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The Governance of Grapes: The NSW Inquiry into the Wine Grape Market and Prices (2010) – An Assessment

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The Governance of Grapes: The NSW Inquiry into the Wine Grape Market and Prices (2010) – An Assessment

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ABSTRACT: The contribution of the grape growing and wine making industries to Australia's continued economic prosperity is under threat. While international market dynamics are often cited as the cause, the problem of oversupply and more specifically calls for government intervention were the focus of the recently completed NSW Legislative Council's Standing Committee on State Development *Wine Grape Market and Prices Inquiry* (Catanzariti Inquiry, 2010a). This paper examines the process and outcomes of the Inquiry and the NSW Government's response to its recommendations. It is argued that a mandatory Code of Conduct ought to be adopted by the industry to govern the relationships between winegrape growers and wine makers.

Keywords: Catanzariti Inquiry, government failure, grape growers, grape prices, market failure, winemakers.

1 INTRODUCTION

The rapid expansion of the Australian wine industry can be measured in several ways. For example, between 1990-91 and 2007-08, wine production increased from 346 million litres to 1.3 billion litres, exports increased from 57 million litres to over 714 million litres, with a commensurate increase in value from \$180 million to \$2.7 billion. Similarly, the total vine-bearing grape area grew from approximately 61 000 hectares to 166 000 hectares. Additionally, beyond mere indices of commodity production and sales, the number of wineries increased from approximately 600 in 1990-91 to almost 1900 in 2004-05 (see, for example, Banks, et al., 2007; ABS 2009a). Moreover, this value-adding economic activity is now widely dispersed across rural and regional Australia, covering over 60 wine-producing regions (Australian Wine Region Maps, 2011).

More recently, however, the industry has been a victim of its own success. While the national production (or ‘crush’) continued to increase up until 2007-08, the value of wine sold domestically declined by 4 per cent (Jackson, et al., 2009: 2) with exports declining 9.2 per cent and the unit value of exported wine continuing to decline from a peak of \$5.17 per litre in 2000-01 to \$3.75 in 2007-08. Further, the value of wine imported into Australia during the same period increased by 40.8 per cent from 2006-07 (ABS, 2009). Imported wine is expected to rise to 18 per cent of domestic consumption by 2013-14 (Jackson, et al., 2009: 2). The problem of oversupply has been widely recognised from 2006 (see, for example, ABARE, 2006; Gent, 2010) and according to the Australian Bureau of Agricultural and Resource Economics (ABARE) (Jackson, et al., 2009) has its origins not only in rapidly expanded capacity, but stagnant demand for wine globally, as well as relative decreasing costs of production in Australia’s new world and old world competitors. The industry has found itself ‘holding the baby’ of expanded capacity – and an inventory estimated at 100 million cases, set to double in three years. While this situation might signal a boon for domestic consumers, the wine industry has claimed that ‘oversupply is unpicking our price structure, distorting perceptions about our product and exacerbating competitive pressures’; further, ‘we have been forced to trade in the low value/low margin market to sell excess wine’ (WRAA, 2009b). Moreover, with increasing costs and unfavourable terms of trade continuing, many have forecast that the viability of the industry is under significant pressure (see, for example, Sheales, et al., 2006; WRAA 2009a; 2009b).

What, if any, action can be taken to alleviate this situation has been the subject of intense debate in Australia. This debate, anchored in arguments concerning government intervention into commodity production, ‘market failure’, ‘government failure’ and the

continuing prosperity of Australia's disparate regions, form the subject of this paper. For while it may be convenient to sheet home the idea of heavy-handed regulation of primary industries in Australia to a time passed (see, for example, Gow and Grant, 2010) the situation of the wine industry, and, in particular, the plight of grape growers has risen to political prominence at both state and federal levels of government. More specifically, this paper examines the relationship of the industry to government regulation through the lens of the recently completed NSW Legislative Council's Standing Committee on State Development Wine Grape Market and Prices Inquiry, headed by Hon. Tony Catanzariti, from September to December 2010 (Catanzariti Inquiry) and to which the O'Farrell Coalition Government tabled a response on 12 December 2011 (NSW Government, 2011).

The paper itself is divided into six main parts. Section two examines the four recent responses to the deteriorating fortunes on the wine industry, namely: (i) populist calls for a vine-pull scheme; (ii) recent attempts at industry self-regulation, (iii) the analysis of ABARE and the (iv) advice stemming from the 2005 Senate Inquiry *The Operation of the Wine-Making Industry* (Murray Inquiry, 2005). Section three describes the Catanzariti Inquiry (2010), focussing in particular on the way in which the concept of market failure was discussed in the course of depositions and the Inquiry's *Final Report* (Catanzariti Inquiry, 2010a). Section four examines the recommendations of the Inquiry and O'Farrell Government's response to the Inquiry's recommendations, arguing that the NSW Government missed an opportunity to encourage innovation in the industry, and that it ought to have grasped the nettle and introduced a mandatory Code of Conduct for the NSW wine industry. Section six summarises the findings of the discussion.

2 RESPONDING TO UNCERTAIN TIMES

Figures for 2009-10 indicate that the wine industry has commenced a belated adaptation to the twin problems of oversupply and falling demand. The national production (or 'crush') for 2009-10 was measured at 1.6 million tonnes (a decrease of 0.1 million tonnes or 7.5 per cent) and the total area of grape cultivation fell from 166 to 152 thousand hectares; a significant reversal of long term trends. Further, yields dropped from 11.8 to 10.1 tonnes per hectare and total wine production decreased by 3.4 per cent to 1.14 billion litres (ABS, 2009; 2010). This decrease in overall supply contrasts with projections made by ABARE as recently as 2009, which forecast production continuing to increase to include a total area of vines under cultivation of 171 thousand hectares, with the reality now falling some 20 thousand hectares short of this mark.

This small but significant contraction in vine area was matched by other encouraging signs, with exports rising by 4.8 per cent to 789 million litres, domestic sales increasing by 4.7 per cent and the value of the national inventory declining by 8.3 per cent to 1.7 billion litres (ABS, 2009; 2010). Despite imports of wine increasing by 3.3 per cent from 2008-09, this increase has to be considered in the context of the substantial 40.8 per cent rise in imports the previous year (ABS, 2009; 2010). Yet the encouraging picture suggested by this data – of slowly declining production and inventory matched by increasing exports – does not mitigate the longer term trends and dynamics described for the sustainability of the Australian wine industry generally, particularly in newly emerging regions. The notional correction to oversupply in 2009-10 was recently labelled by one key industry player as being far from adequate to address the problems and long-term situation of the industry (ABC, 2011).

Four reactions to the changing fortunes of the Australian wine industry can be identified. The first has been the call for a vine-pull scheme. For example, on 6 January 2010 Doug Lehmann, Managing Director of Peter Lehmann Wines, ‘warned that the Australian wine industry must rip out 35,000 hectares of vineyards to restore the imbalance between supply and demand’ (Greenblat, 2010a). This call was also echoed on 12 January 2010 by John Casella, who suggested that the market was suffering from a 20 per cent oversupply of grapes and called for a similar response (Greenblat, 2010b). While this reaction by two of Australia’s largest wine producers may be understandable in the face of falling demand and falling returns, it can nevertheless be labelled a populist reaction based not upon a reasoned course of policy. Moreover, it failed to take into account the adverse affects of the last government-assisted vine-pull scheme (see, for example, Gow and Grant, 2010).

The second response has seen an attempt at industry self-regulation. On 10 November 2009 four industry organisations, the Winemakers’ Federation of Australia (WFA), the Wine Grape Growers’ Association (WGGA), the Australian Wine and Brandy Corporation (AWBC; now Wine Australia) and the Grape and Wine Research and Development Corporation (GWRDC) released a *Joint Statement and Supporting Report* titled the ‘Wine Restructuring Action Agenda’ (WRAA, 2009a; 2009b). The statement called for a range of measures to be introduced by government and industry. These included, as an ‘immediate response’, the encouragement of a critical self-assessment of the economic viability of individual wine operations based upon region-specific data and specific wine industry accounting tools, alongside briefings in fourteen targeted regional areas and negotiation with the federal government over ‘improved exit packages for growers and small wineries seeking

to leave the industry along the lines of drought and small irrigator exit packages' (WRAA, 2009a).

While negotiations for exit packages proved ultimately unsuccessful, the WRAA also undertook to work with the federal government to re-examine elements of the Wine Equalisation Tax (WET) 'that artificially allow uneconomic business to stay in business'; to clarify misconceptions surrounding the profitability of investing in the wine industry based upon Managed Investment Schemes (MIS) and address issues of environmental as well as financial sustainability at a regional level. The WRAA also included commitments to R&D initiatives concentrated on market development, in particular in N.E. Asia and promotional activity in that region (WRAA, 2009a). While some elements of these proposals have been criticised as favouring particular sectors of the Australian wine industry (see Grant, Gow and Dollery, 2011; for a reply, see Strachan, 2010) the actions of the four peak industry organisations was far removed from a demand for wholesale government intervention into the industry.

The third response that can be identified is that of the peak agricultural research organisation in Australia, ABARE. Through a series of reports (see, for example, Jackson, et al., 2009; Sheales, et al., 2006), ABARE has recommended a market-based approach to the problems facing the Australian wine industry, including identifying emerging markets (as per the WWRA discussed above) and increasing the competitiveness of the industry based upon six recommendations:

- Increasing the average size of grower operations (partly through smaller operators leaving the industry) so as to realise scale efficiencies
- Adjusting business models through more contracting, leasing, share farming and cooperative arrangements designed to achieve better financial performance for growers and the industry as a whole
- Maintaining or increasing investment in research and development aimed at developing and adopting new technologies to increase on- and off-farm productivity
- Developing improved relationships between wineries and grape growers to ensure that information flows will better equip industry participants to respond to new and emerging market trends
- Maintaining an appreciation of global and domestic supply chain dynamics to allow growers and wineries to better position their businesses and products and
- Developing value adding opportunities that satisfy changing consumer demands (Sheales, et al., 2006: 5).

As such, while ABARE has recommended an increase in the size of firms alongside a variety of other reforms – including the exploration of different business models to encourage

enhanced financial performance – it did not advocate direct government intervention into the market.

The fourth response has been that of the federal government. As we have seen, interactions between the industry and government have recent times been mediated by several organizations – many of which, such as the WFA, Wine Australia, the WGGGA and the GWRDC – are statutory corporations of the federal government. This era of state-industry relations ought to be viewed as qualitatively distinct from the previous situation where, in common with the other agricultural commodities, both the wine grape and dried fruit grape industries were heavily regulated and protected, with some prices for both commodities vested (see, for example, Gow, Kane and Musgrave, 1991¹). Yet this change in regulatory environment has not taken place in the absence of political interest in the industry. On the contrary, three Commonwealth Parliamentary Committee Inquiries have been conducted since 1999. The first of these was a Select Committee on the New Tax System which was responsible for the drafting of the Wine Equalisation Tax (WET) Bill, alongside the Luxury Car Tax Bill, conducted in April 1999; the second was conducted in August 2004 by the Economics Committee into the Wine Producer Rebate and Other Measures Bill (Parliament of Australia, 2011).

While these two Inquiries largely confined themselves to the introduction of the WET, then compensation to the industry for it, the terms of reference (TORs) for the third Inquiry, ‘The Operation of the Wine-making Industry’, chaired by Hon Senator Andrew Murray (Murray Inquiry) conducted by the Committee for Rural and Regional Affairs and Transport in 1995, were more broad. The Inquiry was asked to examine ‘the operation of the wine-making industry, with particular reference to the supply and purchase of grapes’ (Murray Inquiry, 2005, 1). The Inquiry chose to focus upon four factors, (i) ‘the size and nature of the winegrape glut and the inventory levels of producers; (ii) the structure of the industry, in particular the relationship between growers and winemakers as expressed in contracts

¹ Gow, Kane and Musgrave (1991) noted that grape production is inherently unresponsive to market signals due to the planning horizon of production being approximately 40 years – the life of a vine – encouraging producers to accept prices below the cost of production for several consecutive years due to costs of change. Further, Gow, Kane and Musgrave (1991) also noted the regulation surrounding the grape industries (both winegrape and dried fruit grape) in the 1980s. First, both commodities were subject to an exemption of Section 45 of the *Trade Practices Act 1974* – that part of the Act prohibiting price fixing, monopolisation and exclusive dealing) so that a two-price scheme for each commodity could operate (one price for the domestic market; one for exports) from which levees were drawn and redistributed to producers. Second, both industries were overseen by ‘single desk’ bureaucracies that fixed prices, with the federal government underwriting sultana production equal to eighty percent of the average equalised returns over the previous three seasons. (see, in particular, Gow and Grant, 2010, 29).

between the two, with a view to assessing the implementation of a code of conduct – either voluntary or mandatory; (iii) what it termed the ‘adequacy’ of the *Trade Practices Act [TPA] (1974)* to the industry and (iv) the need for a national grape-growers representative body (Murray Inquiry, 2005).

The Committee received a relatively small number of submissions – 30 – comprising of several from growers complaining that, for example, while ‘some wineries treat growers reasonably, others act like Nazis’ by taking advantage of an asymmetrical market, imposing penalties and deductions on growers for the quality and timing of their grapes and paying unreasonably low prices (Murray Inquiry, 2005, 75). The Australian Consumer Competition Commission (ACCC) also made a submission (ACCC, 2005) as did several industry peak bodies, including the WFA, the AWBC and the WGGA (Murray Inquiry, 2005). The Committee made four recommendations:

1. The committee recommends that the Department of Agriculture, Fisheries and Forestry should consult with state authorities and peak bodies with a view to establishing a national register of vines.
2. The committee recommends that the Government should give priority to amending the *Trade Practices Act 1974* to add unilateral variation clauses in contracts to the list of matters which a court may have regard to in deciding whether conduct is unconscionable.
3. The committee recommends that the Government, in consultation with representative organisations for winegrape growers and winemakers, should make a mandatory code of conduct under the Trade Practices Act to regulate sale of winegrapes.
4. The committee recommends that any national wine industry body should be separate from a winemaker’s representative body (Murray Inquiry, 2005, 65).

The response by Government – a short three page document – endorsed only the second recommendation, namely an alteration of the *TPA 1974*, specifically that section 51AC ‘be amended to provide that unilateral variation clauses should be added to the list of matters which a court may have regard to in deciding whether or not conduct is unconscionable’ (Minister for Agriculture, Forestry and Fisheries, 2006). In effect, the response by the federal government, despite recognising the importance of the industry to Australia’s economy, chose to take the advice of the ACCC (2005) which noted in its submission that while it had received complaints over the conduct of wineries, it found that practices ‘fall short of being *unconscionable conduct* within the meaning of the Trade Practices Act’ (Murray Inquiry, x; emphasis added) and noted *inter alia* that ‘in many instances growers had not effectively utilised the review and mediation provisions of their contractual agreements’, and that

'grower complaints over the fairness of price and quality assessments are not always completely accurate (ACCC, 2005, 5).

The recommendations of the Murray Inquiry did find affect beyond the Australian Government's response: A national representative body for grape growers – the WGGA – was formed in 2005 following a report from the Centre for International Economics (WGGA, 2011a). Further, a voluntary code of conduct was introduced in December 2008, although to date it has few signatories, albeit being inclusive of the major companies in the Australian market (see WGGA, 2011b). Nevertheless, as we shall see, the problem of grape producers being price-takers in a market of oversupply continues. It is to this continuing problem that the Catanzariti Inquiry (2010) was directed to address and it is to this that we now turn.

3 NSW LEGISLATIVE COUNCIL'S STANDING COMMITTEE ON STATE DEVELOPMENT *WINE GRAPE MARKET AND PRICES* (CATANZARITI INQUIRY) (2010)

The Catanzariti Inquiry was one of 197 inquiries conducted by the fifty fourth Parliament of NSW. The Inquiry was undertaken by the Standing Committee on State Development, which in turn is one of 47 Committees of the Parliament, comprised of members of the Legislative Assembly, Legislative Council or both (in the form of Joint Committees) alongside individuals representing particular organisations, such as the NSW Ombudsman. The processes of parliamentary inquiries and the responses of government offer a fascinating portrait of some of the day-to-day work of Parliamentarians and, importantly, those employees of the Parliament who are tasked with organising the work of the committees. For example, the fifty fourth Parliament held inquiries on an impressive range of topics, including improper associations in the NSW police force, environmental grants administration and graffiti and public infrastructure (Parliament of New South Wales, 2011).

The problem of oversupply and, more specifically, the depressed prices grape growers were receiving in the Riverina district of NSW was the catalyst for the Inquiry. The Wine Grapes Marketing Board (WGMB), an organization that has continually operated in the local government areas of the City of Griffith, Leeton, Carrathool and Murrumbidgee (the Riverina) since 1933, called upon the State Labor Government to inquire into the industry. The WGMB did not mince its words:

The Board in seeking this inquiry is of the belief that the industry's market is flawed and requires legislative instruments to be introduced to remedy many of the problems that are being faced by wine grape growers that are not typical of a market with current structural supply and demand problems (WGMB, 2010: 1).

Terms of reference (ToRs) for an Inquiry were referred to the Legislative Council's Standing Committee on State Development by Steve Whan MP, Minister for Primary Resources, Emergency Services and Rural Affairs on 5 August 2010. MP Tony Catanzariti, head of the Committee on State Development and hailing from the Griffith area, was appointed Chair of the Inquiry, with the National Party's Hon. Rick Colless serving as Deputy Chair². The Terms of reference stated that the Committee inquire into 'factors affecting the wine grape market and prices', in particular:

- a. Price formation, including factors affecting supply and demand
- b. The role of the Wine Grapes Marketing Board has played in facilitating the use of voluntary codes of conduct and sale contracts
- c. The potential for collective bargaining and/ or codes of conduct to contribute to an efficient market
- d. Whether there are any measures which could improve market signals which would be consistent with competition principles and law
- e. Any other related matter.

Notable is the similarity between these terms of reference and how the Murray Inquiry (2005) chose to approach its broad ambit. Moreover, the specific TORs of the Catanzariti Inquiry strongly inferred that the Committee consider the problems which formed the central focus of the Murray Senate Inquiry (2005), namely the relationship between grape growers and winemakers; more specifically in the traditional, warm climate regions of the Riverina and Murray Valley areas of NSW. Perusing the submissions to the Inquiry from grape growers in the Riverina (see, for example, submissions Nos. 1-13, Catanzariti Inquiry, 2010b) as well as the transcript of day two of the hearings, conducted in Griffith, 14 October 2010 (Catanzariti Inquiry, 2010c), it is clear that grape growers in the Riverina were very much 'price-takers' in the current market conditions.

A portrait of the situation in this particular region was provided by Mr Lawrie Stanford, Executive Director, Wine Grape Growers Australia (WGGA – one of four industry bodies behind the WRAA; Mr Stanford was also previously Manager of Information and Analysis with the AWBC), who, in his spoken evidence to the Inquiry 13 October 2010, chose to frame the problems facing the wine industry in terms of market failure:

² The other Members of the Committee were the Hon Sophie Cotsis (ALP), the Hon Matthew Mason-Cox (Liberal Party), the Revd. the Hon Fred Nile MLC (Christian Democratic Party) and the Hon Mick Veitch (ALP) (Catanzariti Inquiry, 2010a, v).

The industry is significantly oversupplied and in a free market situation that creates a very unfavourable environment for wine grape growers ... The belief is that the market will sort it and nothing needs to be done, but on two counts I would say there needs to be consideration of intervention. One is a case I would make for market failure particularly in respect to coastal temperate production, which is all of the production outside of areas like the Riverina...

...

The second reason I see a need for some consideration of intervention is the fact that markets do not always deliver social expectations, and that is why economists do not run the country, politicians do, and economists advise politicians—so, welcome to you all—and there are certain community expectations about ethical commercial behaviour and we see a clear instance in the negotiation of market prices for wine grapes for that to occur. (Stanford, cited in Catanzariti Inquiry, 2010d, 2).

In fact, the Final Report of the Catanzariti Inquiry (2010a, 22-23) took some time to examine the concept of market failure and the claims surrounding it, citing extensively from evidence given on 13 October by Stewart Webster from NSW Industry and Investment (NSW I&I). On the one hand, the Final Report clearly recognised the importance of the principles of free market competition in determining prices, citing Mr Webster to this effect:

Competition principles agreements are pretty clear. Governments have a responsibility to first determine if the market failure is great enough to warrant intervention because all intervention has cost associated and, as it says, the costs have to be outweighed by the benefits. Secondly, just because you think that there is a market failure that you could do something about and in doing so derive a benefit for the community, it does not follow that you can pick the most powerful intervention off the shelf. You should pick the one that will deal with the market failure with the least cost associated with it (Webster, cited in Catanzariti Report, 2010a, 22).

However, Mr Webster also stated:

The reason that we have AIS [Agricultural Industry Services] committees in New South Wales is because there has been market failure—and there are about half a dozen of them identified, and those committees are seen as the least competition-restricting way of dealing with those market failures. The kind of markets you might be interested in here—there are two of them—is what they call imperfect competition, which is your market power discrepancy and there is also possibly an information asymmetry market failure, which is where one side of a deal knows more than the other side (Webster, cited in Catanzariti Report, 2010a, 23).

Further, when giving oral evidence to the Inquiry on 13 October 2010, Chief Economist for I&I NSW, Mr Scott Davenport, urged the Inquiry to focus on precisely the same issue which the 2005 Senate Committee had chosen *not* to regulate, namely that of ‘unconscionable conduct’, stating: ‘If I could comment just quickly... the market failure that we are talking about here is that *unconscionable conduct issue*, so we can refine our focus to that’ (emphasis added). In his evidence Mr Davenport also stated: ‘The Commonwealth has always taken a

strong view that that is what the Trade Practices Act is there for...I think that is sort of getting to the nub of the answer...'³ (Davenport, cited in Catanzariti Inquiry, 2010d, 28).

As such, the Committee of Inquiry heard strong, diametrically opposed arguments. On the one hand, an argument for government intervention based upon two particular types of market failure: First, that based in market power asymmetry; second, that based in information asymmetry. On the other hand, a strong argument for non-intervention into the market was put forward by I&I NSW. These objections to government intervention were grounded on the principles of competition (in evidence presented by Stewart Webster) and reinforced in Scott Davenport's suggestion that the focus of the Inquiry ought to be confined to the issue of *unconscionable conduct*, that is, that recourse to the principle of contract under current arrangements ought to suffice as a mechanism for the governance of grape prices.

Additionally, the Committee of Inquiry was also made aware that the problem of depressed grape prices and market failure were by no means uniform across the state. On the contrary, while evidence presented by the WGMB suggested that it was the financially unviable production of wines in temperate regions which were responsible for oversupply, alternatively, both oral and written evidence given in joint submission by the University of Southern Queensland and the University of New England argued that cool climate producers were attracting good prices per tonne for their produce, as opposed to the paltry sums being achieved by growers in the Riverina (see, for example, Grant, cited in Catanzariti Inquiry, 2010d, 32). Moreover, these submissions also argued that while grape growing in cool climate regions was to an extent protected from the worst extremes of depressed markets due to it being horizontally integrated (i.e., as an element to mixed farming activities, such as beef and wool production) it was also holding out the promise of revitalising some regions in NSW on the basis of vertical integration, wherein grape growing was seen as one element to a wine and food tourism industry (see, Catanzariti Inquiry, 2010d, 28-32). Thus, the decision by the Inquiry as to intervene into the market or not – and to what extent – was also conflated by the concept of inter-regional equity, and the fact that one region's pudding might be another's

³ The Catanzariti Report (2010a, 23) also noted that while unconscionable conduct might be the nub of the issue, it was by no means clear what constituted unconscionable behaviour. For example, Mr Davenport argued that it is important to distinguish between low prices generated by market conditions and unconscionable behaviour:

We need to be mindful of whether we are talking about just price declines due to those international market conditions or we are talking about unconscionable conduct. That is a very key distinct point to try to look at to see what evidence there is of unconscionable conduct as opposed to wineries just normally meeting, as was said in our submission, capacity constraints (Davenport, in Catanzariti Inquiry, 2010a, 23-34).

poison (see, in particular, Mounter, et al., 2011). It was with these factors in mind that the Committee developed its recommendations and the newly elected O'Farrell Coalition Government responded. It is to a consideration of these events that we now turn.

4 Catanzariti Inquiry (2010) Recommendations and O'Farrell Government Response (2011)

With these perspectives all impressing themselves on the Committee, the Inquiry tabled its *Final Report* on 2 December 2010, the recommendations of which are contained in Column 1 of Table 1. The O'Farrell Government's response to these recommendations, which was initially scheduled to be tabled 2 June 2011, but which was eventually tabled 12 December 2011 (the delay being due to the change in Government following the State election on 13 March 2011) are contained in Column 2 of Table 1.

Table 1 Catanzariti Inquiry (2010) Recommendations and O'Farrell Government Response (2011)

Catanzariti Inquiry (2010) Recommendations, 2 December 2010	O'Farrell Government Response, 12 December 2011
1. That Industry and Investment NSW and the Wine Grapes Marketing Board fund a consultant to provide targeted business advice for grape growers in the Riverina district to assist in responding to industry re-structuring.	The Rural Financial Counselling Program already provides business advice in the region, funded by the NSW and Australian Governments.
2. That the NSW Government consult with stakeholders, including other governments as appropriate, to determine the cost-effectiveness of scientific methodologies for analysing red wine grape colour.	The NSW Government is already supporting research being undertaken by the National Grape & Wine Industry Centre at Wagga Wagga - a joint Department of Primary Industries and Charles Sturt University facility.
3. That the NSW Government seek an amendment to the <i>Wine Grapes Marketing Board (Reconstitution) Act 2003</i> to require wineries to publish by 30 June each year an indicative price list for wine grapes for winegrapes for the coming season.	The introduction of this recommendation has been previously attempted and was rejected by both growers and winemakers.
4. That the NSW Government consult with the wine grape industry to determine the most effective safeguards to ensure that the indicative price list system provides an accurate source of information to wine grape growers.	An annual price dispersion report is already published in July each year, four months after the end of vintage.
5. That the NSW Government investigate the feasibility of requiring that all wineries offer the same terms of payment for wine grapes to growers	This would be anti-competitive for the market, as it would put NSW winemakers and growers at a competitive disadvantage with other regions where such requirements do not apply.
6. That in the absence of a mandated Wine Industry Code of Conduct, which includes a terms of payment schedule, the Wine Grapes Marketing Board's terms of payment function continue.	The industry already has a national voluntary code that deals with the terms and conditions of payment. This code is currently under review.
7. That the NSW government investigate the most appropriate methods to ensure that a winery has paid in full for the previous season's vintage before it can accept any wine grapes from the next growing season.	See response to (5).
8. That the NSW Minister for Primary Industries pursue the introduction of a mandatory Code of Conduct through the Primary Industries Ministerial Council, including reviewing the effectiveness of penalties for breaches of the Code.	The NSW Government will reserve its position on this recommendation until the review of the industry's current Code of Conduct is completed, and adequate consultation has been conducted with NSW growers.
9. That if the Wine Industry Code of Conduct is mandated, the NSW Minister for Primary Industries ask the Ministerial Council to review its dispute resolution process to determine its effectiveness.	No outcomes have been produced from the review of the current Code of Conduct.
10. That if the Wine Industry Code of Conduct remains voluntary, the NSW Government investigate the utility of forming an independent dispute resolution body to monitor and investigate complaints and disputes concerning price determination and contractual disputes in the wine grape sector.	The dispute resolution facilities of the voluntary Code of Conduct would be adequate if used.
11. That the Wine Grapes Marketing Board works with growers in the Riverina to develop a model for collective marketing of grapes.	No response was given to this recommendation.

Source: Catanzariti Inquiry 2010a, xiii-iv; NSW Government, 2011.

An examination of Table 1 reveals that while pursuing the combined recommendations of the Inquiry would constitute significant government intervention into the situation of perceived market failure, the response of government was distinctly *laissez faire*. Of the eleven recommendations of the Inquiry, # 3 ('That the NSW Government seek an amendment to the *Wine Grapes Marketing Board (Reconstitution) Act 2003* to require wineries to publish by 30 June each year an indicative price list for wine grapes for winegrapes for the coming season'), # 4 ('That the NSW Government consult with the wine grape industry to determine the most effective safeguards to ensure that the indicative price list system provides an accurate source of information to wine grape growers') as well as # 5 ('That the NSW Government investigate the feasibility of requiring that all wineries offer *the same terms of payment* for wine grapes to growers' [emphasis added]) amount to government regulating wine grape prices to the extent that a price guarantee (i.e.: vesting) is implemented for grapes with particular qualities – hence the need to find an objective benchmark of quality as specified in recommendation # 2 ('that the NSW Government consult with stakeholders, including other governments as appropriate, to determine the cost-effectiveness of scientific methodologies for analysing red wine grape colour')⁴. Further, recommendation # 7 ('that the NSW government investigate the most appropriate methods to ensure that a winery has paid in full for the previous season's vintage before it can accept any wine grapes from the next growing season') can also be assessed as 'heavy handed' in that it suggests the introduction of specific oversight and regulation of contracts in addition to that provided in law by (for example) the *Trade Practices Act (1975)*.

Further, recommendations # 1 ('that Industry and Investment NSW and the Wine Grapes Marketing Board fund a consultant to provide targeted business advice for grape growers in the Riverina district to assist in responding to industry re-structuring) and # 11 ('that the Wine Grapes Marketing Board works with growers in the Riverina to develop a model for collective marketing of grapes') suggest that the NSW Government, in association with a statutory corporation of federal government (i.e.: the WGMB) initiate a marketing strategy for the Riverina region. While in itself these recommendations amount to government, or at least public-private partnerships developing so-called 'club goods' and 'chain goods' (McNutt, 1999) for the burgeoning industry, and as such may appear to be a reasonable way to proceed

⁴ The extent to which such an objective standard, or indeed set of objective standards, is achievable, let alone desirable, is dubious indeed: In an industry to an extent predicated on highly subjective standards and comprised of both innovation and fashion, this would appear to be beyond the scope of the most rigorous set of scientific procedures.

(see, for example, Mounter, et al., 2011) the fact that the Inquiry made this recommendation for the Riverina district *alone* (i.e.: not coinciding with a similar strategy for other wine regions in NSW, such as the Hunter Valley, Central Tablelands, Hilltops, etc.) is extraordinary.

Recommendations 8, 9 and 10 all deal with the implementation of a Code of Conduct for the industry: Recommendation # 8 argues that the NSW Minister for Primary Industries pursue the implementation of a national, mandatory Code of Conduct through the Primary Industries Ministerial Council; recommendation # 9 suggests a court of dispute in the event of such a mandatory Code being introduced, while recommendation # 10 argues for the implementation of ‘an independent dispute resolution body’ should such a Code of Conduct remain voluntary – when such a body is already in place under the existing voluntary Code of Conduct, a fact duly noted in the response to the recommendations by the O’Farrell Government. As such, the Inquiry’s recommendations can be assessed as strongly favouring intervention of the kind suggested by Mr Lawrie Stanford, Executive Director of WGGGA, ranging from vesting prices on the one hand (based upon objective, arbitrary markers of grape quality) to the implementation of various regimes of oversight and the development of a marketing plan for but one wine region in the state, the Riverina.

The O’Farrell Government was dismissive of all the Inquiry’s recommendations on the basis of *laissez faire* principles. Examining column 2 of Table 1, we can see that to the suggestion that ‘all wineries offer the same terms of payments for wine grapes to growers’ (recommendation # 5) the Government response stated: ‘This would be anti-competitive for the market, as it would put NSW winemakers and growers at a competitive disadvantage with other regions where such requirements do not apply’. It reiterated this response in dealing with recommendation # 7, namely that the Government ‘investigate the most appropriate methods to ensure that a winery has paid in full for the previous season’s vintage before it can accept any wine grapes from the next growing season’; it was equally dismissive of recommendations # 1 and 11, that the government introduce further targeted business advice, or that be involved in developing a model for the collective marketing of grapes (in fact, it did not even respond the latter recommendation). Moreover, it ‘reserved its position’ with respect to all recommendations involving the introduction of a mandatory Code of Conduct, or indeed developments to the voluntary Code of Conduct, on the basis that at the time the Voluntary Code of Conduct was at the time under review.

So what are we to make of this episode in the ‘governance of grapes’ in NSW as we have discussed it here, and any possible broader implications for the Australian wine industry?

Should governments intervene into this burgeoning – but faltering – element of Australia’s regional economies – as argued by the WGGGA, the recommendations of the Catanzariti Inquiry and others? Alternatively, should those growers that fail to adapt be left to ‘wither on the vine’, as the O’Farrell Government’s response to the recommendations of the Inquiry appears to imply? Or is the problem that the policy alternatives are posed in precisely this way, namely as intervention *versus* the ‘free market’? It is to these questions that we now turn.

5 OBSERVATIONS: BEYOND THE IDEOLOGICAL DIVIDE? A MANDATORY CODE OF CONDUCT?

The first point to be made in this regard is to emphasise the ideological nature of the choices represented by the recommendations of the Committee on the one hand and the response of the O’Farrell Government on the other. Faced with evidence presented by both representatives of growers and state government bureaucrats, the Committee – comprised of individuals from all points of the political spectrum in Australian politics (Labor, National, Liberal and even Christian Democrat) reached for policy instruments which relied upon the concepts of market failure based power discrepancy and asymmetrical information, and which exhibited a clear regional bias (and as such was open to charges of being inequitable).

Equally, the response of the O’Farrell Government can be seen to echo the arguments of those witnesses from I & I NSW, in particular that of Mr Webster, who argued that any market failure identified has to be great enough to warrant intervention because any intervention has costs associated with it, *and* that the type of intervention must be the one with the least associated costs⁵. In fact, the response of the O’Farrell Government was couched in precisely these terms in its dealing with recommendation # 5 of the Inquiry, guaranteeing grape prices: ‘This would be anti-competitive for the market, as it would put NSW winemakers and growers at a competitive disadvantage with other regions where such requirements do not apply’.

Yet the fact that the Inquiry resulted in a ‘Mexican Standoff’ between ideological options belies not just the complexity of the empirical world *writ large*, but also research into the wine industry which suggests that there are options for the advancement of regions based upon strategies which are grounded in vertical integration, horizontal integration and

⁵ Another witness to the Inquiry, in giving oral evidence, was even more adamant: ‘[W]e are facing a massive oversupply. The industry has to adjust one way. If some people have to get out of the industry, this is what they have to do. It is the same with anything...’ (Grant, in Catanzariti Inquiry, 2010d, 32).

collective action in the form of both ‘chain goods’ and ‘club goods’ in McNutt’s (1999) sense⁶. Perhaps the example most readily at hand to encapsulate the advantages of all these situations is that of the ‘Bishop of the Barossa’, Peter Lehmann, who initiated a winery to process grapes from share farmers who were suffering the disadvantages of being price-takers for their grapes – very similar disadvantages based upon both the power differential and information asymmetry currently being experienced in the Riverina (for a discussion of the Peter Lehmann example, see Gent, 2003, 315-317). In effect, the problem of being a ‘price-taker’ is removed if one is making one’s own wine, or if grape growers choose to invest in the development of their businesses from grape growing on the one hand to providing a wine tourism experience on the other (for an example of this at the individual business level, see Grant, 2010).

Similarly, economies of both scale and scope can be achieved through collective action. For example, in her analysis of the growth of the Languedoc-Roussillon region in the south of France from the 1960s, Garcia-Parpet (2008) forcefully argued that the local producers were able to affect such a successful branding strategy that it undermined the powerful *Appellations d’Origine Contrôlée* (AOC) classification system, to the extent that what was once perceived to be *le gros rouge* wine of the region was transformed to the *avant-garde*. While pursuing a sophisticated marketing strategy clearly represents an economy of scope in the sense that an individual grape grower or wine maker could not achieve this by themselves, Garcea-Parpet (2008) also provided clear examples of economies of scale being achieved, such as the access to technology achieved which was not available to individual producers or indeed communes in the region prior to them coming together to share a common strategy, and the storing of some surplus of their wines for several years such that it achieved the status of *vin de garde* rather than *vin de table*.

Evidence given to the Inquiry discussed these examples (see, for example, Catanzariti Inquiry, 2010e) and some scope can be found for pursuing strategies such as those discussed above in recommendation # 11 of the Committee’s *Final Report*, namely ‘That the Wine Grapes Marketing Board works with growers in the Riverina to develop a model for

⁶ ‘McNutt observed that club good could be considered as public goods without the condition of non-excludability. Chain goods resemble club goods in that they are non-rivalrous and selectively excludable. That is, members of society outside the value chain are excluded from sharing in any benefits from collective action within the chain unless scope exists for “free riding” or because certain members of the chain do not cooperate because they feel that they are ‘forced riders’ ... Horizontal and vertical strategic alliances are mechanisms to internalise chain goods, formed among groups at the same level and across different levels, respectively, in the value chain’ (Mounter, et al., 2011).

collective marketing of grapes' (see Table 1, column 1). Yet the newly elected O'Farrell Government chose to totally ignore this recommendation of the Inquiry.

While such industry-initiated options are available at a regional level, research also suggests that 'light-touch' governmental assistance can be similarly effective. For example, commenting on the development of the branding strategy for the newly named New England Australia Wine Region, one local producer praised the NSW I&I Business Development Manager in that particular region, stating: 'Peter Sniekers from the [then] New South Wales Department of State and Regional Development started giving us some guidance. He was great from day one. We wouldn't have an industry without his input, I feel ...' (Cassidy, in Grant, 2010, 5). The employment of one individual and minimal support staff liaising closely to nurture a fledgling industry constitutes 'light touch', effective assistance of the wine industry in a regional setting⁷. Again, while the Catanzariti Inquiry recommended that the Riverina-based WGMB affect such a regional branding strategy for the Riverina, this recommendation was not responded to by the O'Farrell Government. Nevertheless, the point in this context is that the options available to both industry and government agencies in these contexts, while presented as evidence to the Catanzariti Inquiry and reflected (albeit very subtly) in the Inquiry's final recommendations, were in effect scotched, rather than explored, encouraged or developed by the response of the O'Farrell Government. Yet these innovations at a local level might well constitute models of business development and government assistance that have assisted in growing the wine industry in NSW and in Australia more generally.

Finally we turn to the issue which was the subject of 4 of the 11 recommendations of the Catanzariti Inquiry, the Australian Wine Industry Code of Conduct. While in this context we are unable to discuss this issue in any degree of depth (and concede that this exercise would in any event perhaps best be undertaken by our colleagues in the legal fraternity), some observations are warranted.

The dual aims of the Code as it currently stands (i.e.: as it was jointly devised by the WFA and WGGGA and implemented in December 2008) fall within the ambit of the Catanzariti Inquiry, namely: 'Firstly to establish a common Australian wine grape supply contract framework; secondly to provide a dispute resolution system to manage disagreements which

⁷ In the same interview, the local producer noted that local council had also been involved in the regional branding strategy for New England Australia: 'To Armidale-Dumaresq Council's credit, they see the potential in this region, as far as tourism goes, and they have invested in our branding strategy' (Cassidy, in Grant, 2010, 4).

exist over price or quality assessments’ (WFA/WGGA, 2008, 3). As it currently stands, the Code of Conduct offers elegant, yet comprehensive guidelines to achieve these goals. It is comprised of 3 main parts. First, that covering ‘Winegrape purchase agreements, dealing with no less than 17 elements of the relationship between grape sellers and grape buyers, including minimum standards for agreements (they must be in writing, and contain minimum terms and conditions, recognition of the relevance of the Code, for example), pricing methods, price notification, terms of payment, winegrape standards and assessment, etc. – all elements of the grape grower-winemaker relationship which, as we have seen, the Catanzariti Inquiry grappled with. Second, a ‘Dispute Resolution’ procedure, which recognises two types of disagreement: those over winegrape price (and for which a resolution procedure over approximately two weeks is specified) and those over ‘downgrades or rejections of grapes’ (for which a far hastier, 7-point procedure is provided over the course of several days). Finally, the Code specifies conditions for alleged breaches of the code and procedures for dealing with these (WFA/WGGA, 2008).

As noted in the O’Farrell Government’s response to the Catanzariti Inquiry’s recommendations, the Code then under review. Nevertheless, it can be characterised as a document resting upon consensual agreement between contracting parties: These parties agree to prices, grape quality, delivery schedules, etc., and importantly the appointment of an independent expert in the event of any disagreement (with a 3-person committee appointing the expert in the case of disagreement concerning who the expert ought to be). In essence, it is designed to mitigate against market failure based upon power and information asymmetries. Indeed, an analogy can be drawn between the Code and enterprise agreements in industrial relations, in that prices are not centrally fixed (as recommendation # 5 of the Inquiry sought to do) nor are they determined in haste in situations of the aforementioned asymmetries. Rather, they are consensually agreed upon with a mechanism of arbitration resting some distance from the negotiation of agreements, but to which an appeal can nevertheless be made.

The problem with the Code of Conduct as it stands, however, is that very few winemakers are signatories. At its commencement in December 2009, only 7 winemaking companies were signatories – albeit some of these 7 being extremely large concerns⁸. At the time of writing, both the WFA and WAGGA were only targeting 25 percent of the top 100 wineries to sign up by December 2012 and 50 percent by December 2013, with WGGA

⁸ The original signatories to the agreement were Banlaves of Coonawarra, Constellation Australia, Henry Holmes Wines, Orlando Wines, Rusden Wines, Treasury Estate Wines and Tyrrell’s Vineyards (WGGA, 2011b, 2).

stating: '[we] see the large weight of promotional responsibility to fall on the WFA'; and that: 'at the same time, WGGGA urges its members to insist that their off-takers [i.e.: buyers] are signatories' (WAGGA, 2011b, 2).

Potentially, one way of overcoming this problem would be to legislate that all commercial winemakers in a particular jurisdiction are obliged to be signatories to the Code – in fact the Catanzariti Inquiry did recommend 'that the NSW Minister for Primary Industries pursue the introduction of a mandatory Code of Conduct through the Primary Industries Ministerial Council' (i.e.: recommendation # 8), to which the O'Farrell Government replied by delaying any response until the current review of the Code of Conduct is completed. There are no specific objections to the introduction of the Code being mandatory in the literature of the Catanzariti Inquiry. Yet it is not difficult to construct such an argument based on *laissez fair* principles. Such an argument would assert that adherence to a code would constitute an unnecessary transaction cost to the business of making wine, thereby rendering the industry less efficient. It might also argue that an otherwise unnecessary bureaucracy would be created to oversee and enforce the Code – to which there is opportunity costs attached, and that the wine industry would suffer as it became more prone to institutionalised disputes between growers and wine makers; in effect a 'kangaroo court' which would conflate the operation of well established legislation such as the *Trade Practices Act (1974)*.

However, several factors suggest that the scenario envisioned by the *laissez fair* argument would not eventuate. First, there are inherent disincentives for any party to become involved in any dispute procedure: As well as the sheer time and vexation of such an exercise, all costs of providing an Independent Expert are borne by the parties involved, not government. Further, developing a reputation as a vexatious supplier of wine grapes would also act as a disincentive against initiating a dispute. Moreover, due to the necessarily speedy nature of the stipulated dispute resolution procedures with respect to both prices and downgrades and rejections, disputes could not be extended, litigious affairs: They might be cause of considerable vexation for the parties involved; however this type of procedure does not bear the same magnitude of costs associated with formal court proceedings.

Second, we observed in our account of the evidence given to the Catanzariti Inquiry that according to the Chief Economist of NSW I& I, Scott Davenport, 'the market failure we [ought to be] talking about here is the *unconscionable conduct issue*, so that we confine our focus to that'. While Mr Davenport also asserted that 'The Commonwealth has always taken a strong view that this is what the Trade Practices Act is there for...', a Code of Conduct does not interfere with the operation of any such law. Indeed, in the case of the Wine Industry

Code of Conduct, the document states that ‘the provisions of this Code are subject to all applicable Commonwealth, State and Territory laws and common law rights and obligations (WFA/WAGGA, 2008, 7). Arguably, the effect of the Code becoming mandatory would be to simply render what is conscionable conduct open to negotiation underlain by the rule of law: In effect a ‘Gentleman’s Agreement’ which by definition is pre-litigious. This does not imply that such agreements would be free from conflict based upon power asymmetries and perceived (and real) conflicts of interest. Nevertheless, it provides some structure for this conflict and for its resolution – in other words, politics, properly conceived (i.e.: institutionalised and subject to democratic oversight).

Third, the introduction of a compulsory Code of Conduct would not be at the expense of competition, nor of the operation of markets: It does not imply price-setting other than between those who are part to a contract. If such a price cannot be agreed upon, a contract is not initiated. This fact allows for what many, in their evidence to the Catanzariti Inquiry, perceived as the necessary structural adjustment of the industry in dealing with the problem of oversupply to take place. Forth, two of the intrinsic advantages of Australia’s federal system of government (indeed any federal system generally) is that legislation can be designed which will be effective for one jurisdiction while it may not be effective for all, and as an adjunct to this, one sovereign jurisdiction can act as a laboratory for all others by testing different regulatory regimes. In this sense, recommendation # 9 – that the NSW Minister for Primary Industry Minister pursue national implementation of a mandatory Code of Conduct through the Primary Industries Ministerial Council – can be assessed, with hindsight, as somewhat misdirected. NSW could introduce a mandatory Code of Conduct and trial it for a specific period.

Finally, perhaps the most appealing reason for introducing a mandatory Code of Conduct is that it necessarily brings the two parties of what has in some instances been an antagonistic relationship to the table. While the immediate goal may be to fairly negotiate a price for wine grapes, initiating such a dialogue could form the basis of exploring possibilities for different business models based upon different forms of cooperation such as those centred on club goods, chain goods and horizontal and vertical integration. This, combined with ‘soft touch’ government and industry assistance – can form the basis of a revitalised, adaptive industry.

6 Conclusion

This paper has examined the background, operations and recommendations of the Catanzariti Inquiry conducted by the NSW Legislative Council's Standing Committee on State Development in 2010 and the ensuing response by the O'Farrell Government, tabled 12 December 2011. We have argued that the responses to the travails of the NSW wine industry – in particular its grape growers – by both the Inquiry and the Government were blunted by ideological responses juxtaposed against one another. Further, we have suggested that the basis for more a subtle interpretation of the dilemmas facing the industry has been laid in previous research, and that the introduction of a mandatory Code of Conduct, for a trial period in NSW has much to offer as a means to redirect what we have referred to as 'the governance of grapes'.

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