HOW LONG WILL AUSTRALIA’S WINE BOOM LAST? LESSONS FROM HISTORY

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More than 100 years ago it was claimed that “many of the leading wine merchants of London and other important commercial centres admit that Australia promises to become a powerful rival in the world’s markets with the old-established vineyards of Europe” (H.W.H. Irvine, *Report on the Australian Wine Trade*, Melbourne, 1892, p. 6). Clearly the Australian wine industry has had a long gestation period. Until the 1970s domestic consumption had grown only very slowly. And while exports have boomed several times in the past, in each case those booms have plateaued and the expanded acreage has meant grapegrowers went back to receiving low returns. Indeed in the latter 1970s/early 1980s exports were so low that Australia became a net importer of wine. And as recently as 1985 a Government-funded vine-pull compensation scheme encouraged grapegrowers to move to alternative crops, so dire were the wine industry’s prospects viewed at the time.

Yet, like a phoenix, the industry has risen again and grown with renewed vigour during the past decade. The real value of both winegrape and wine production has grown at more than 10 per cent per annum over the past dozen years. For the first time more than 30 per cent of annual wine sales are now in export markets, up from just 2 or 3 per cent in the mid-1980s. The history of fluctuating fortunes raises the obvious question of whether the export-oriented wine boom of the 1990s is to be followed by yet another crash, at least in winegrape prices if not in wine production and exports. The wine industry is very bullish, having in 1995 set itself targets of doubling exports to $1 billion by the turn of the century and of trebling the real value of wine production within 30 years. Others, aware of the boom-bust cycles of the past, are sceptical or at least still need to be convinced that this time the expanded demand is here to stay long enough for growers to recoup a return from what looks set to be a doubling in Australia’s grapevine area during the 1990s.

To help resolve this difference in views, what can we learn from the industry’s history? A report from a new wine economics research project at the University of Adelaide recently
examined the industry’s long-run trends and its four previous cycles around those trends since 1850. It suggests the past history is both sobering and encouraging for those currently involved or contemplating investing in the industry.

On the one hand, it is difficult not to be sobered by the past. This is because, as is clear from Figure 1, each of the first four booms in the Australian wine industry finished with a plateau in vineyard area and winery output growth -- periods when returns to grapegrowers and often also winemakers were depressed for years because of the extent of new plantings during the boom. Nor is this phenomenon unique to Australia. On the contrary, it has periodically been the case in grape and wine markets elsewhere in the world for at least two millennia. Surely Australia’s current boom will have to plateau eventually or at least slow down soon?

Yet, on the other hand, our past history also is encouraging, because it shows the current boom to have several positive features that contrast with those of earlier booms. The timing and magnitude of the booms are summarized in Table 1.

The first boom, from the mid-1850s, was almost exclusively driven by domestic demand growth following the gold-rush induced trebling in Australia’s population in the 1850s. However, the wine produced from that excessive expansion was not able to be exported profitably, largely because of high duties on inter-colonial trade plus poor marketing and high transport costs in exporting the rather crude product of that time to the Old World. Hence returns slumped quite quickly in that first cycle.

The second boom, from the 1880s, was due to a mixture of domestic and export demand growth, the latter involving better marketing and lower transport costs for what were higher quality but still mostly generic bulk (rather than winery bottled and branded) dry red wines. The relatively open British market absorbed one-sixth of Australia’s production early this century, before the first world war intervened.

The acreage boom induced by soldier settlement after World War I provided the basis for the next export boom, from the mid-1920s. That third boom was helped by irrigation and land development subsidies, a fortified wine export subsidy, and a 50 per cent imperial tariff preference in the British market for fortified wines. The decline in domestic consumption, induced by the export subsidy and the Depression, added to wine exports in the 1930s – which by then accounted for more than one-fifth of production. The subsequent removal of the export subsidy, and the huge hike in UK tariffs on fortified wine in the latter 1940s, caused a severe decline in export orientation. As well, the return to normal beer consumption after war-induced grain rationing kept down domestic wine sales growth.

The fourth boom, following two post-war decades of slow growth in the industry, was entirely domestic. It emerged as tastes became more European, as licencing and trade practice laws changed with income growth, as corporatization of wineries led to more-sophisticated domestic marketing and new innovations (including casks, or wine-in-a-box), and as Britain’s wine import barriers rose again with its accession to the EEC. Initially domestic demand grew for red wine. Then the cask attracted a new clientele of white wine drinkers, causing per capita consumption to more than treble during the fourth cycle.

How does the fifth and latest boom, which began in the late 1980s, differ from the earlier booms? One difference is that it is overwhelmingly export-oriented. This contrasts with the
first and fourth booms at least which were overwhelmingly domestic. It also differs from the inter-war boom which took on exports more as a way of disposing of soldier-settlement induced surplus production than as a pre-planned growth strategy.

Secondly, the current boom is mainly market-driven, which is not unlike the first two booms but contrasts markedly with the third (inter-war) boom: that third boom evaporated once government assistance measures were withdrawn. In the present boom the only form of assistance offered and hence able to be withdrawn is the tax incentive to expand plantings via the tax-reducing accelerated depreciation allowance for some vineyard construction costs.

Another major difference between now and the past is that the quality of wine output has improved vastly during the past decade or so. Moreover, for the first time, the industry is in a position to build brand, regional, and varietal images abroad to capitalize on those vast improvements in the quality of its grapes and wines. That image building has been partly generic, with the help of the Australian Wine Bureau’s activities in Europe; but increasingly, and especially since the late 1980s, it is coming also from the promotional activities of individual corporations and their local representatives abroad as those firms have become ever-larger and more multinational via mergers and takeovers.

A fourth feature distinguishing the current situation is the health factor. An ever-wider appreciation of the desirability of moderate over heavy drinking, and of the possible health benefits of a moderate intake of red wine, are ensuring that the consumer trend towards spending on quality rather than quantity of wine (and on wine in preference to beer and spirits) will continue for the foreseeable future.

And fifth, Australian wines are still exceptionally good value for money in Northern Hemisphere markets, despite the real price increases of the 1990s. The recent depreciation of the Australian dollar will allow that to continue for a while longer. Should other countries lower their tariff and non-tariff barriers to imports, Australia will be well poised to expand sales there. And with nearly half of Australia’s wine exports going to the United Kingdom and another fifth to North America, plenty of scope exists for geographic market diversification through greater penetration of other high-income and rapidly industrializing countries.

These are all reasons to be optimistic about Australia’s long-term future as a successful exporter of premium wines. However, there are some other developments that need to be kept in mind.

One is the current financial crisis in East Asia. While Australian wine exporters are only very slightly exposed to East Asian markets, and are in a very advantageous position vis-a-vis other wine-exporting countries to penetrate them once those economies recover, that increased penetration will be delayed by the crisis. In so far as it also lowers income growth rates in other parts of the world, it will dampen demand growth elsewhere as well. Such a dampening of incomes outside the region is expected to be only slight, however. And even within the region, wine exports to Japan seem to be growing rapidly despite the economic slowdown there.

Another cause for concern with developments abroad is the rapid expansion in plantings of premium grape varieties in numerous other countries recently. Like Australia, California has doubled its area of premium grapes in the past five or so years. Chile and South Africa have
been expanding and upgrading also; and in both East and West Europe attention is being focused increasingly on replacing non-premium varieties with better-quality ones. Those trends, together with the continuing decline in (especially non-premium) wine consumption per capita in many traditional wine-drinking countries, may put some downward pressure on export prices of Australian wine. They in turn would be reflected in declines in winegrape prices.

The prospect for such a downturn in grape prices is likely to be reinforced by another trend also. With both Europe and the New World seeking to expand their output of high-quality wine, individuals and firms with expertise in the Australian industry are being sought after as consultants or joint-venture partners. This is a part of the globalization of the world wine industry that the international transport, information, and communications cost revolutions have generated. An important consequence is that Australia’s grape producers will face increasing international competition because the wine industry’s technological innovations and marketing skills are being transferred rapidly to other producing regions. Thus not only are wineries more easily able to import wine for blending with local product (as is happening in making cask wine, for example), but as well they are able to take some of their capital and skills in wine making and marketing to other countries. These possibilities will help to keep profits of Australian-based multinational wine companies higher than they otherwise would be, but eventually will tend to put more downward pressure on the currently very high prices for winegrapes in Australia.

Some uncertainties at home also could affect the industry’s future. Changes in the tax system are imminent, and could result in an increase in wine consumer taxes. That would push more Australian wine into international markets. The reform could also see a switch from a percentage to a specific or volumetric means of taxation (per litre of alcohol). The latter would harm non-premium producers relative to premium producers, especially since Australia is not very competitive internationally in the non-premium market and so there is less of an option of exporting a tax-induced excess supply of cask-quality wine. There is also the possibility that the accelerated depreciation provision in the income tax law that has encouraged vineyard construction since 1993 might be withdrawn – although that would directly affect prospective investors rather than current producers. Water pricing reforms also are under active consideration, which will raise irrigation costs. However, since vines use relatively little irrigation water, grapegrowers may benefit relative to other agricultural producers from higher pricing of water.

On balance, the wine industry’s future looks very bright for the next few years at least. Beyond that, grapegrowers’ returns will continue at high levels only if demand for Australian wines continues to grow more rapidly than supply. That each of the booms in vineyard area in the past has been followed by a long plateau and a large decline in grape prices is sobering. Yet the reasons as to why this present boom may be sustained for a longer than usual period are encouraging, and are are continuing to stimulate new planting investments. A more precise assessment of export prospects requires better information on recent and intended plantings of premium grapes around the world, on the changing nature of consumer preferences in different parts of the globe, and on the extent to which government domestic taxes and subsidies and trade policies might change abroad. With that information it would be possible to develop and use forward-looking economic simulation models for obtaining projections into the future. Of particular interest in such projections exercises would be the impact on returns to grapegrowers relative to winemakers: the former have enjoyed a rising share of the benefits of
the current boom so far, but for how much longer? Should international prices of Australian
wines fall, winemakers will inevitably pass the decline back to grapegrowers. Since the
grapegrowers’ share of the pre-tax wholesale price of wine is currently at the top end of the
usual 20-30 per cent range, the proportional decline in their returns could be considerable,
perhaps two or three times as large as any percentage decline in wholesale wine prices.
Potential investors in vineyards need to be aware of that risk.

Further reading: R. Osmond and K. Anderson, Trends and Cycles in the Australian Wine Industry,
1850 to 2000; G. Wittwer and K. Anderson, Tax Reform and the Australian Wine Industry; and N.
Compendium. All three reports were published by the University of Adelaide’s Centre for
International Economic Studies in June 1998. Prices are $12, $9 and $25, respectively, or $39.10 for
all three (a 15% saving), including postage. Orders to CIES on fax (08) 8223 1460 or phone (08)
8303 5672.
Figure 1: Area of vineyards, Australia and South Australia, 1849-50 to 1997-98

Source: See Osmond and Anderson (1998, Table 2).
### TABLE 1: SUMMARY OF BOOMS AND PLATEAUS IN AUSTRALIAN WINE INDUSTRY DEVELOPMENT, 1849-50 TO 1997-98

<table>
<thead>
<tr>
<th>Vintages:</th>
<th>Boom/plateau/cycle number</th>
<th>No. of years</th>
<th>Increase in vine area, Aust. (% pa)</th>
<th>Increase in vine area, Sth Aust. (% pa)</th>
<th>Increase in wine prodn., Aust. (% pa)</th>
<th>Increase in wine prodn., Sth Aust. (% pa)</th>
<th>Increase in wine export volume, Aust. (% pa)</th>
<th>Share (%) of wine prodn. exported</th>
<th>Annual per capita consumptionb (litres)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1854 to 1871</td>
<td>1st boom</td>
<td>17</td>
<td>15.5</td>
<td>16.0</td>
<td>18.4&lt;sup&gt;a&lt;/sup&gt;</td>
<td>19.9&lt;sup&gt;a&lt;/sup&gt;</td>
<td>14.1</td>
<td>1.8</td>
<td>na</td>
</tr>
<tr>
<td>1871 to 1881</td>
<td>1st plateau</td>
<td>10</td>
<td>-1.1</td>
<td>-3.5</td>
<td>-0.6</td>
<td>-8.2</td>
<td>-5.2</td>
<td>1.6</td>
<td>na</td>
</tr>
<tr>
<td><strong>1854 to 1881</strong></td>
<td><strong>1st cycle</strong></td>
<td><strong>27</strong></td>
<td><strong>8.4</strong></td>
<td><strong>6.8</strong></td>
<td><strong>10.7</strong></td>
<td><strong>7.3</strong></td>
<td><strong>8.2</strong></td>
<td><strong>1.7</strong></td>
<td>na</td>
</tr>
<tr>
<td>1881 to 1896</td>
<td>2nd boom</td>
<td>15</td>
<td>9.7</td>
<td>10.1</td>
<td>7.5</td>
<td>8.7</td>
<td>23.0</td>
<td>9.8</td>
<td>na</td>
</tr>
<tr>
<td>1896 to 1915</td>
<td>2&lt;sup&gt;nd&lt;/sup&gt; plateau</td>
<td>19</td>
<td>-0.1</td>
<td>1.9</td>
<td>-0.4</td>
<td>4.8</td>
<td>0.4</td>
<td>16.5</td>
<td>5.1</td>
</tr>
<tr>
<td><strong>1881 to 1915</strong></td>
<td><strong>2nd cycle</strong></td>
<td><strong>34</strong></td>
<td><strong>3.9</strong></td>
<td><strong>5.7</strong></td>
<td><strong>3.3</strong></td>
<td><strong>7.0</strong></td>
<td><strong>8.7</strong></td>
<td><strong>14.4</strong></td>
<td>na</td>
</tr>
<tr>
<td>1915 to 1925</td>
<td>3rd boom</td>
<td>10</td>
<td>7.0</td>
<td>7.0</td>
<td>12.7</td>
<td>16.1</td>
<td>4.5</td>
<td>8.5</td>
<td>5.8</td>
</tr>
<tr>
<td>1925 to 1945</td>
<td>3&lt;sup&gt;rd&lt;/sup&gt; plateau</td>
<td>20</td>
<td>0.9</td>
<td>0.9</td>
<td>0.1</td>
<td>-0.4</td>
<td>-1.2</td>
<td>16.4</td>
<td>4.0</td>
</tr>
<tr>
<td><strong>1915 to 1945</strong></td>
<td><strong>3rd cycle</strong></td>
<td><strong>30</strong></td>
<td><strong>2.4</strong></td>
<td><strong>2.4</strong></td>
<td><strong>3.6</strong></td>
<td><strong>4.1</strong></td>
<td><strong>4.9</strong></td>
<td><strong>14.9</strong></td>
<td>na</td>
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<tr>
<td>1945 to 1968</td>
<td>slow growth</td>
<td>23</td>
<td>0.2</td>
<td>-0.1</td>
<td>2.1</td>
<td>1.8</td>
<td>0.2</td>
<td>5.4</td>
<td>6.2</td>
</tr>
<tr>
<td>1968 to 1975</td>
<td>4th boom</td>
<td>7</td>
<td>3.3</td>
<td>3.7</td>
<td>6.2</td>
<td>3.8</td>
<td>-1.4</td>
<td>2.7</td>
<td>10.9</td>
</tr>
<tr>
<td>1975 to 1987</td>
<td>4&lt;sup&gt;th&lt;/sup&gt; plateau</td>
<td>12</td>
<td>-1.7</td>
<td>-2.2</td>
<td>1.0</td>
<td>0.1</td>
<td>8.4</td>
<td>2.2</td>
<td>19.1</td>
</tr>
<tr>
<td><strong>1968 to 1987</strong></td>
<td><strong>4th cycle</strong></td>
<td><strong>19</strong></td>
<td><strong>0.2</strong></td>
<td><strong>0.1</strong></td>
<td><strong>3.1</strong></td>
<td><strong>2.0</strong></td>
<td><strong>2.5</strong></td>
<td><strong>2.4</strong></td>
<td><strong>16.0</strong></td>
</tr>
<tr>
<td>1987 to 1998&lt;sup&gt;c&lt;/sup&gt;</td>
<td>5th boom</td>
<td>14</td>
<td>4.6</td>
<td>5.3</td>
<td>5.3</td>
<td>4.4</td>
<td>18.8</td>
<td>17.9</td>
<td>21.0</td>
</tr>
</tbody>
</table>

| 1850 to 1998<sup>c</sup> | 148 | 2.6 | 2.8 | na | na | na | 9.7 | na |
| 1900 to 1998<sup>c</sup> | 98 | 1.6 | 1.9 | 3.6 | 4.2 | na | 9.8 | na |
| 1950 to 1998<sup>c</sup> | 48 | 0.7 | 0.6 | 3.7 | 2.5 | na | 9.1 | na |
