

# MACRO-ECONOMIC IMPACT OF THE WINE INDUSTRY ON THE WESTERN CAPE

## SUMMARY

### STUDY DONE BY CONNINGARTH CONSULTANTS FOR SAWIS (SOUTH AFRICAN WINE INDUSTRY INFORMATION AND SYSTEMS)

#### 1 RECENT DEVELOPMENTS

- In overall terms, the liquor trade in 2003 was not as buoyant as in 2002. The interest rate and tax cuts had just been made and had not worked through to increased spending by consumers. In fact demand for lower priced white wines declined.
- The wine industry has been doing battle with an unstable Rand currency. The Rand depreciated to R12 to the US Dollar at the end of 2001 and then regained its strength to an average of R7,50 to the dollar in 2003.
- Local liquor prices (including wine) increases have outstripped that of overall inflation. This increase in wine prices is mainly a function of supply and demand although production input costs rises could also not be absorbed in total. This led to price reductions in certain instances but increases in others.
- Liquor consumers now started to “downtrade”, i.e. buying more beer, to the detriment of lower priced wines. A certain section of the market switched towards more premium brand wines and flavoured alcoholic fruit beverages.
- It is important to note that since the previous study (2000), as was predicted then, the growth in the wine industry has come from the young plantings of red varieties that have come into production. The demand of white varieties continued to decline, which led to a decline in the local supply of white wines.

#### 2 INSTITUTIONAL CHANGES AND FUTURE STRATEGY

The wine industry is currently in the process of transformation as reflected by the changes in its economic structure and institutional framework. To deal with the challenges that lie ahead, the South African Wine Industry set in motion a strategic process to focus and ensure that the industry's transformation is in line with the dominant trends in the domestic and global wine business environments. This project, called Vision 2020, involved research in three stages over a six month period each and its results are now being implemented. A few outstanding outcomes are as follows:

- A formal representative structure, the South African Wine and Brandy Company (SAWB) was established in 2002 by representatives of the wine producers, cellars, labour and wholesale merchants, with the aim of implementing the Vision 2020 strategic outline to ensure the industry's development towards global competitiveness.

- The Wine Industry Plan (WIP) was prepared by the SAWB with the purpose to align the country's Vision 2020 initiative with the Strategic Plan for SA Agriculture. The WIP is a commitment by the South African wine industry to deal with the legacy of a highly regulated economic environment and challenges such as, increasing global competitiveness and discrimination along racial and gender lines.
- The first active steps toward the drafting of a South African wine industry Black Economic Empowerment (BEE) Charter and Scorecard, have been after representatives from all sectors of the wine industry recently approved the industry's transformation plan. The BEE Charter will have a major impact on the wine industry and could play a profound role in increasing its competitiveness.

### **3 MAIN ECONOMIC ATTRIBUTES**

#### **3.1 TURNOVER**

The total turnover of the wine industry in 2003 amounted to R10 675,27 million. Of that amount R3 153,40 million was exported directly. Imports amounted to R274,46 million or  $\pm 3,6\%$  of domestic sales. In actual fact, primary agricultural output valued at R2 597,44 million was beneficiated and added in value downstream to the value of R10 675,27 million i.e.  $\pm 4$  times the initial value of the raw materials. An additional amount of R4 198,37 million was generated indirectly through wine tourism.

Compared to the 2000-study, it is evident in table 1 below that the wine industry as a whole did somewhat better over the 1999 – 2003 period. Total turnover grew by 44,86% (i.e.  $\pm 11\%$  p.a.). The growth in value of domestic sales in nominal terms, over the period 1999 – 2003, amounted to  $\pm 7\%$  p.a.

**Table 1 Economic structure and the flow of goods and services**

Market Segment Economic Sector	Turnover added at each phase	Exports	Domestic Sales	Current import level	Potential Import source of business	Western Cape <sup>1</sup> sourced production
<b>R Million, 2003</b>						
1 Primary Agricultural Production						
2 Cellars		(191.74)				
<b>Total Primary</b>	<b>2,597.44</b>	<b>191.74</b>	<b>2,405.70</b>			<b>2,405.70</b>
3 Manufacturing Wholesale & Retail						
3.1 Manufacturing	3,274.27	1,701.08	1,573.19	116.05	5,847.20	1,573.19
3.2 Total Trade & Transport	3,910.45	1,260.58	2,649.87	77.29		2,649.87
3.3 Taxes (VAT & Excise)	893.10		893.10	81.12		893.10
Sub-total	8,077.83	2,961.66	5,116.16	274.46	5,847.20	5,116.16
<b>TOTAL (1+2+3)</b>	<b>10,675.27</b>	<b>3,153.40</b>	<b>7,521.87</b>	<b>274.46</b>	<b>5,847.20</b>	<b>7,521.87</b>
4 Tourism						
4.1 Foreign	913.90	913.90				913.90
4.2 Local	3,284.47		3,284.47			3,284.47
Sub-total	4,198.37	913.90	3,284.47	-	-	4,198.37
<b>GRAND TOTAL</b>	<b>14,873.64</b>	<b>4,067.30</b>	<b>10,806.34</b>	<b>274.46</b>	<b>5,847.20</b>	<b>11,720.23</b>

<sup>1</sup> Including Orange River production

Excluding all export activities for this exercise

As in the previous study, an attempt was made to estimate what the effect would be on the country's economy if the wine producing activities in the Western Cape would cease to exist. It was concluded in broad terms that local businesses would "lose" R7 521,87 million if the Western Cape ceased to provide the raw materials for wine production. On the other hand, if totally sourced from raw material imports, "new" business worth R5 874,2 million would probably take the place of the existing activities.

### 3.2 CONTRIBUTION TO GDP

The wine industry (including tourism) contributes R22 549 million to annual GDP of the country. Starting at farm level, the initial value of the raw material in terms of income (GDP) created, amounts to R1 593 million and ultimately leads to a total GDP value of R16 318 million (excluding tourism). The primary agricultural sector has a low direct/indirect ratio of 1:1,3 compared to the 1:2,8 of the manufacturing sector.

However the question is whether the wine industry contributes a fair and reasonable share to GDP per unit capital invested compared to other industries. The study showed that its GDP/Capital ratio of 0,46 is only slightly lower than the national average (0,47). Even though this is not a measure of the profitability of the industry it does signify that its capital "productivity" is in line with the average for the national economy.

The wine industry, obviously, has its roots in the Western Cape. By using a Western Cape SAM based model, it is estimated that 70 per cent of the industry's activities have a direct impact on the Western Cape's economy. A

rough estimate therefore shows that of the R16,3 billion of GDP that the industry creates, about R11,4 billion eventually would remain in the Western Cape to benefit its residents. In 2003 this would have amounted to approximately 8.2 per cent of the Western Cape's total Gross Geographic Product (GGP).

### **3.3 INCOME DISTRIBUTION**

A total household income of R10 607 million was generated by the wine industry in 2003 (excluding tourism). Of this 18 per cent or R1 910 million is destined for the lower income groups of which a large portion is spent in the Western Cape region. Coupled with the annual expenditure by farmers on production inputs, it is clear that the wine industry forms the economic backbone of the economy of many districts in the Western Cape.

The 18 per cent of household income generated by the wine industry (excluding tourism) destined for low-income households, is only slightly below the average for the economy as a whole (18.4).

### **3.4 EMPLOYMENT**

The wine industry supports employment opportunities for 256 908 people including tourism. According to the Labour/Capital ratio (5.51) it is obvious that capital is applied slightly more effectively regarding job creation as the ratio is slightly higher than that of the national economy (5.04). The relative labour intensiveness of the wine industry is specifically the result of the intensive labour production methods which are followed in the primary agriculture i.e. farming (ratio of 5.9). Primary agriculture is responsible for 24 per cent of the total employment generated by the industry. On the other hand, it uses 46 per cent of the capital employed directly by the wine industry in total (excluding tourism).

It is significant to note that the wine industry directly and indirectly supports 197 579 (excluding tourism) job opportunities throughout the economy. The industry directly employs 108 675 people. The primary agricultural sector of the wine making process directly employs the most people, while directly and indirectly it is also responsible for 56% of the jobs which are dependent on the wine industry if the tourism industry is included. Tourism as such contributes roughly 23% of the grand total.

**Table 2 Employment**

ECONOMIC SECTOR	1999		2003	
	TOTAL	%	TOTAL	%
<b>A PRIMARY AGRICULTURE</b>	<b>68 226</b>	<b>32.8</b>	<b>61 603</b>	<b>24.0</b>
Direct	55 218		43 718	
Indirect	13 007		17 885	
<b>B CELLARS</b>	<b>9 461</b>	<b>4.5</b>	<b>6 026</b>	<b>2.3</b>
Direct	3 455		1 838	
Indirect	6 006		4 188	
<b>C MANUFACTURING</b>	<b>32 824</b>	<b>15.8</b>	<b>47 514</b>	<b>18.5</b>
Direct	15 755		19 633	
Indirect	17 069		27 881	
<b>D WHOLESALE and RETAIL</b>	<b>49 442</b>	<b>23.7</b>	<b>82 435</b>	<b>32.1</b>
Direct	29 372		43 486	
Indirect	20 070		38 950	
<b>WINE INDUSTRY</b>	<b>159 952</b>	<b>76.8</b>	<b>197 579</b>	<b>76.9</b>
Direct	103 800		108 675	
Indirect	56 152		70 025	
<b>E TOURISM</b>	<b>48 346</b>	<b>23.2</b>	<b>59 329</b>	<b>23.1</b>
Direct	14 536		17 335	
Indirect	33 809		41 995	
<b>TOTAL</b>	<b>208 298</b>	<b>100.0</b>	<b>256 908</b>	<b>100.0</b>
Direct	118 336		126 009	
Indirect	89 962		130 899	

### 3.5 CAPITAL UTILISATION

A capital stock of R13 440 million (2003 prices) is required directly in the wine industry to sustain a level of production/turnover of R10 675 million. Indirectly a further R22 419 million of capital is required in the supporting industries to sustain this level of production (excluding tourism).

The wine industry is probably more capital intensive than believed. Although the primary agriculture portion of the wine industry is relatively labour intensive, the other portions of the industry (i.e. cellars and refining) are more capital intensive. On average the total industry (including tourism) is on par with the economy as a whole.

## 4 CONCLUSION

The South Africa African wine industry has gone through a tough period of major changes over the past 10 years, as largely reflected by the changes in its economic structure and institutional framework. Its re-introduction into world markets has brought about huge opportunities, as reflected by the increase in exports, but on the other hand has brought pressure on its competitiveness, both locally and overseas.

Due to this situation, the industry has embarked on a process of strategic planning and re-focussing over the past number of years. The project, named Vision 2020 is aimed to design specific strategies for the three wine sectors, namely brandy, wine distillates and other grape-based products. The purpose of The Wine Industry Plan (WIP) that was prepared by the South African Wine and Brandy Company (SAWB) is to align the industry's Vision 2020 initiative with the Strategic Plan for South African Agriculture.

The strategic goals of the South African wine industry are:

- To increase global competitiveness and profitability;
- To generate equitable access and participation within the wine value chain;
- To enable environmentally sustainable production systems; and
- To promote social responsible consumption of the produce of wine.

The wine industry's size and structure in terms of forward and backward linkages has been proved to be substantial. Its magnitude in terms of, for example investment, employment and income generating activities, not only in the Western Cape, proves to be of crucial importance to the South Africa's economic well-being. This is in terms of the contribution to the economic existence and well-being of lower income groups, especially on wine farms, demonstrating its vital social and development role, particularly in the rural context.

The industry has acknowledged the challenges that need to be addressed in a co-ordinating way to ensure its long-term financial viability. It will have to become more market-driven and will need to ensure its information requirements are met on a more regular basis.

The following table is a summary of the macroeconomic impact analysis of the wine industry.

<b>Criteria</b>	<b>1999</b>		<b>2003</b>	
<b>Macroeconomic indicators</b> (Tourism included)				
GDP (R million)	14 557		22 549	
Total labour	208 298		256 908	
Total capital (R million)	38 263		51 392	
<b>Household income</b> (Tourism included)				
Total (R million)	9 764		14 715	
Low-income groups (R million)	1 798		2 623	
<b>Effectiveness criteria</b>	<b>Western Cape</b>	<b>Total economy</b>	<b>Western Cape</b>	<b>Total economy</b>
GDP/Capital ratio *	0.38	0.47	0.44	0.47
Labour/Capital ratio **	5.4	5.0	5.00	5.04
Low income/total income (%)	18.4%	19.2%	17.83%	15.41%
Income ratio ***	3.1	-	-	-

\* The GDP/capital ratio for the wine industry, including tourism is 0.44. It means that for every R1 invested, R0.44 of income (GDP) is generated.

\*\* Every R1 000 000 investment creates 5 jobs.

\*\*\* The total income ratio for the wine industry in 1999 was calculated at 3.1. This means that for every R1 production-factor income generated directly in the industry, R3 will be generated throughout the economy based on its sectoral backward linkage structure.