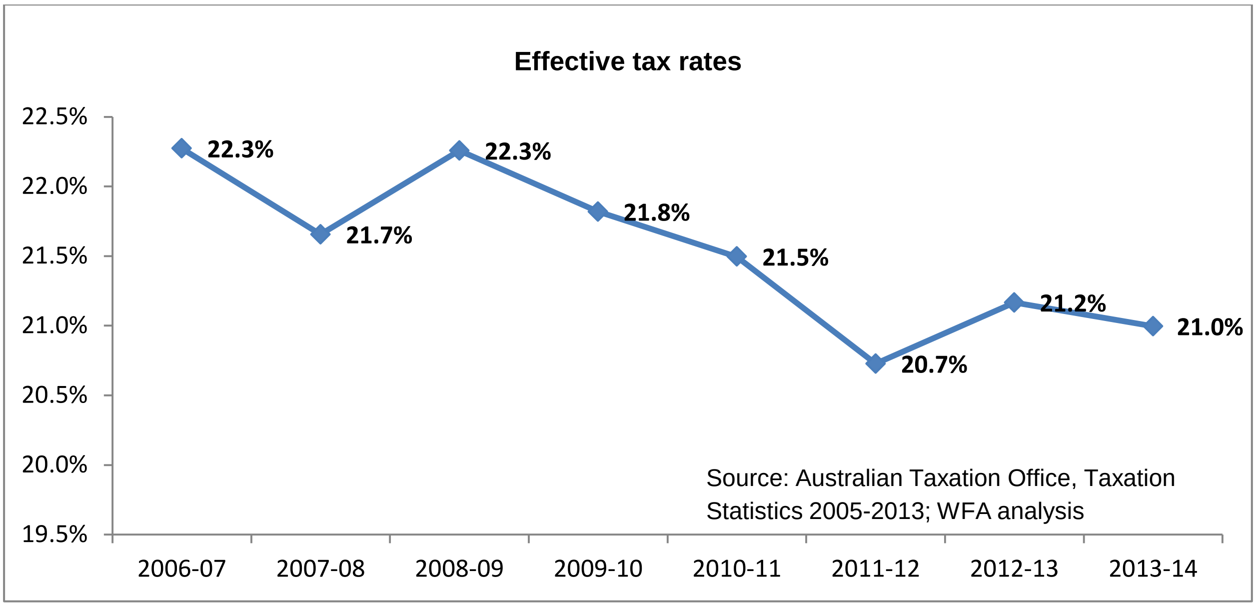
[22] WFA estimate

The growth of the Total WET rebate is faster than WET payable

The faster growth of total WET rebate compared to WET payable, has delivered a decrease in the effective tax rate.



This evidence that the rebate is growing at a faster rate than the amount of WET collected and that the sector continues to attract more producers claiming the rebate at a time when the industry is in a sustained period of downturn, has heightened concerns about the future of the rebate and a desire to pursue reforms to ensure its on-going integrity and sustainability.



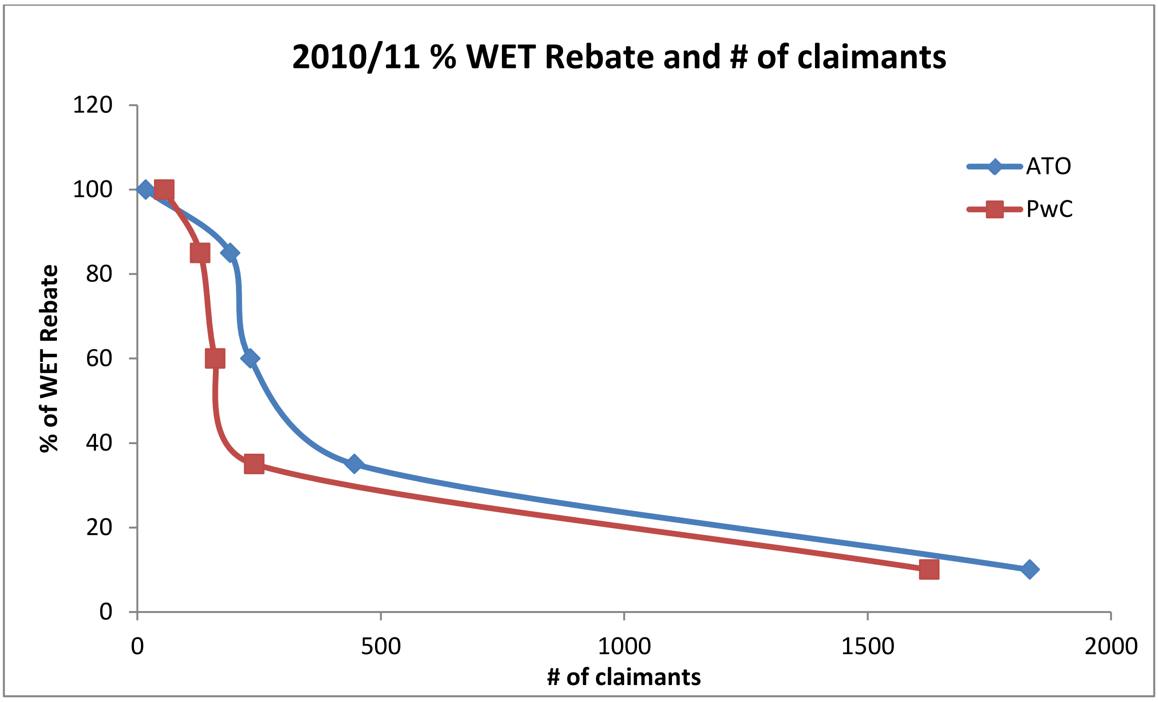
Supporting advice on the impact to Commonwealth revenue

WFA has sought specialist advice to model the Commonwealth savings if the WET rebate was phased out for bulk, unbranded and home brand wine. The savings are estimated to be $202 million over four years. (See Appendix F for PwC advice on *Returning WET Rebate to Fairness & Original Policy Intent- Supporting Advice on the Impact to Government Revenue for more economic modelling details.)*

The industry structure approach in the attached expert advice examined the structure of the producers of wine to match those producing wine with those receiving the rebate. The ABS publication 1329.0 was used to estimate the number of producers by size of crush. This data source was compared to ATO data provided in Senate Estimates. The ATO data identified 446 producers receiving a rebate over $100,000. This is in contrast to the 240 producers who are identified based on ABS data as having produced $344,829 of wine or more. If rebate eligibility is changed so only producers of finished, packaged and branded wine are eligible for the rebate thereby removing any rebate entitlement from the on-sale of wine to related or unrelated entities for processing, savings are estimated to be $73 million in 2018-19.

% of max rebate	Value of rebate	ATO data		ABS data		Difference (ATO- ABS)	
		No.	$ mil	No.	$ mil	No.	$ mil
0-20%	$0 to $100,000	1,387	41.7	1,387	41.7	0	-
20-50%	$100,000 - $250,000	214	32.1	80	12.1	134	20.1
50-70%	$250,000 - $350,000	41	12.3	31	9.3	10	3.0
70-100%	$350,000 - $500,000	174	74.1	74	31.5	100	42.6
>100%	> $500,000	17	8.5	55	27.5	-38	- 19.0
Total		1,833	$168.7	1,627	$122.0	206	$46.7

The graph below illustrates the huge differences in the number claimants reported by the ATO and the analysis made by PwC which is based on ABS data.



The increasing incidence of uncommercial arrangements

On 8 October 2013, the ATO issued TA 2013/2 to most, if not all, wine producers. The Alert identifies two arrangements the ATO believes are contrived, and which are designed to create additional WET producer rebates through non-commercial dealings between entities.

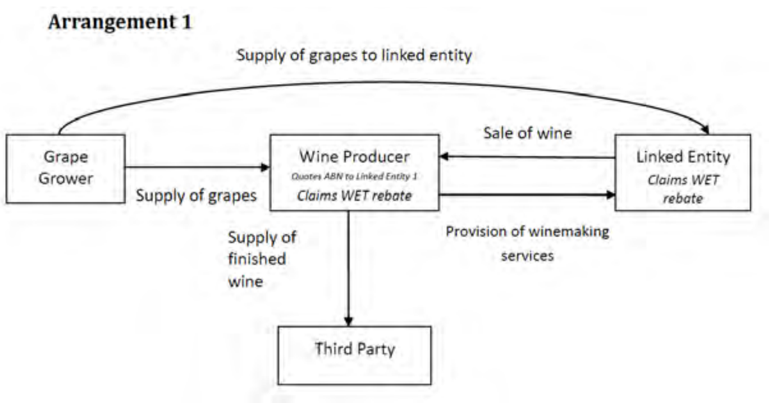
Arrangement 1 – Additional Manufacturer

Arrangement 1 centres around a wine producer who maxes out its annual $500,000 WET rebate cap early in the financial year. It involves:

- an entity, not at arm's length to that wine producer (***linked entity***), being established to buy grapes from the wine producer or someone from whom the wine producer would normally buy grapes;
- the wine producer contract manufacturing those grapes into wine on behalf of the linked entity;
- the wine producer buying the resultant wine from the linked entity, which triggers a WET rebate claim by the linked entity;
- the wine producer quoting its ABN to the linked entity so no WET is payable on the sale; and
- the end buyers of the wine being those purchases to whom the wine producer would otherwise sell.

The combined WET rebates claimed in the financial year by the wine producer, and the linked entity, therefore exceed the wine producer's maximum entitlement. A portion of the WET rebates claimed by the linked entity are passed through to the wine producer, by manipulating the prices charged between the parties for the grapes, wine or wine making services.

The Alert contains the following schematic representation of Arrangement 1:



Arrangement 2 – Blending Chains

The second arrangement also centres on a wine producer who maxes out its annual $500,000 WET rebate cap early in the financial year.

It involves:

- an entity, which is not at arm’s length to the wine producer (***linked entity 1***), buying bulk wine (or possibly grapes) from the wine producer and/or another supplier/s arranged by the wine producer;

- linked entity 1 contracting with the wine producer to blend the wine on its behalf, so that it is taken to manufacture the blend and thus qualify as a producer for WET rebate purposes;

- linked entity 1 selling the blend to another non-arm's length entity (***linked entity 2***), and claiming a WET rebate on the sale;

- linked entity 2 quoting its ABN to linked entity 1 so no WET is payable on the sale;

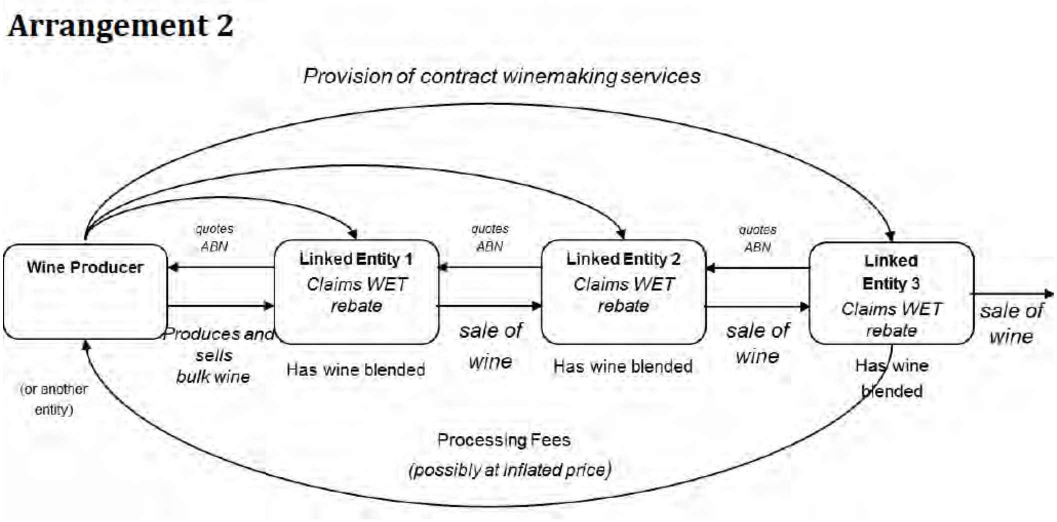
- the wine producer, as it did for linked entity 1, supplying or sourcing further bulk wine, or grapes, for linked entity 2 to blend; and

- linked entity 2, and potentially numerous other linked entities, repeating the same process as linked entity 1, until a batch of wine is sold, in accordance with the wine producers specifications, to same third party to whom the wine producer would ordinarily sell.

Accordingly, a significant number of extra WET rebates are created through the series of staged wine sales between interposed entities purporting to blend the wine. Since each entity in the chain quotes their ABN, no corresponding amount of WET is collected on each staged sale. Therefore, this arrangement is especially abhorrent to the ATO, as the WET rebates paid out far exceed the WET collected.

A portion of the WET rebates claimed by each linked entity are passed through to the wine producer, by manipulating the prices charged between the parties for the grapes, wine or wine making services.

The Alert contains the following schematic representation of Arrangement 2:



Application of Associated Producer Provisions to Arrangements 1 & 2

The ‘associated producer provisions’ in section 19-20 of the WET Act are integrity provisions designed to prevent large wine producers gaining access to multiple WET rebates.[23] They operate by limiting ‘associated producers’ to one annual $500,000 WET rebate as a group.[24] In broad terms, producers will be associated producers if:

1. one controls the other (i.e. holds at least 40% of the voting power in the relevant company or receives at least 40% of the income or capital of the relevant trust or partnership56), or both producers are controlled by the same third entity;[25] or

2. one could reasonably be expected to act in accordance with the directions, instructions or wishes of the other in relation to its financial affairs.[26]

[23] Revised Explanatory Memorandum accompanying the Tax Laws Amendment (Wine Producer Rebate and Other Measures) Bill 2004, [1.24].
[24] WET Act, section 19-15(3).
[25] WET Act, section 19-20(1)(a).
[26] WET Act, section 19-20(1)(b) & (c).

Generally most WET rebates schemes can be easily structured to avoid the first limb. The real issue is whether the second limb will apply to arrangements which resemble Arrangements 1 or 2. This limb was judicially considered for the first time last year by the Administrative Appeals Tribunal in *SJ Buller Pty Ltd v Commissioner of Taxation* [2013] AATA 617 (***SJ Buller***). (S*ee Appendix E1 for Finlaysons paper on Wine Equalisation Tax-Back to the Future.)*

The severity of the situation has been further highlighted by the Australian Taxation Office with the Tax Commissioner rating the compliance risk associated with its administration of WET as 'high'. The ATO has issued a series of Tax Alerts to Industry on rebate compliance issues.[27] In addition, the Financial Review published an article in June 2014 titled "Tax office goes after wine rorts in $32m WET hit" with the following extract:

"The tax office is auditing people it believes may have claimed multiple rebates against the wine equalisation tax (WET). The amount includes $18.5 million in extra tax bills and penalties of more than $13 million, illustrating the size of the problem.

The tax office has been increasingly concerned about rorting of the system. There have been hundreds of artificial transactions between related corporate entities which claim to be blending or finishing off the winemaking process before the wine is sold. Companies have been set up for the purpose of claiming rebates. In some cases, there have been up to 10 claims each for $500,000 on the same wine."

In a recent meeting with the ATO, the updated figure of total penalties (adjustments and fines) is now $47.8 million.

In response to this analysis and with a view to returning the rebate to a more sustainable footing, the industry supports a three stage approach to reforming the rebate:

Addressing the concerns through reform of the WET rebate

In response to this analysis and with a view to returning the rebate to a more sustainable footing, the industry supports the following approach to reforming the rebate:

1. Reduce uncommercial claims on the rebate.
2. Phase out rebate eligibility for bulk and unbranded wine and wine destined for the home brand of the retailers, and
3a. Abolish the New Zealand producers' rebate (and transfer their claimant eligibility to the same basis as Australian and other foreign country claimants, as per next point)
3b. Create a level playing field for all WET rebate claimants regardless of nationality to ensure the rebate continues to deliver support for regional communities
4. Introduce transitional measures to support mergers within the industry
5. Recognise that support will be required for grape and wine businesses impacted by the reform measures

Reform #1: Reducing uncommercial claims on the WET rebate

Addressing this growing list of unintended WET rebate recipients has widespread support among winemakers to ensure the rebate is being accessed only by those who make a contribution to regional communities. This is what WFA believes is the original policy intent of the rebate and what it should be going forward. Maintaining the integrity of the rebate system is important to safeguard its retention for those who are entitled to claim it.

[27] http://law.ato.gov.au/atolaw/view.htm?DocID=TPA/TA20132/NAT/ATO/00001

WFA believes more can be done in partnership with the ATO within the existing legislative framework to improve compliance and restrict the eligibility of uneconomic arrangements and schemes designed primarily to access the rebate. This will continue a strong working relationship between the two organisations that most recently delivered important changes to blending rules in late 2012.

Specifically, WFA will continue to assist the ATO in its understanding and identification of uneconomic practices which are not in keeping with the original policy intent and what steps can be taken to stamp them out. WFA will also examine with the ATO the adequacy of the recent changes to the eligibility rules for blending and the rules intended to prevent related entities from making multiple producer rebate claims and whether any changes are required. It is in the industry's interests that we do all we can to maintain the integrity of the rebate and improve our understanding of the issues.

The ATO has stated that its compliance activities into WET rebate claims have already recovered over $47m in penalties and adjustments. They have also said that further investigations are underway and it is likely savings on the projected WET rebate expenditure in the Forward Estimate will be further reduced. However, for the purposes of this submission, we have conservatively estimated no ongoing savings to the Commonwealth from on-going compliance activity but it is likely to be substantial.

Reform #2: Phase out rebate eligibility for bulk and unbranded wine

WFA believes brands and ‘brand power’ at all price points enable producers to engage consumers and command loyalty, take price, maintain sustainable margins and generate profit growth that can be reinvested back into regional communities and infrastructure.

WFA believes ‘cleanskins’, other unbranded wine and the private labels of the retailers work against these objectives and therefore do not play a long term role in encouraging regional development. For this reason bulk wine, unbranded wine, wholesale and retail private label, and wine that is not fit for retail sale also should not be eligible for the WET rebate.

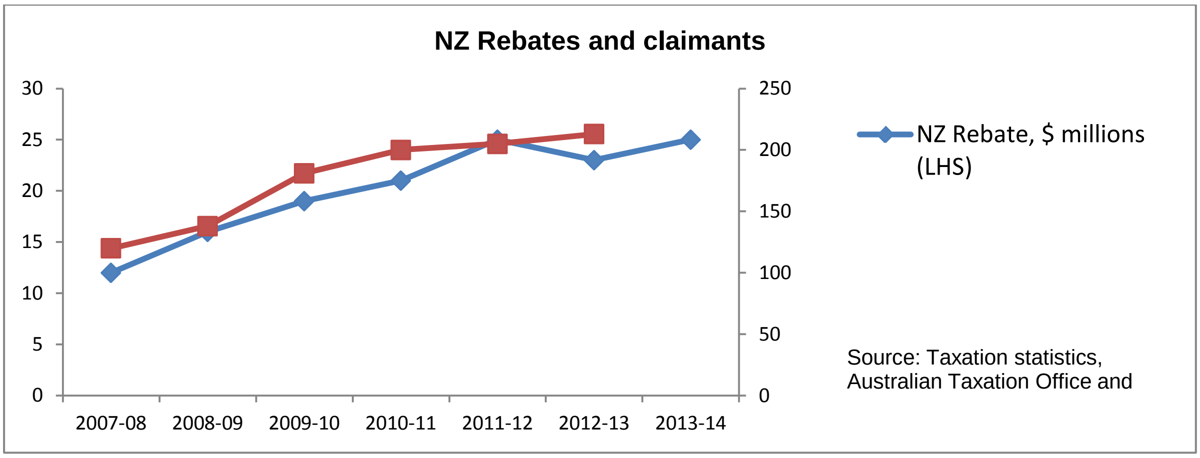
The Commonwealth should phase out WET rebate eligibility for bulk and unbranded wine at 25% per year starting at 75% of the rebate rate from implementation. This can be achieved by changing the legislative definition of rebatable wine for the WET rebate to:

> *‘rebatable wine means *grape wine, *grape wine products, *fruit or vegetable wine, *cider or perry, *mead or *sake, that is packaged in a single container with a capacity not exceeding 5 litres at the time of the dealing, and which is labelled with a brand on the primary packaging that is wholly owned by, or licensed exclusively to, the producer of the wine.’*

(Please refer to Appendix E2 for the supporting legal advice.)

Reform # 3a: Abolish the unfair New Zealand producers rebate and its preferential treatment of NZ producers and replace with a ‘level playing field’ for all rebate claimants regardless of nationality.

Since the creation of the separate New Zealand producers rebate in 2005, the number of New Zealand claimants has grown:



In recent years we have seen New Zealand imports increase from 21 million litres in 2007 to over 51 million litres in 2014 and 30% of the total value of the leading 20 SKUs sold in Australia are from New Zealand. This loss of market share to New Zealand imports has directly harmed Australian producers. WFA believes that providing foreign entities with access to the rebate at a time of high exchange rates and low profitability is not consistent with the original policy intent, indeed, is directly damaging branded Australian wine businesses that support employment and tourism in local regional communities.

In 2012/13, 213 wine producers in New Zealand had registered for the scheme from a population of 699 wineries. The rebate paid to New Zealand wine producers represented eight per cent of the total producer rebate paid in 2009-2010. Furthermore, a 2010 ANAO report on wine tax administration asserts that the cost to Australian government revenue of extending the rebate to New Zealand wine producers has risen strongly in each year since its introduction, increasing from around $5 million in 2006-2007 to over $19 million in 2009-2010.

WFA believes the extension of the rebate to New Zealand producers in 2005 was inconsistent with the original policy intent of the rebate and has created an unfair advantage for New Zealand producers. This position is strongly supported by the Australian wine industry.

The table below summarises the requirements to claim the producer rebate under the *current* arrangements, and the benefits afforded to New Zealand wine producers which are not afforded to other foreign wine producers.

Claim requirements under the current WET producer rebate schemes			
	Australian wine producers	*New Zealand participants*	*Other foreign wine producers*
GST registration required	✓	✗	✓
Wine tax must be paid	✗	✓	✗
Australian income tax obligations	✓	✗	✓
In-country administrative assistance provided	✓	✓	✗
Entity required to be exporter of wine	N/A	✗	✓

Regardless of the potential net income tax outcome relating to a particular producer operating in Australia, it remains the case that New Zealand wine producers are currently not subject to the compliance costs associated with claiming the WET producer rebate. As can be seen from the comparison table above, while Australian and other foreign wine producers are liable for the upfront expenses associated with claiming the WET producer rebate, New Zealand participants in the rebate arrangements do not incur similar costs.

In administering the producer rebate for New Zealand participants, the ATO works closely with New Zealand Inland Revenue (NZIR). While this is not a benefit provided to New Zealand participants directly by the Australian Government, the flexibility afforded by the ATO to NZIR in providing control over certain aspects of the administration of the producer rebate is not available to other foreign wine producers.

It is industry's view that New Zealand wine producers are afforded what is arguably a preferential approach by the legislative provisions which operate to provide them with easier access to the producer rebate. As such, the preferential treatment afforded to New Zealand producers is an unintended consequence and should be corrected immediately by abolishing the New Zealand producer rebate.

While some $25m per annum is currently rebated to New Zealand producers, the abolition of the separate New Zealand scheme plus the proposed changes to future rebate eligibility including the requirement to hold local liquor licences and business premises (see Reform #3b) and the removal of the rebate from bulk and unbranded wine from New Zealand will deliver a net savings to the Commonwealth of $44.9m over four years.

Applying the proposed changes would look like:

Claim requirements under the recommended reforms to create a level playing field for all claimants			
	Australian wine producers	*New Zealand participants*	*Other foreign wine producers*
GST registration required	✓	✓	✓
Wine tax must be paid	✗	✗	✗
Australian income tax obligations	✓	✓	✓
In-country administrative assistance provided	✓	✓	✗
Entity required to be exporter of wine	N/A	✓	✓
Required to hold a State/Territory Liquor License	✓	✓	✓

While the New Zealand producer rebate remains in operation, Australia remains vulnerable to allegations that the existence of the current separate rebate scheme for NZ discriminates against other foreign wine producers by way of the preferential treatment to NZ relative to foreigners. The result of this discrimination is that Australia is at risk of facing trade disputes on the grounds that it is breaching the WTO principle of most favoured nation (MFN).

Under the WTO agreements, Australia cannot normally discriminate between its trading partners. If Australia grants the goods from one country a special favour (such as a lower customs duty rate for one of their products, or a tax rebate, or preferential administrative treatment), it must do the same for similar goods from all other WTO members. It is considered as being so important that it is the first article of the WTO General Agreement on Tariffs and Trade (GATT), which governs international trade in goods.

The scope of the MFN principle contained in Article I of GATT covers any advantage, favour, privilege, immunity granted by Australia to foreign goods.

WFA considers that the MFN principle contained in Article I of GATT is currently being breached by Australia (in the context of the separate NZ rebate scheme) because it is according legislative flexibility to NZ importers through a separate WET rebate scheme which it does not extend to importers from other WTO members. The trade precedents we have reviewed in the course of our research support our belief that the current scheme – if challenged by a trading country through a formal dispute mechanism– would be seen as a breach of Australia's WTO obligations.

The implication of this WTO breach is that it opens the Australian government up to trade disputes from other trading partners who can claim that NZ producers are being afforded preferential treatment relative to their producers. For example, it Chile were to bring a WTO dispute against Australia under this approach, it would be able to claim compensation equal to the value of having access to the NZ WET rebate scheme. Chile could either claim this compensation through a monetary payment or through imposing increased tariffs on Australian goods.

The fact that foreign producers have not disputed the current NZ rebate scheme formally has allowed the current arrangements to continue to operate, however we understand that some foreign wine producer nations are aware of the issue and have expressed informal objections.

The current NZ rebate scheme should be abolished on the grounds that it violates Australia's international trade obligations. As a result, since all foreign producers of wine would be afforded with equal treatment in terms of access to WET rebates, there would be no violation of the WTO principle of most favoured nation (MFN). In essence, in order for Australia to adhere to its fundamental international trade requirements under the WTO and GATT it is imperative that the NZ WET rebate scheme be abolished.

Abolishing the NZ rebate scheme would also mitigate against the risk of other trading partners lodging formal trade disputes against Australia and demanding similar separate schemes of their own.

Reform # 3b: The Commonwealth should create a level playing field for all WET rebate claimants regardless of nationality to ensure the rebate continues to support local employment and tourism in wine regions.

To further ensure the WET rebate continues to deliver its original policy intent, namely to support local employment and tourism in wine regions, and to create a level playing field for all rebate claimants regardless of their nationality, WFA recommends that the criteria for future rebate eligibility be restricted to producers who:

- manufacture and sell wine in a form fit for retail sale, where the finished product is identifiably theirs; and
- have business premises in Australia (potentially, in a designated wine region in Australia); and
- hold a licence, issued by the Government of a state or territory in Australia, to sell liquor in that state or territory; and
- are self-employed or engage one or more employees to perform work for the winemaker; and
- sell their wine either:
  - by retail sale, or under quotation, from the business premises referred to above; or
  - by internet or mail order sales (in which case the sales would be deemed to take place at the above premises).

The intention of the recommendation is to make the WET rebate available to winemakers who are carrying on business in Australia, are self-employed or have employees, have business premises in Australia and hold a licence to sell liquor in an Australian state or territory. By doing so, the WET rebate should be restricted to winemakers who provide local employment and tourism in wine regions, in line with the original intention when the rebate was introduced in 2000.It does not require claimants to have physical production assets.

Furthermore, the recommendation should not breach the ANZCERT Agreement since the recommendation would not give effect to a policy differentiation between the tax treatment of Australian and New Zealand producers but instead – consistent with the original intention of the rebate - would promote employment and tourism in Australia's wine regions.

In addition, the recommendation should not breach Australia's WTO obligations since the effect of the WET rebate is not to displace or impede the imports of wine of another member and the effect is not a significant price undercutting by the Australian product.

Reform #4: Introduce transitional rebate measures so that, following a merger of two businesses which are both entitled to the rebate, the merged entity can continue to claim the second rebate but be phased out at 25% per year over 4 years.

WFA believes that current rebate arrangements may be inhibiting industry consolidation at a time when there is considerable pressure to rationalise and capture efficiencies and economies of scale. Wineries that believe their future lies in consolidation should not be stymied by the unintended consequence of a tax measure. Transitional rebate rules should be introduced to support merger activity.

This measure would be of particular benefit to small and medium wine businesses. WFA recommend that the measure be accessible on a once-only basis. This is to prevent the original merged entities from accessing the measure again if they later merge with additional entities.

PwC modeled the impact of this proposal and found it would save the Commonwealth $31 million over the forward estimates. WFA, following consultation with WGGA, is also recommending the Government provide assistance to growers impacted by the WET rebate changes by boosting R&D activities that will deliver lower exit cost and lower transition costs to alternate land uses. This recommendation has most recently been made in our submission to the Government's WET Rebate Discussion Paper (see Appendix G).

Reform #5: Recognise that support will be required for grape and wine business impacted by the reform measures

WFA and WGGA recognise that some support will be required for grape and wine businesses that will be adversely impacted by the reform measures proposed in this submission.

Provisionally, the support may include transition programs when WET rebate access is removed or adjustment programs that facilitate uptake of more suitable business models, initiatives to address barriers to vineyards exits, to facilitate quicker turn-over in vineyards, capability building among vineyard operators, improving market operations that hasten market forces to bring about adjustment or innovation in vineyard management.

WFA and WGGA will develop such proposals further in consultation with AGWA and the Government.

Other tax proposals

The Committee should note that on broader wine tax matters, the WFA position is:

- No overall increase in the total tax revenue from the wine sector
- No use of tax or artificial minimum pricing measures as a lever for health reform, as non-price measures better target hazardous consumption
- Maintenance of the differential tax rates for wine, beer and spirits (ie, no 'equivalency') to reflect the significant differences between wine and other forms of alcohol.

It should also be noted that the WFA Board recently agreed to an amended position on wine tax. The Federation believes that wine should be taxed within the existing WET legislative framework and that any future changes to wine tax arrangements be made within this framework and not shifted to an excise-based approach as is the case for beer and spirits. The Federation does not advocate how the WET should be calculated.

(d) In summary, WFA identifies the following impacts and application of the WET rebate on grape and wine industry supply chains:

- The WET Rebate remains an important revenue source for small and medium winemakers in both the fine wine and commercial segments.
- It is clear that without the rebate a significant number of wine businesses would be severely impacted.
- Whether originally intended or not, the rebate has been factored into business models and pricing strategies at all points in the supply chain.
- However, there are widespread concerns that the WET rebate has evolved beyond its original intent of supporting regional employment and tourism, and is being compromised on three fronts:
    1. The ability of brokers, intermediaries and uncommercial arrangements to access the entitlement;
    2. The proliferation of retailer home brands supported by the rebate on bulk wine sold domestically; and
    3. The ability of New Zealand to access the rebate on preferential commercial terms compared to other foreign country and Australian claimants.
- These concerns have been fueled by an increase in the amount of claimants on the rebate and the amount being claimed at a time when the industry is in a sustained period of downturn.
- The rebate is also growing at a faster rate than the amount of WET collected and the industry continues to attract more claimants in spite of the downturn, heightening concerns about the future of the rebate and desire to pursue reforms to ensure its on-going integrity and sustainability.
- The ATO has rated the compliance risk association with is administration of the WET as “high” and has issued a series of Tax Alerts to industry on rebate compliance issues.
- The ATO’s compliance activities into WET rebate claims have already recovered over $47million in penalties and adjustments.

Government reform of the WET rebate is needed to restore the integrity of the scheme and to return it to a more sustainable footing. WFA commissioned specialist economic modelling and legal advice to underpin the following recommendations to government on reform of the WET rebate.

- Phase out WET rebate eligibility for bulk and unbranded wine at 25% per year starting at 75% of the rebate from implementation. This can be achieved by changing the legislative definition of rebatable wine and will realise savings of $202million over the forward estimates.
- Abolish the separate NZ scheme because it affords NZ producers a commercial advantage over Australian and other foreign country claimants whereby they avoid the compliance costs associated with claiming the WET producer rebate. In its place, NZ producers would be able to claim the WET rebate but on the same terms as all other claimants – creating a level playing field.
- Introduce transitional rebate measures for merged claimants, phasing out at 25% per year over four years to encourage industry consolidation by enabling merged entities to continue to claim the rebates they accessed when separate so that this loss of benefit does not impede consideration of mergers. Will be of particular benefit to small and medium wine businesses.
- Recognise that support will be required for grape and wine businesses adversely impacted by the reform measures and for the Government to work with WFA and WGGA on developing industry assistance.

(e) The extent to which grape and wine industry representation at regional, state and national level effectively represents growers and winemakers with respect to equity in the collection and distribution of levies;

Industry Summit

A wine industry leaders' meeting 'Grape and Wine 2015, A Focus for Action' was held in Adelaide in late August. It had two objectives: the first to agree on the two or three key issues to accelerate return to profitability and which will be advanced with united industry support from representative bodies.

The second objective was to achieve agreement or a process to reach agreement on an optimal future representative industry structure that presents a united industry voice on key issues and maximises industry's resources and influence and at the same time values state and regional representation.

A small group of national and state industry leaders have been working on the concept and details of the leaders' meeting since late 2014 following agreement that a more united approach is required to effectively work through the industry's challenges and opportunities. The Summit initiative was also supported by peak State Wine Associations including the South Australian Wine Industry Association, NSW Wine Industry Association, Wines of WA and Wine Victoria and grape grower organisations including Wine Grape Growers Australia, Murray Valley Winegrowers, the Wine Grapes Marketing Board, the Riverland Wine Industry Development Council, the Wine Grape Council of South Australia, and the Winemakers' Federation of Australia.

The meeting agreed that:

- A return to profitability requires a national response from all levels of industry representation and consensus on what must be done.
- There are a number of factors and influences that will need to be addressed to enable the industry to return to profitability. Among the range of issues considered, three key underpinning themes emerged. These were a need to address:
  - supply related issues;
  - demand related issues; and
  - capabilities of businesses, organisations and individuals across the industry.

The meeting also acknowledged that the structure and relationships between the various wine industry representative organisations are one of the mechanisms that can contribute to addressing these issues and help move the industry towards a more sustainable & profitable position. It was agreed that a strong collective voice from industry was an important part of the solution. Central to this, it was agreed that the various wine industry representative organisations must work more collaboratively.

The meeting discussed and agreed on a core set of guiding principles that should shape future representative organisational structures. Central to these core principles were a need for:

- a voice for all industry;
- clarity around the roles and responsibilities of all organisations in the representative structure;
- inclusive, transparent and evidence-based decision making;
- a strong focus on industry engagement and communication; and
- a consumer-centred approach.

The leaders supported a plan to progress discussions, actions and outcomes.

This plan involves:

- Engaging with the wider industry on the discussions and outcomes of *Grape and Wine 15*. Information about the discussions and points of agreement will be shared with the whole industry.

- Tasking the working group for *Grape and Wine 15* (a group of some nine representatives from across Australia who managed the organisation of *Grape and Wine 15*) to undertake further analysis of other governance structures and models and to develop specific options for consideration and further discussion towards the end of 2015; and to then

- Re-convene participants from *Grape and Wine 15* to take next steps based on the working group's input.

With considerable work still to be done, the meeting delivered a valuable first step in agreeing the key issues and how representative organisations can contribute to addressing and resolving the issues that should enable individual wine sector businesses to more actively manage their pathway to profitability.

AGWA

The Australian Grape and Wine Authority (AGWA) is funded by grape growers and winemakers through levies (collected by the Department of Agriculture and then redirected to AWGA) and user-pays charges, and by the Australian Government, which provides matching funding for R&D investments[28].

AGWA's primary sources of funding are 1) Market development funding 2) RD&E funding; 3) Regulatory funding and; 4) User-pays charges.

Market development levies - Wineries pay the promotion component of the **wine grapes levy** in a stepped amount per tonne. The promotion component is payable on grapes delivered to a winery once the threshold of 10 tonnes has been reached. Wine businesses also pay the **wine export charge** on wine produced in and exported from Australia. The amount of levy payable is based on the free-on-board (FOB) sales value of wine for the levy year.

RD&E funding - The **grape research levy** (grapegrowers pay $2 per tonne of winegrapes crushed) and the R&D component of the **wine grapes levy** (wineries pay $5 per tonne of winegrapes crushed) are matched dollar-for-dollar by the Australian Government.

WFA and WGGA continue to support investment in R&D through an industry levy matched by Government, with a cap on matching contributions for all statutory levies at 0.5%, managed on behalf of industry by the Australian Grape and Wine Authority. It is important that industry play a role in setting AGWA's R&D priorities and that these priorities are used to guide the expenditure of Government-matched industry levies.

Regulatory activities: are funded on a cost-recovery basis through activity-based fees. In addition, wine businesses, regional associations and state government pay voluntary contributions to participate in market development activities.

In 2012/13, industry levies amounted to $17m which consisted of $11.6m of wine grapes levies, $2.2m of export levies and $3.4m of grape research levies. See below diagram for 2013/13 levy split.

[28] Information from AGWA's Strategic Plan 2015-2020

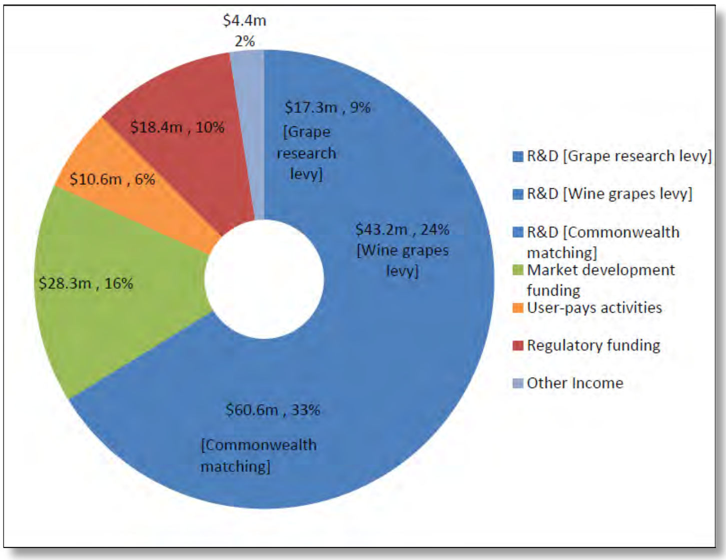
	2012/13	%
Wine grapes levy	3.235	
Export levy	2.142	
Levy Receipts WAC	**5.377**	**31%**
Grape Research Levy	3.354	
Wine grapes levy	8.385	
Levy Receipts GWRDC	**11.740**	**69%**
Total	**17.117**	**100%**
Wine grapes levy	11.621	
Export levy	2.142	
Winemakers/Wine Exporters	**13.763**	**80%**
Grape Research Levy	3.354	
Grapegrowers	**3.354**	**20%**
Total	**17.117**	**100%**

Of significance to AGWA is the fact that funding streams are tied to certain activities, which imposes constraints on its flexibility in allocating resources. They are committed to using their funds as effectively as possible and constantly seeking the best return for the wine sector's and Australian Government's investment. See table on AGWA's projected income 2015-16 to 2019-20 and chart on AGWA's projected income over the five years to 2020 by funding source:

Projected income 2015-16 to 2019-20 (assuming 2% growth p.a. in wine export charge)

	2015–16 $m	2016–17 $m	2017–18 $m	2018–19 $m	2019–20 $m	Total $m
Grape research levy	3.5	3.4	3.4	3.4	3.4	**17.3**
Wine grapes levy	8.8	8.6	8.6	8.6	8.6	**43.2**
Commonwealth matching	12.8	11.9	11.9	11.9	11.9	**60.6**
Total RD&E Funding	**25.1**	**24.0**	**24.0**	**24.0**	**24.0**	**121.0**
Market development funding (assuming 2% growth in wine export charge)	**5.7**	**5.6**	**5.6**	**5.7**	**5.7**	**28.3**
User-pays activities	**2.1**	**2.1**	**2.1**	**2.1**	**2.1**	**10.6**
Regulatory funding	**3.6**	**3.6**	**3.7**	**3.7**	**3.8**	**18.4**
Other income	**0.9**	**0.9**	**0.9**	**0.9**	**0.9**	**4.4**
	37.3	**36.2**	**36.3**	**36.4**	**36.5**	**182.8**

Projected income over the five years to 2020 by funding source



Following consultation with AGWA, WFA proposed a targeted marketing effort to help grow the demand for Australian wine in key export markets. Funding of $43.4 million over four years is required to support this activity. Growing the demand for the export of our Australian wine is an important activity in its own right but it has the added, critical benefit of helping to counter the flat domestic demand and help alleviate the chronic and prolonged domestic supply/demand imbalance.

At this point in time, it would be difficult to redistribute research and development funding from within AGWA to cover our recommended marketing activities. An explicit commitment to the Australian wine industry made by Government and WFA/WGGA to gain support for the merger of the two statutory authorities to create AGWA, was to quarantine R&D levies and the supporting co-contributions from Government for R&D projects and this was reflected in the enabling legislation for the merger. It is unlikely at this time that industry would support such a redistribution of levy funding and any change would require significant industry consultation and legislative reform as required under the Act.

WFA also does not believe the funding shortfall for AGWA's marketing activities can be met by increasing existing compulsory industry levies given the low levels of wine business profitability. Even if there was capacity within the industry to increase levies, the potential sums are insufficient to support the marketing capability and projects we believe are necessary.

It should also be noted that a wine industry leaders' summit has been called for August where issues on how industry associations at all levels can work more efficiently together will be an agenda item.

AGWA has recently developed a 5-Year Strategic Plan. It will be important that this plan makes clear how funding provided through levies will be used to help grow the demand for Australian wine and how success will be measured.

(e) In summary, with respect to industry organization and equity in the collection and distribution of levies:

- Industry is in the process of reviewing the options for further organisational reform following the merger of the two statutory authorities into AGWA in 2014.
- Over the next five years, 33% of AGWA's income is projected to come from industry. Of this, winemakers will contribute 24% and grape growers will contribute 9% through the payment of compulsory levies.
- AGWA funding streams are tied to certain activities, which imposes constraints on its flexibility in allocating resources.
- The current allocation for marketing Australian wine is inadequate.
- Industry would be unlikely to support a redistribution of levy funding to marketing at the expense of R&D; in fact, when negotiating the establishment of AGWA, government and industry reached agreement which explicitly prevented such action. Any change would require significant industry consultation and legislative reform.
- Increasing levies to funding marketing is not the answer. The low levels of wine business profitability make this prohibitive and secondly, the potential sums from this activity would be insufficient to support the required marketing effort.
- With the commencement of a new five year strategy, it is important that levy payers receive clear communications from AGWA on the marketing strategy for growing the demand for Australian wine and reports on tracking and measuring success.

WFA recommends:

- **Government funding of $43.4million over four years** for AGWA to undertake targeted and impactful demand-led marketing programs to help grow the demand for Australian wine in key overseas markets. The **resulting growth in exports will** importantly help to **alleviate the domestic supply/demand imbalance** which impacts grape growers and winemakers.
- Industry participation needs to be encouraged in setting R&D priorities and these used to guide the expenditure of Government-matched levies.

(f) The work being undertaken by AGWA pertaining to levy collection information;

Australian Grape and Wine Authority (AGWA) is funded largely through levies that are collected under the *Primary Industries Levies and Charges Collection Act 1991.* The Department of Agriculture has responsibility for levies collection of behalf of the Australian government and they deduct the cost of collection, from the levies collected. The industry and AGWA have worked with the Department of Agriculture over recent years to reduce this cost of collection, but it still remains prohibitive (Table 1).

Table 1: Levy collection cost for the Australian Grape and Wine Authority

Year	2011-12	2012-13	2013-14	2014-15
Collection costs	$956,183.44	$1,093,036.63	$1,056,530.42	$974,166.46
Levies Disbursed	$17,183,774	$17,116, 821	$18,486,133	$17,525,053

Source: Department of Agriculture

It appears that most of the efficiency gains possible by the Department of Agriculture have now been made. Any future reductions in the cost of levies collection will come from either:

1. Increasing the efficiency of levy collection through changing the provider; and/or
2. Reducing the complexity of the levy collection system by reducing the number of levies and/or collection points.

AGWA believe that they can make a substantial cost saving from collecting the export levy directly, given they already operate an export licence system and collect FOB export values through the Wine Export Approval System. We believe this reform will deliver a more efficient and effective collection system, with the expected savings of approximately $200K to $250K per annum being available to provide enhanced services for the grape and wine sector.

It is our understanding that the *Primary Industries Levies and Charges Collection Act 1991* provides the Secretary of the Department with power to authorise another body such as AGWA to assume responsibility for levy collection, but he is required to consult with the relevant industry body before any changes are made.

WFA and WGGA have both expressed their support for this initiative and will continue to work with the Australian Government and AGWA to achieve this outcome.

Reducing the complexity of the levy collection system is a far more complex task and to provide equity and efficiency gains mean that it is a longer term option. This would of course require wide industry consultation and compliance with the Levy principles.

(f) In summary, on the work being undertaken by AGWA pertaining to levy collection information:

- In spite of efforts to reduce costs, the cost of levy collection by the Department of Agriculture, remains prohibitive.
- Further cost reductions could be realised through changing collection agencies.

WFA recommends:

- That AGWA take over the collection of the export levy given they already operate an export licence system and collect FOB export values through the Wine Export Approval System.
- This reform will deliver a more efficient and effective collection system, with the expected savings of approximately $200K to $250K per annum being available to provide enhanced services for the grape and wine sector.

(g) The power and influence of retailers of Australian wine in domestic markets

The wine industry continues to be concerned at the level of market power of the two dominant domestic wine retailers. The situation has been exacerbated by their ability (backed by existing Competition Law) to vertically integrate into wine production and vineyard ownership. For many winemakers, the retailers are now both their major customer and major competitor and this has subsequently introduced a higher level of insecurity in regards to brand management, discounting, contracting and certainty in future sales. This position has also enabled retailers to grow the 'home brand' segment in a domestic market already in oversupply and to suppress retail and wholesale pricing growth and winemaker margins. Ultimately this translates into low wine grape prices.

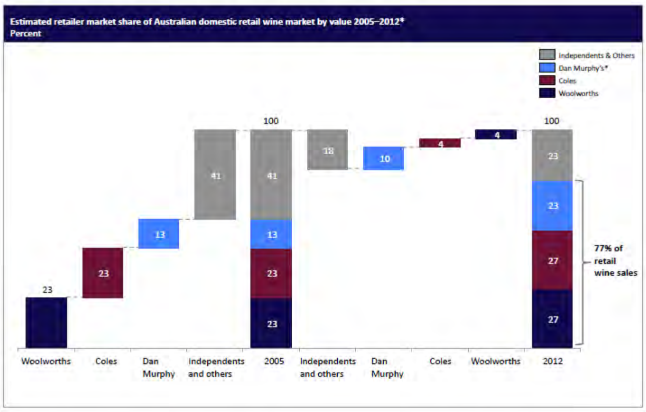
While some progress has been made, much more can be done by government to help alleviate the concerns of the industry as outlined below.

The Expert Review (Appendix A) commissioned by WFA and produced by Centaurus Partners analyzed the power and influence of retailers in the domestic wine market. We have provided a relevant extract below and then moved into discussion on the work we are doing and recommendations.

Retailer Consolidation and Power

The combined groups of Coles and Woolworths distribute and sell circa 80% of all wine sold off premise (Exhibit 17 from Appendix A) up from circa 60% in 2007. This translates to about 70% of all domestic sales, on and off-premise. *We do not have access to the full Nielsen data or that of the retailers therefore these shares are estimates based on our interpretation and analysis of numerous sources.*

Exhibit 17: Change in domestic retailer market share



* Numbers for Dan Murphy's estimated. (Need to follow up on estimate for 2005.) Woolworths share does not include Cellarmasters & Langtons. Off-premise only.
Source: Estimates based on interviews; company filings & analyst reports; media; analysis

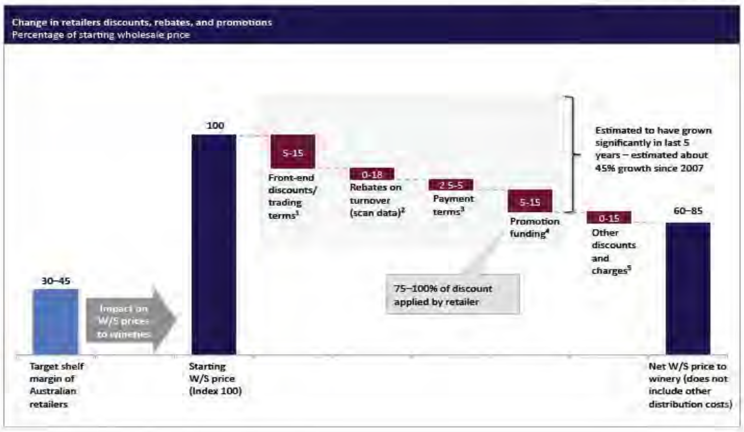
Woolworths is now a fully integrated wine player—owning and/or controlling all elements of the wine making process from vineyards, winemaking, bottling and packaging, and distribution to retail sales (on and off premise). The private labels of both retailers are estimated to account for at least 16% of domestic sales (off premise). In contrast to this retail and distribution consolidation, the Australian wine industry is highly fragmented (with circa 2,400 producers and 30,000 retail SKUs. Though the 38 largest producers account for 88% of total production (already a large number of alternate suppliers for retailers to leverage) the single biggest has less than 15%, most of which is exported.

The retailers have numerous sourcing options to leverage due to 1) this fragmentation, 2) the excess supply of grapes and wine, and 3) the ability to sell imported wine at attractive margins. As a result, there has been a massive increase in discounts and rebates (producer selling costs).

In addition, average discount levels being achieved by the major retailers are estimated to be about 30% and as high as 40% - up from 10–15% five years ago (Exhibit 18 from Appendix A).

Exhibit 18: Increase in retailer discounts and margins—impact on winemakers

WORK IN PROGRESS



Source: Interviews; WFA Retail Discussion Paper; WFA board member survey; analysis

Winemakers are affected directly and indirectly by the ability of retailers to significantly impact a company's volume/sales through their market share and related behaviours including: access to shelf space, promotional activity, volume for exclusivity, and de-listing. The risk of these behaviours to winemakers is extensive as they make production decisions far in advance of sale, have expensive inventories, and limited alternate distribution options. In addition, winemakers struggle to pass on genuine cost increases to retailers that are not then taken away by increased rebates and discounts.

The analysis shows that from 2007 to 2012 overall consumers did not benefit from the profit margins retailers have extracted across the portfolio of wines sold by the winemakers we analysed [on a confidential basis]. Though consumers of some of the lower priced wines in the portfolio benefited from lower prices, the profit margins to retailers grew due to falls in net wholesale prices (driven by rebates, discounts and promotions).

In addition, retailers generate most margins on wine sales than sales from beer and spirits. Wine sales provide two to three times more margin than beer. The ability of retailers to extract greater margins from wine can be a reflection of the highly fragmented industry structure and ease of transferring costs to wine producers.

WFA's work on codes of conduct with retailers

In line with WFA's 43 *Actions for Profitability*, specifically Action 4.2 which states: "WFA will work with the national chains to adopt an Industry Code of Conduct based on agreed Principles and Practice".

In August 2014, WFA launched the "*Good Wine Buyer and Supplier Principles: A Code for Fairness and Transparency"* with the Woolworths Liquor Group (WLG) (see Appendix H). In the Preamble of this document we state:

> *WLG and the Winemakers' Federation of Australia (WFA), acting for the benefit of Australian wine producers and for customer choice, agree that WLG and wine suppliers will act honestly and deal fairly with each other and will be transparent in their processes and decision making, within the limitations of commercial confidentiality. WLG will reflect these good wine buyer and supplier principles set out in the Good Wine Buyer and Supplier Principles (Principles) and WFA will encourage wine suppliers to do likewise in all agreements and dealings. Implicit and explicit in this approach is that neither party will in any way unfairly disadvantage the other for requesting adherence to these Principles.*
>
> *WLG and wine suppliers agree to honour the spirit and intent of these Principles which will be supported through the dispute mechanism of this code that allows a review of any decision or action deemed unfair or contrary to these Principles by a third party agreed to by WLG and WFA. A joint forum made up of WLG and WFA representatives will ensure the Principles are publicised and promoted; monitored for compliance; and regularly reviewed. Each organisation will also appoint a Compliance Manager as the first point of contact in understanding how the Principles work.*
>
> *WLG and WFA will formally review the Principles every two years from 1 July 2014 to consider any changes in scope and content necessary to ensure their on-going relevance and effectiveness.*

The Principles covered are as follows:

Principle 1: A fair and clear commercial relationship

Principle 2: Clarity in marketing and promotional activity

Principle 3: Open, honest and early communication

Principle 4: Protection of intellectual property

Principle 5: Dispute resolution

Discussions between WFA and other wine retailers on achieving a similar agreement to the Principles have also underway.

Australian Food and Grocery Code of Conduct

The Government tabled the Food and Grocery Code of Conduct in March of this year. In tone and detail, it is very similar to the WFA Principles document with WLG. The Code remains 'opt in' for retailers. The key difference with the WFA Principles document is that the ACCC has an enforcement role to ensure compliance with the Code from those who have chosen to be part of it.

At this stage, alcohol remains outside of the AFGC Code of Conduct. However, WFA notes that the Code is due for review in three years and would expect this to change. WFA is supportive of this.

The Harper Review of Competition Framework

In our submission to the Harper Review of Australia's Competition Framework, WFA called for the Government to analyse practices and agreements which enable retailers to demand retrospective pricing support from suppliers and determine whether they are a potential misuse of market power and even if they do not fall within the existing technical definition of "misuse of market power", and whether they should be explicitly dealt with through amendments to existing anti-competition laws. It is unclear to us whether the proposal in the Harper Review to review Section 46 of the *Competition and Consumer Act 2010* (CCA) to introduce an "effects test" will help to address the wine industry's concern around potential misuses of power in relation to retrospective pricing.

In relation to the Harper Review, WFA also called for specific review of how the competitive process embodied in our competition laws operates for small and medium businesses and more generally for effective competition. Related to this, WFA also called for rethinking and modification of the current legislative framework for protection of small and medium businesses.

The Productivity Commission and further market analysis

The Expert Review we commissioned has provided good initial analysis of the domestic market and the impact of retail consolidation on margins and profitability. This work needs to continue to help build a fact base, inform future policy discussions and assess the findings of the Review. WFA believes the Productivity Commission has the appropriate resourcing and expertise to conduct such research.

Appropriate labelling for homebrands

WFAs consultations with industry has highlighted strong support for the labels of brands owned by retailers to be clearly marked as such to ensure consumers are aware of the origin of the wine. WFA recommends the Government require that all brands owned by retailers be clearly labelled to inform consumer purchasing decisions. WFA contends that additional regulation would improve the competitive process and enable consumers to make informed choices.

(g) In summary, on the power and influence of retailers of Australian wine in domestic markets:

- The combined groups of Coles and Woolworths account for approximately 70% of all domestic sales, on and off-premise.
- The private labels of both these retailers account for at least an estimated 16% of domestic sales (off premise). Consumers are generally unaware they are purchasing a home brand.
- In contrast to this market block, the rest of the industry is highly fragmented with circa 2,400 producers and 30,000 retail SKUs.
- Discounting by retailers is an impactful and growing issue. The average discount levels of the major retailers are estimated to be between 30-40%, up from 10-15% five years ago.
- Retailers significantly impact a wine company's volume/sales through their market share and relation behaviours including access to shelf space, promotional activity, volume for exclusivity and de-listing. The risk of these behaviours to winemakers is extensive as they make production decisions far in advance of sale, have expensive inventories, and limited alternate distribution options.
- The retailers' ability to extract greater margins from wine, compared to beer, is a reflection of the highly fragmented industry structure and ease of transferring costs to wine producers.
- In line with its Actions for Profitability, WFA is progressing Industry Codes of Conduct based on agreed Principles and Practice with the national chains. In August 2014 WFA and Woolworths launched the "Good Wine Buyer and Supplier Principle-A Code for Fairness and Transparency" and is progressing a similar agreement with Coles.
- WFA welcomes the Australian Food and Grocery Code of Conduct and is supportive of efforts to extend the code to cover alcohol.

WFA recommends:

- That the Productivity Commission be tasked to conduct analysis of the domestic wine market and the impact of retail consolidation on margins and profitability for wine businesses.
- WFA recommends the Government require that all brands owned by retailers be clearly labelled to inform consumer purchasing decisions.
- WFA recommends that the Government's response to the Harper Review enable a determination to be made of whether retailers' demands on retrospective pricing support from suppliers, in fact constitutes a misuse of market power.

(h) The adequacy and effectiveness of market intelligence and pricing signals in assisting industry and business planning;

Declining investment in data collection and analysis by both government and industry has reduced the availability of market intelligence and pricing signals and constrained the ability of industry and businesses to plan.

There are two particular aspects that we would like to discuss – foundation data and market analysis.

The importance of foundation data

First, WFA supports the principle of developing policy from a sound and robust evidence base. In seeking to understand industry dynamics from such a position, WFA in 2012 commissioned independent expert analysis (Appendix A) to help underpin its Action Plan (Appendix D) to return profitability and restore asset values in the industry.

The analysis estimated up to 70% of total current wine grape production may be uneconomic with the most significant profitability issues concentrated in lower grade grapes. The oversupply of certain grape types is having the effect of distorting prices across the entire market.

This oversupply is likely to continue even under the most optimistic projections of demand growth for the domestic and international markets and will continue to see downward pressure over the long term on grape prices.

WFA has identified steps to hasten the correction and bring supply into better balance with demand, while also reducing pricing distortions. Priorities outlined in WFA's Action Plan include:

- a better understanding and directly addressing the drivers of the slow adjustment;
- developing strategies to encourage fair and equitable dealings between grape grower and winemaker; and,
- Identifying future research and programme priorities to improve the competitiveness of Australian wine through technical, economic and product innovation.

While many of these activities will be pursued by WFA and WGGA, the Australian Government has a key role in helping secure the data required to progress evidence-based policies that will help address the demand-supply imbalance.

In the past, the Australian wine industry had world-class information, statistics and analysis to help guide policy development, industry planning and individual business decision making. The information had been made freely available to industry.

Historically the information came from the following sources:

- GWRDC (now AGWA) funded ABS vineyards survey census providing foundation viticulture data;
- Federal Government funded ABS annual wine statistics collections providing annual foundation data on wine grape crush, wine production, domestic sales and wine inventories;
- Export shipment data freely provided as a by-product of Wine Australia's Export Approval System, established for export shipment approvals;
- WAC (now AGWA) funded market insight and in-market, off-take data reports from various commercial suppliers; and
- WAC (now AGWA) funded reports interpreting and analysing the various forms of data.

Foundation data enables more effective decision making at every level of the wine sector. It is a tool to overcome market failure in the sector to enhance vineyard profitability, incorporate better information in decision-making on cost structures, improve vineyard quality, and undertake better business decisions (i.e. to consolidate/diversify or to exit the industry). It is more efficient to provide such data centrally rather than every producer, region, state and national organisation investing in collecting and compiling data. Consequently, there is a high return from investment in category level foundation data because it focuses and frames all business decisions. It also constitutes an invaluable asset for category planning and reporting, without which many individual research projects would have to collect data on a one-off basis.

A major concern for industry is the intelligence gap left by the withdrawal of funding for ABS to collect industry data viewed as critical to long-term planning and monitoring. There are no ongoing arrangements in place for the supply of viticultural data and the Australian Government has advised it no longer supports the collection of annual wine statistics post 2013/14. This includes the Vineyards Survey (which had been conducted by the ABS for over a decade) and the annual wine statistics collections (wine grape crush, wine production, wine inventories and domestic wine sales).

It remains critical for industry to have access to key foundation data such as this for industry planning and strategic development. Industry has looked at the data collection mechanisms and identified the Australian Wine and Grape Authority is ideally placed to be the new central data repository. AGWA has stepped into the gap and stated its intention to collect and disseminate data required for all of industry decision making and strategic planning in the future. To alleviate some of the gaps in the short term and to gain a better understanding of sector engagement and the need for a mandatory approach, AGWA will use a range of electronic methods to collect high-level foundation data from AGWA levy-payers for the 2014 vintage.

We believe the Government has a leadership role to play in ensuring future collections are conducted and agricultural statistics and data provided to assist industry in planning for the future.

The importance of market data

The second issue relates to better information to allow wine businesses to make informed decisions based on a better understanding of market dynamics. In the wine sector, grape prices not only reflect climatic conditions and the inputs used (such as agricultural chemicals, water, pruning, and environmental management), but also the ebb and flow of domestic and international grape supply.

Pricing of grapes in the wine industry is determined by contracts between processers and grape growers. However, the final price will be determined by fruit grade and its destined product line. In order to resolve disputes over price, the Wine Industry Code of Conduct (the Code) was established in 2009 by WGGA and the Winemakers' Federation of Australia and is supported by the Australian Government's Department of Agriculture, Fisheries and Forestry.

WGGA and the WFA believe a framework for fair and equitable grape purchase agreements and an impartial, cost effective dispute resolution scheme will help improve relationships between wineries and grapegrowers. In turn, our industry’s market prospects will be improved by improving the supply chain’s ability to meet consumer demand, as well as demonstrate to both consumers and retailers that the industry has sound and fair commercial practices in place.

A key element in the Code is for the provision of indicative prices in some instances. Indicative prices are not necessarily required as the Code allows a range of variations as long there are arrangements in place for determining a fair and reasonable price. This means that ideally growers should know in good time *before* their grapes are handed over, what price they will receive. The contract could provide for any of the following:

- A fixed price/tonne;
- Payment based on weighted district average; and
- Grape price to be paid in line with general market price.

In such a case, then, an indicative price does not need to be offered. However, growers support the provision of an indicative price as it potentially allows them to make business decisions based on what they can expect to receive on sale of the crop. However in practice the indicative price has not provided such certainty. Indeed, indicative pricing had been identified as a major disincentive by wineries to sign the Code. It was also identified by the grape grower representatives as a major problem in recent vintages as it encouraged lower across-the-board prices.

WFA believes the provision of better information relating to supply and demand throughout the season would assist growers make better business decisions and remove the need for indicative pricing. Such information would best be provided by the Australian Wine and Grape Authority and/or a well-respected and independent research organisation such as ABARES.

WFA believes the Australian Government has a critical role in helping secure the data required to progress evidence-based policies that will help address the demand-supply imbalance. It remains critical for industry to have access to key foundation data for industry planning and strategic development. Industry has looked at the data collection mechanisms and identified the Australian Wine and Grape Authority is ideally placed to be the new central data repository.

(h) In summary, on the adequacy and effectiveness of market intelligence and pricing signals in assisting industry and business planning:

- In the past, the Australian wine industry had world-class information, statistics and analysis to help guide policy development, industry planning and individual business decision making. The information had been made freely available to industry.
- It is more efficient to provide data centrally than through multiple organisations, and thus avoid duplication in collection and compilation.
- The industry believes AGWA is ideally placed to be the central collector and distributor of foundation industry data.
- WFA believes the provision of better information relating to supply and demand throughout the season would assist growers make better business decisions and remove the need for indicative pricing. Such information would best be provided by the Australian Wine and Grape Authority and/ or a well-respected and independent research organisation such as ABARES.
- Pricing of grapes in the wine industry is determined by contracts between processers and grape growers. However, the final price will be determined by fruit grade and its destined product line.
- In order to resolve disputes over price, the industry and government worked together to develop the Wine Industry Code of Conduct. There remains a mix of views on the merits and timing of indicative pricing.

WFA recommends:

- That AGWA be the central depository and communicator for foundation data.
- That AGWA or ABARE be the provider of information on market dynamics and for this information to be released through-out the season.

(i) The extent to which the Australian grape and wine industry benefits regional communities both directly and indirectly through employment, tourism and other means.

(j) any related matters

Contribution to the national economy

The wine industry has earned the reputation of being one of Australia's most significant globally competitive industries. This achievement reflects decades of investment, hard work and collaboration by winemakers and growers and many others across Australia. This international reputation and collaborative approach will be an advantage when competing in new markets well into the future.

Wine is a truly value-added Australian Export. No other commodity carries its Australian heritage in quite the same way as a bottle of wine. Australians are rightly proud of their wine industry and how it has managed to take on the Old World and produce wines of exceptional quality across all price points.

The wine industry is also a significant contributor to the national economy both in terms of creating direct and indirect employment, and generating export and tourism revenues.

In 2013-14, it was estimated that the industry directly employed more than 16,000 people in grape growing and winemaking activities. The wine industry also continues to significantly contribute to tourism. For year ending September 2014, there were 696,602 international visitors to wineries. This is up by 1% from the previous year and represents 11% of the tourism market. The estimated overall visitor expenditure, both from international and domestic visits, is AU$8.20 billion.

Detailed data on the industry can be found in the table below and in the expert review found in the table below.

Snapshot of the Australian Wine Industry			
Wine Producers			
Wineries		Value	% change over last 12 months
2014	number	2,573	-3.6%
# Decrease	number	92	
Wineries by Size of Crush (2013)			
< 500 tonnes	number	2,244	0.04%
500-4,999 tonnes	number	177	-2.3%
5000-9,999 tonnes	number	14	-12.5%
>=10,000	number	28	-9.7%
Unspecified	number	110	0.9%
Direct Employment			
2014-15	number	16 186	0.4%
Viticulture			
Winegrape Crush			
2014	'000 tonnes	1 700	-7.4%
Winegrape Price			
Australian average, all varieties (2014)	$A	441	-11.6%
Environment			
Water Use (2012-13)			
Megalitres per hectare	ML	2.52	21.7%
Beverage Wine Production			
2014	million litres	1 202	-2.4%
Sales & Trade			
Domestic Sales - Volume			
2013	million litres	459	1.0%
Domestic Sales - Value (wholesale,using fob prices)			
2012-13	$A million	2 369	-5.0%
Imports - Volume			
2013	million litres	83	-1.2%
Imports - Value			
2013	$A million	610	9.0%
Exports - Volume			
2014	million litres	700	2.0%
Exports - Value			
2014	$A million	1 820	2.0%
Exports - Value per Litre			
2014	$A/litre	$2.60	0.0%
Wine as % of total value of crops export (fob)			
2013-14	%	8%	
Wine Exports' Ranking on major agricultural, fisheries and forestry commodities exports			
2012-13	ranking	6th	
Australian Wine's Contribution to Value of World WineTrade (2012)			
Ranking	ranking	4th	
%	%	6%	
Tourism			% market share
International visitors to wineries (year ending Sep 2014)	no.of people	696 602	11.0%
Domestic visitor overnight trips to wineries (year ending Sep 2014)	no. of trips in million	3	4.0%
Estimated tourism revenue generated from international and domestic visits (year ending Sep 2014)	$A billion	8.20	
Consumption			
Wine Consumption Per Capita			
2012-13	litres	29.11	-2.30%
Taxation			
Net Wine Equalisation Tax 2013-14	$A million	766	3.0%

Sources: *ABARES Commodity Statistics, Australian & New Zealand Wine Industry Directory, IBISWorld Industry Report, Tourism Australia, Entwine Member Database, ABS Domestic Sales and Import Statistics and Wine Australia Export Approval Database via Winefacts Statistics; ABS Catalogue No: 1329.0 Australian Wine and Grape Industry, ABS Catalogue No: 8504.0 Shipments of Wine and Brandy in Australia by Australian Winemakers and Importers, , ABS Catalogue No: 4307.0.55.001 Apparent Consumption of Alcohol ,Wine Australia and Treasury (Budget and Mid-year Economic and Fiscal Outlook), Aztec Report; Australian Taxation Office, Taxation Statistics; WFA analysis*

The tax treatment of wine

Wine should continue to receive differentiated tax treatment compared to other alcohol beverage types. This recognises the added production risks, economic footprint and industry structure of wine, compared to spirits and beer manufacturing which are very different. Just because they are all products with an alcohol base does not mean that they should be taxed at similar levels. The unique socio-economic contribution made by the wine industry to Australia and in particular our regional communities should also be considered along with the sector's limited capacity to pay even higher taxes during a period of on-going challenges in both domestic and international markets.

Below is an extract from WFA's paper on "Why should wine continue to receive a differential tax rate compared to other alcohol types?" (See Appendix I for full report):

The wine industry contributes the most of all the alcohol sectors to the national economy and this will continue for the foreseeable future:

- The wine industry contributed around $1.77 billion to the national economy in 2013-14 and this is expected to increase at an annualized rate of 4.3% (vs. annualized GDP growth of 2.5%)
- The spirit industry contributed around $130 million to the national economy in 2013-14 and this is expected to increase at an annualized rate of 3.3% (vs. annualized GDP growth of 2.5%)
- The beer industry contributed around $1.17 billion to the national economy in 2013-14 and this is expected to increase at an annualized rate of 0.5% (vs. annualized GDP growth of 2.5%)

The wine industry employs the highest number of people:

- The wine industry directly employs 16,122 in 1,867 businesses
- The spirit industry directly employs 800 in 55 businesses
- The beer industry directly employs 3,918 in 228 businesses

Wine tourism[29]

- International wine visitors (for year ending September 2014):
  - Account for 696,602 visitors to Australia or 11% of the total visitors to Australia
  - Number of wine visitors increased by 1% from last year
  - Winery visitors account for 40 million nights within Australia or 18% of the market. This represents average annual growth of 1% since the year ending September 2009
  - Contribute $4.9 billion to the overall visitor expenditure to Australia

- Domestic Overnight Wine Visitors[30]
  - Account for 3.1 million trips, a 7% increase from last year
  - Contribute 15.7 million visitor nights (5.2% of total)
  - Contribute $3.3 billion in visitor expenditure to the domestic market

The contribution of the wine industry in attracting international tourists vastly outweighs that from the beer and spirits industry. Tourism Australia estimates that beer and spirit manufacturing and tourism attractions such as the Cascade Brewery in Hobart, the Sullivans Cove distillery (producer of the 'world's best single malt whiskey' in 2014), together with Coopers in Adelaide, the Bundaberg Distillery in Queensland and other micro-breweries and micro-distilleries, for example, would only add up to 10% of the total benefits of wine tourism[31].

[29] Figures for year ending September 2014, Tourism Australia
[30] Overnight trips In the NVS, overnight trips are defined as trips involving a stay away from home for at least one night, at a place at least 40 kilometres from home. Only those trips where the respondent is away from home for less than 12 months are in scope. The trip is the basic collection unit used in the NVS to obtain information about overnight travel undertaken by Australians.
[31] Socioeconomics benefits of the Australian alcohol industry, Deloitte Access Economics, May 2014

APPENDIX

Who We Are

The Winemakers' Federation of Australia (WFA) is the peak body for the nation's winemakers.

We represent and protect their interests, speak on their behalf and help them maximise opportunities so they can build resilient businesses and a profitable and sustainable industry that continues to win praise at home and around the world.

We are the first point of contact for Governments and the avenue through which the industry's views on policy and funding issues are heard. Our members set our agenda and fund our activities which serve to benefit the entire Australian industry, members and non-members alike. Membership is open to all Australian wine producers and we welcome the support of industry partners.

Our objectives are:

- to represent the interests of Australian winemakers and grape growers of all sizes on national and international issues affecting the Australian Wine Sector, through a single organisation;
- to actively promote and protect the reputation and success of Australian Wine and the Australian Wine Sector;
- to encourage unanimity of opinion and action amongst members in all national and international matters pertaining to the Australian Wine Sector;
- to initiate legislative or other regulatory activity, or Government response or action, or otherwise facilitate any outcomes, deemed desirable by the Association for the benefit of the Wine Sector in Australia;
- to provide a medium through which opinions of members may be ascertained or expressed;
- to provide relevant information to members;
- to foster co-operation and goodwill between viticultural and oenological research and education bodies and all other bodies relevant to the Australian Wine Sector;
- to encourage good practice and standards of winemaking and wine business management within the Australian Wine Sector;
- to administer funds collected from members in support of the activities and objects of the Association;
- to protect and enhance community and Government support for the Australian Wine Sector;
- to promote economic, environmental and social responsibility in the production and consumption of wine in Australia; and
- to promote the interests of the Association and to do all such other lawful things as the Association may consider incidental or conducive to the attainment or advancement of the objects of the Association.

WFA is formally recognised as the industry's voice under the *Primary Industries and Energy Research and Development Act* and the *Australian Grape and Wine Authority (AGWA) Corporation Act*. WFA is incorporated under the *SA Associations Incorporation Act 1985.*

WFA membership represents some 80% of the national wine grape crush, with more than 370 winery members who directly fund the organisation's national and international activities.

WFA equally represents small, medium and large winemakers from across the country's wine-making regions. Each group has an equal voice at the Board level. WFA Board decisions require 80% support so no one sector can dominate the decision-making process. In practice, most decisions are determined by consensus.
WFA works in partnership with the Australian Government and our sister organisation, Wine Grape Growers Australia (WGGA), to develop and implement national policy that is in the wine sector's best long-term interests.

WFA's activities are centred on providing leadership, strategy, advocacy and support that serves the entire Australian wine industry, now and into the future.

Appendices:

A: Wine Industry Report: Expert Report on the Profitability & Dynamics of the Australian Wine Industry. Centaurus Partners, August 2013

B: WFA Vintage Report 2015

C: Summary of impacts on the Commonwealth Budget flowing from WFA's proposed reforms to the WET Rebate

D: Actions for Industry Profitability 2014-2016. WFA December 2013.

E1: Finalysons: Wine Equalisation Tax – Back to the Future. 2014.

E2: Finlaysons Legal Advice: Returning WET Rebate to Fairness & Original Policy Intent

F: PwC Report: Returning WET Rebate to Fairness & Original Policy Intent – Supporting Advice on the Impact to Government Revenue, January 2015

G: WFA and WGGA Joint Submission to the WET Rebate Discussion Paper, September 2015

H: WFA and Woolworths Liquor Group: Good Wine Buyer and Supplier Principles. A Code for Fairness and Transparency.

I: WFA: Why should wine continue to receive a differential tax rate compared to other alcohol types