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OVER-PRODUCTION OR RECESSION? CAUSES OF THE LOW PRICES OF TABLE WINE IN ARGENTINA

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Over-Production or Recession? Causes of the Low Prices of Table Wine in Argentina

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Table wines do not shine like Malbec does in Argentina's wine industry; nonetheless they represent two thirds of the wine produced in this country. A key economic indicator of this product is the price of the "vino de traslado" (bulk wine). A grape-grower has two options with his grape: he can sell it or he can elaborate wine (the "bulk wine") and sell it later to a large winery. Thus, the price of the "bulk wine" is a reference of the incomes of grape-growers and small wineries.

In the last five years, this price has been very low, and consequently governments of wine provinces are under social pressure to implement policies to raise it by restricting wine supply and/or by buying wine. Why is this price so low? From a sectorial perspective, there is overproduction, with the consequent increase in wine stocks. This hypothesis is strengthened by the declining domestic consumption of this wine in Argentina for several decades, as well as in other major wine producing countries.

However, there is another view, a crisis one. Over a period of more than three decades, this reference price reaches the minimum levels in each recession in Argentina. After a while, in every economic recovery, this price has increased very strongly. Macroeconomic impacts seem strong.

This study will show in numbers both impacts (of overproduction and recession) on the price of "bulk wine" in the Argentine case. Given the relevance of this price for the grape-grower, the study will analyze the evolution of the producer share in the final price of wine (paid by consumers). In these years of low prices, producers have

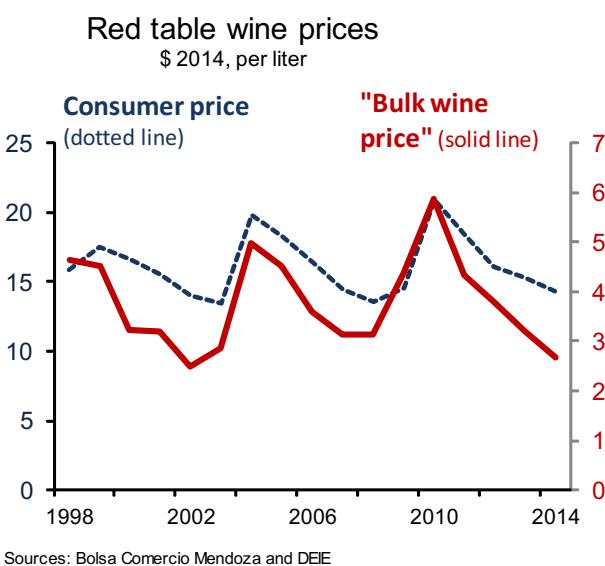
complained of lower share and there is a question whether this phenomenon is a trend observed over time.

1. The Facts: Lower Prices in Generic Wines

The wine business has different branches. One of them is the business of table wines. In Argentina, they were earlier as "table wines" and now as "generic wines". In principle, these wines are of a different quality to varietal wines (Malbec, Chardonnay, etc.), but have higher volumes of sales. These generic wines are considered almost as a commodity, with little price differentiation. In this paper, we will focus on the "bulk" stage of the production of generic wines.

During the last five years (2011 -2015), prices of grapes and red "bulk" wine have remained stable, despite the inflationary economy. In other words, these prices have been losing purchasing power. The key to this is the price of the "wine in box" paid by the consumer. The price of the raw material ("bulk" wine) depends on the price of the final good ("wine in box"). If the "wine in box" becomes cheaper, the same also happens to grapes and bulk wine (graph 1).

Graph 1

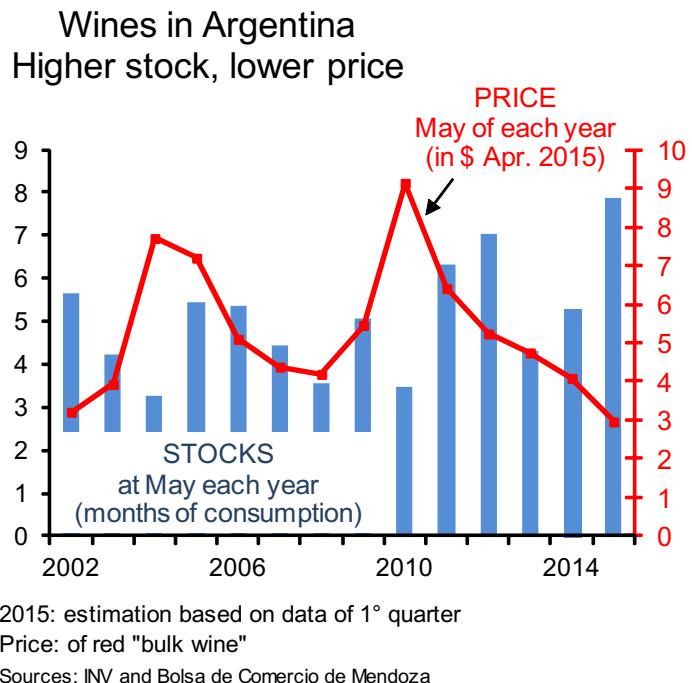


2. Overproduction or Recession?

Why do consumers pay such low prices for wine? There are several reasons. One of the causes is overproduction, due to lower demand and/or higher supply (harvest), which leads to an accumulation of stocks, and therefore to a downward pressure on price. This hypothesis is strengthened by the declining domestic consumption of this wine in Argentina as well as in other major wine producing countries for the past several decades.

We do not unfortunately have stock data disaggregated by types of wines. Knowing that two-thirds of Argentine wines are table wines, we can compare the evolution of the total stocks and the reference price (of red "bulk wines"). Due to the inflationary environment prevalent in Argentina, prices will be expressed in real terms. With few exceptions, the data show that the rule is met: higher stocks are correlated with lower prices (graph 2).

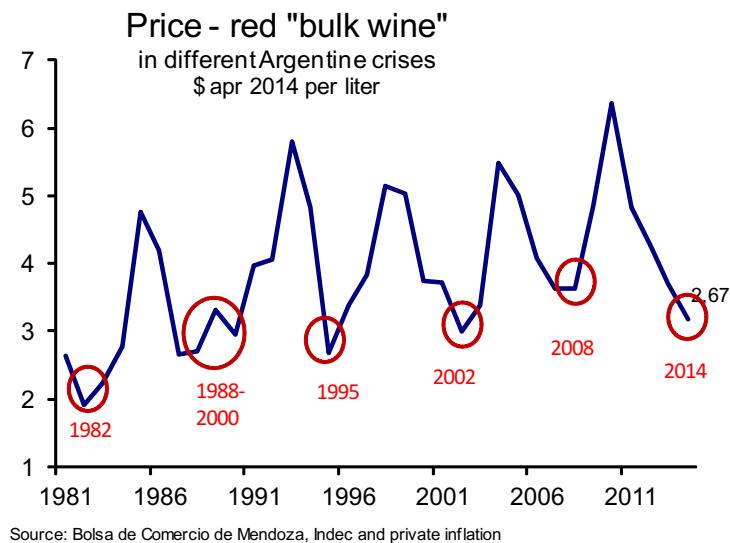
Graph 2



To obtain a different perspective, we examine the recent history of Argentine wine. The graph below shows the evolution of the price of "bulk wine" in real terms. The key

years of different Argentine crises are marked by circles. In most of these crises, the reference price reaches the minimum level (graph 3).

Graph 3



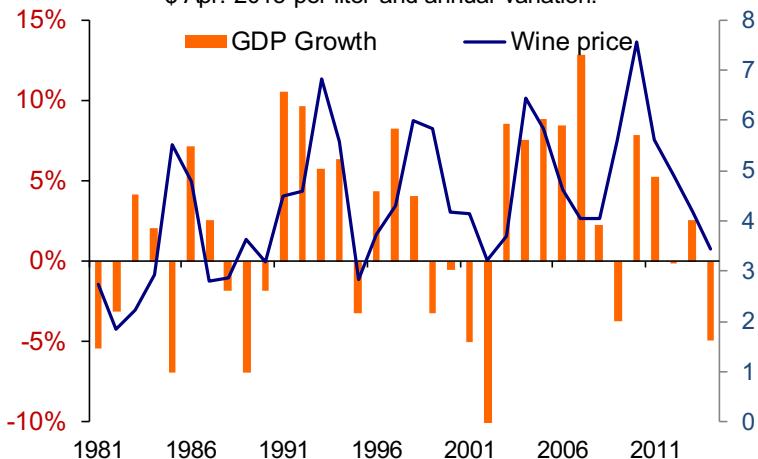
Some issues are worth noting. First, there are exceptions to the “crises” explanation (graph 4):

- Surprisingly, the crisis of 1985 does not appear in Graph 3, when inflation reached high values, and an anti-inflation program, called "Austral Plan", was implemented. During that period, the grape harvest in Argentina had declined strongly during two consecutive years, 35% in total. The lack of grapes overcompensated recession, with higher prices of generic wines.
- During the crisis of 1989, when there was hyperinflation, the minimum price of wine was achieved two years earlier. It was a period of several years of high inflation and low growth.
- During the international financial crisis, the minimum price was also achieved two years earlier (in 2007). The crisis began in late 2008, and the annual data shows recession in 2009.

Graph 4

Wine price and Argentina growth:

\$ Apr. 2015 per liter and annual variation.



Source: Bolsa de Comercio de Mendoza, Indec and OJFerreres

The second issue of note is that as the data in Graph 4 shows, generally, the price of wine reference reaches minimum values during the crises. However, it provides no information about the non-crisis periods. In general, after a recession, the price of “bulk wine” strongly recovers within two to three years, reaching a maximum value. Then it falls, even during periods of economic growth. For example, the price of wine peaked in 2004 and then began to lose purchasing power, even after three years of close to 9% annual economic growth.

Third, the overproduction hypothesis complements the macroeconomic explanation. In a recession, not only does the demand for wine decline, but also its supply increases because producers have to sell their “bulk wines” due to the lack of funds. Both forces work to depress prices and stocks increase. The reverse is true when the economy recovers. However, there were periods with lower wine stocks but prices decreased concomitantly. For example, after a poor harvest in 2012, stocks fell, but prices of “bulk wines” continued losing purchasing power.

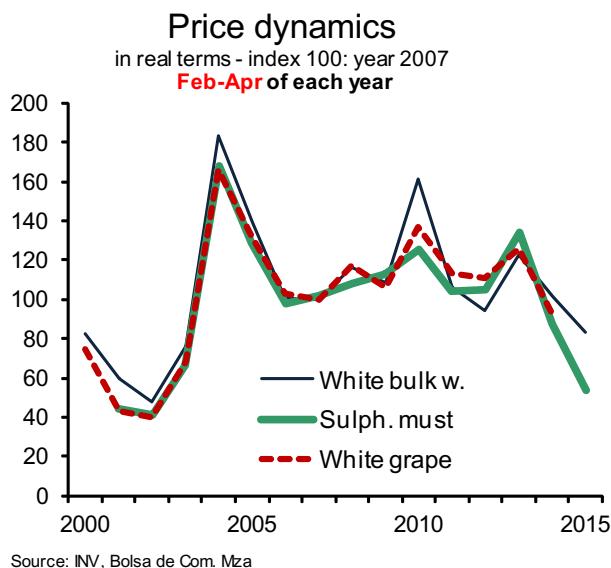
3. White Table Wines are the Exception?

The previous sections have discussed the case of red table wines, for which prices have been declining in real terms since 2011. On the contrary, for wines of other colors,

prices have remarkably kept pace with inflation, until last year. Why does this marked difference exist?

One explanation is the role of the grape juice (must) which is an exportable product. Non-red grapes are mainly used for its elaboration. As previously mentioned, the producer can sell the grape or he can elaborate “bulk wine” to further sell it to wineries. A third option for the producer is to sell the grapes to a firm that elaborates must. For this reason, during the harvest period (February-May), prices of grapes, wines and sulphited must evolve in a similar way (graph 5).

Graph 5



Until mid-2013, the export price of grape juice was increasing. It then began to decline, but was offset by the Argentine devaluation of early 2014. These facts explain why prices of white “bulk wine” have performed better until 2015. The situation is more complex at present. With lower grape juice prices and an appreciating peso, it is difficult to have higher prices in white “bulk wine”.

4. Producer Share in Consumer Price

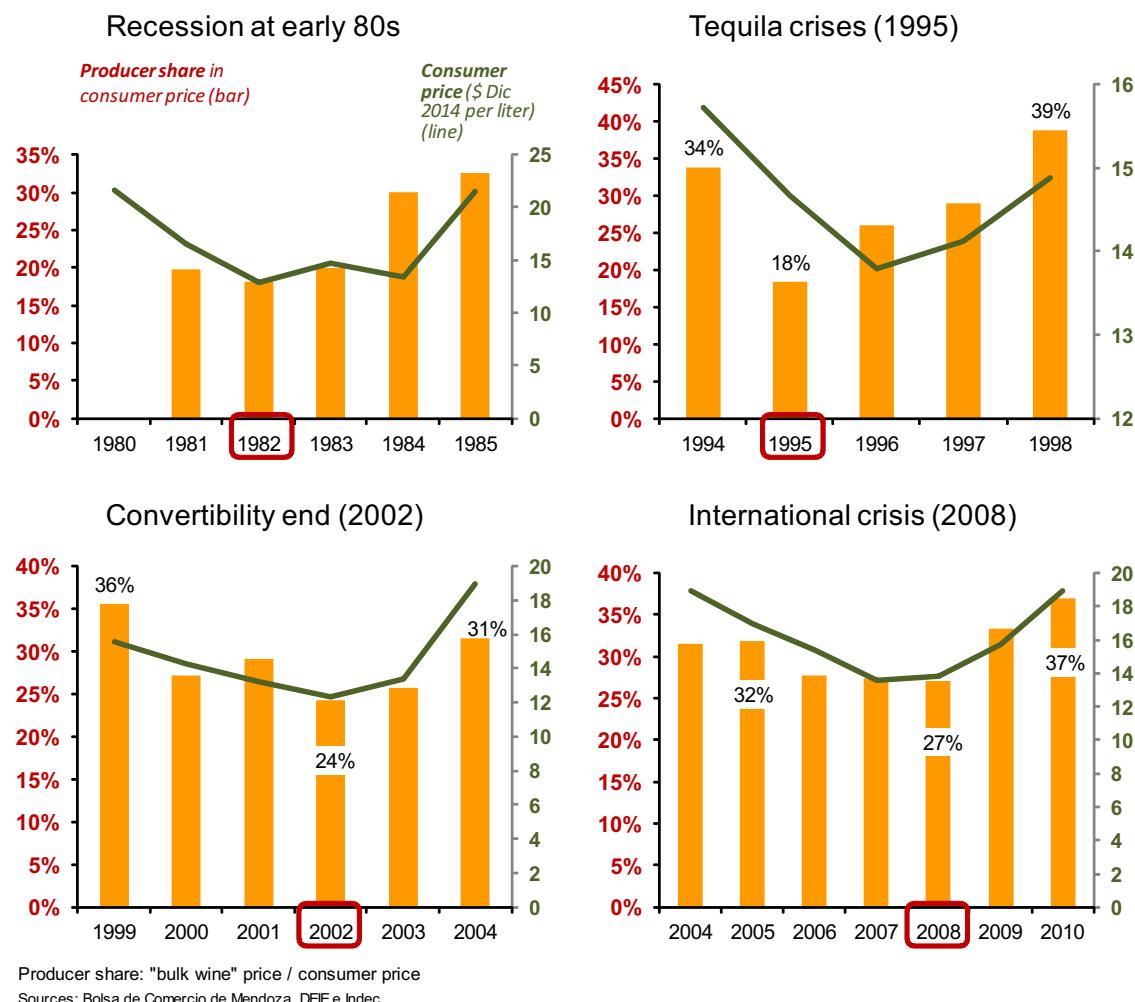
Another important fact is that, during recessions, the raw material (“bulk wine” and grapes) loses share in the final price of the wine sold to consumers. For example, in

2014, the price of "wine in box" increased 24% (in pesos), while "bulk wine" increased by a more modest 15% and the price of red common grapes decreased by 5%.

An explanation is that other costs (elaboration, distribution and sale) increased at a higher rate as the inflation rate was 39% that year. Thus, due to these higher costs, the wineries had less money to pay grape-growers. This resulted in a lower producer share in the price of the final good. For example, in 2010, the share of the "bulk wine producer", was 37% of the price of the "wine in box", while four years later it fell to less than 25%.

Graph 6

"Bulk wine" producer share and Argentine crises



Let's return to the Argentine wine history. We found at least four similar episodes¹, where the price of the final product (wine in box) decreased in real terms, as did the producer share in that price (graph 6).

An additional point is that the peso was overvalued in all these periods. This means that the costs of wineries increased in dollars, and then they had less money to pay for the raw material. This fact strengthened the decline in the producer share in the recessionary phases.

The reverse scenario plays out in the post-recessionary period. After the crisis, the price of the final good improves, and in three of these crises, the peso devaluates, reducing the production costs of wineries in dollar terms. Thus, the price of raw materials (grapes and "bulk wine") increases strongly, further improving the producer share.

5. Concluding Remarks

As mentioned in the introduction, Argentina is presently experiencing a period of low table wine prices for producers. Clearly, overproduction is responsible for this phenomenon. However, Argentine wine history is instructive, as it tells us that surprisingly these prices reach a minimum level in every crisis, as does the participation of producers in the final price. The positive news is that these indicators improved substantially in any ensuing economic recovery. Both variables are highly pro-cyclical. The takeaway from this study is that, if recessions have a strong impact on prices, local wine governments have a small political margin to prevent the loss of purchasing power in prices during the difficult recessionary years.

¹ The four episodes are: (1) a recession in the early 80s (when there was a huge devaluation), (2) the Tequila crises (when Mexico devaluated its currency at the end of 1994, with a negative influence in Argentina economy), (3) the end of Convertibility, an anti-inflationary plan, with a subsequent devaluation, and (4) the international financial crisis.

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