Winemakers' Federation of Australia
For the Industry by the Industry

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WINEMAKERS' FEDERATION OF AUSTRALIA

SUBMISSION TO THE AUSTRALIA-CHINA FREE TRADE AGREEMENT FEASIBILITY STUDY

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ABOUT THE WINEMAKERS' FEDERATION OF AUSTRALIA INCORPORATED (WFA)

The Winemakers' Federation of Australia Incorporated (WFA) is the national peak body for the wine industry with voluntary membership representing more than 95% of the wine produced in Australia. The Federation consists of two electoral colleges, the Australian Wine and Brandy Producers Association and the Australian Regional Winemakers' Forum.

WFA's direction and activities are driven by the Winemakers' Federation of Australia Executive Council, which is made up equally of representatives from the two electoral colleges. Executive Councilors have one vote regardless of the size of the company they represent. The Winemakers' Federation of Australia (WFA) is recognised in legislation and in all other areas as the peak body for the Australian wine industry. As such, it develops policies and programmes that are in the interests of the whole industry.

Making decisions on an 80% majority basis to ensure equitable representation of small and medium as well as large winemakers, WFA delivers a strong, unified voice on a range of political, social, environmental, trade and technical issues. WFA represents the industry's interests on national / international issues, on issues that may be local but have national implications, or on issues where a State Association has sought WFA's assistance.

INTRODUCTION

While the market for wine in China is still in its infancy, with total consumption of less than 1/3 litre per capita, domestic wine production is increasing and showing a gradual improvement in quality. As income levels continue to rise, along with strong forecast economic growth, there are clear opportunities for imported wines in the longer term.

Although the wine market in China is emerging from almost zero consumption a decade ago, there is already a small but loyal following in major urban areas. The urban consumer class, which is estimated to exceed the total population of the United States, should develop as wealth increases into a substantial market for both imported and domestic wine.

Beijing and Shanghai are generally considered to have the largest markets for western foods and most major hotels and restaurants feature wine quite prominently. Red wine is becoming fashionable at lounges, night clubs, discos and some upscale Chinese restaurants and banquets. Wine consumption, especially imported wine, is virtually nonexistent outside of major cities.

Most domestic wine production has been produced from domestic grapes blended with cheap imported bulk wine often resulting in low price wines which dominate the bottom end of the market. However, as domestic grape production has increased and wine production techniques improved, the importation of bulk imports for blending has dramatically decreased. The top end of the market is dominated exclusively by imported labels.

Wine is also available in some retail outlets, but local consumers tend to use wine for toasts in social settings rather than at home over a meal. Most consumers are attracted to wine by the positive press accounts of its health benefits rather than for its taste. Undoubtedly, it will take time for a wine culture to develop in a country that is truly unexplored territory in terms of wine appreciation.

Price is a major consideration to most Chinese, and imported wine is out of reach to most consumers. A domestic bottle of wine may retail for as little as US$3 while imported wine is generally $10-$20 a bottle or more.

DOMESTIC PRODUCTION[1]

About twenty years ago during China's initial opening to the west, several joint venture wineries, mostly Sino-French or Hong Kong invested emerged and laid the ground work for the current industry. Development of the grape wine industry has been assisted by official government encouragement to divert consumption from grain-based high alcohol wines like baijiu. The press often prints articles extolling the health benefits of red wine in particular.

Wine production in China has developed and is projected to continue to develop at a healthy rate of 12-15% per year. There are about 190,000 hectares of land in China planted to grapes. The regions of Xinjiang, Tianjin, Shandong, Liaoning and Henan are suitable for wine grape production.

Chinese grape wine quality did not have a good reputation, but this is rapidly improving. Chinese wine companies in many cases have brought in European expertise and are developing a sizeable domestic wine industry capable of turning out some very passable wines. A well known UK wine critic visiting China was quite impressed with the Chardonnay from Huadong winery in Qingdao and also expressed great interest in wines from Xinjiang province.

The market is dominated by domestic brands such as Dynasty, Great Wall, Dragon Seal and Imperial Court. The major local companies are described below:

- GREAT WALL: Possibly China's best known brand, located in Zhangjiakou, in Hebei province, owning a 750,000 m^2 vineyard at Shacheng. Total production is about 50,000 tons per annum, spread amongst seven different types. Of this about 1,500 tons are exported annually - just under 50% of China's total wine exports. Established in 1983.
- DRAGON SEAL: Founded in 1987 with the French corporation Pernod Ricard. Has 12 million m^2 vineyards in South Beijing and Shacheng in Hebei. Annual capacity is 40,000 tonnes. Real production of 2001 is more than 10,000 ton.
- CHANGYU: Changyu is the largest wine manufacturer of Asia, with employees of 4,000, total assets of 2.29 billion RMB, annual capacity of 80,000 ton. Products are exported to Malaysia, America, Holland, Belgium, Korea, Thailand, Singapore, Hong Kong and elsewhere. www.changyu.com.cn/english/about/index.asp.
- HUADONG: Established in 1985, has a total of 5 vineyards of 10 million m^2 in Shandong, close to Qingdao. Annual production capacity is 60,000 ton, specializing in white wine varieties: www.huadongwinery.com/egsjj.htm

[1] *The Wine Market in China*, May, 2003, The Canadian Embassy, Beijing

- LOU LAN: Producing 5,000 tons per annum from their own vineyard. Extensive use and partnerships with French experts produces a wide range of wines. Established in 1976.

IMPORTS OF WINE[2]

Chinese imports of wine are still at a relatively low level, but lower tariffs due to WTO accession have provided a spike to imports (see tariff section). According to AUSTRADE, in 2003, Australia exported a total of 995,629 litres of wine (HS Code. 2204) to China, an increase of 36.31 per cent compared with the previous year.

Australian wine is gradually gaining popularity and reputation for its premium quality in the market. As the table below shows, Australian wine ranked second in terms of its export volume to China for bottled wine in 2003 (HS code: 2204 2100):

Country	2001	2002	2003
France	990,921	1,542,317	1,857 783
Australia	**428,519**	**626,202**	**797,402**
USA	371,103	442,276	544,914
Spain	91,017	247,052	326,369
Italy	186,955	294,141	309,476
Chile	35,921	143,009	182,793

(Source: China Customs)

More Australian wine exporters have entered or are preparing to enter the Chinese market as a result of liberalised trade practices since China's accession to the World Trade Organization.

China is still an **emerging market for wine**, however, the market has become much more sophisticated and competitive. Not only are there more foreign wine imports available in restaurants and in the shops, but the number, variety and quality of domestic wines has also increased. This has served the market by providing local consumers with a great array of cheaper products to try.

High quality wine in China is actually the medium-end wine in Australia. The acceptable **retail price** for Australian wine ranges from A$12.50–A$23 in Shanghai retail markets or bars. If we trace back this kind of wine to FOB price, the price might be A$5–A$8. There are lots of middle costs involved: tariff duty, value added tax, consumption tax, Chinese label registration cost, importer cost, distributor's margin, entrance fee or listing fee to retailers/hotels/bars, etc. The market is small in China for any Australian wine with FOB price over A$12.

[2] AUSTRADE

Retail Prices[3]

The following retail wine prices in Beijing stores were representative of the market prices for wine (May 2003). The approximate exchange rate for the Renminbi (RMB) which is the official Chinese unit of currency, is 8.3 RMB = 1 USD.

Retail Wine Prices in Beijing Stores	
750 ml bottles	**Price (RMB)**
Red (domestic)	
Dragon Seal Cabernet Sauvignon	55
Dragon Seal dry red	33
Dragon Seal Gamay	56
Dynasty Extra dry red	34
Great Wall Dry Red	30
Red (imported)	
Chateau St. Pierre dry red (US)	45
Jacobs Creek red (Australia)	109
Calvet red (France)	118
Gaston Cabernet Sauvignon(France)	88
Zonin Valpolicella (Italy)	72
BIN 555 Sauvignon (Australia)	156
White (domestic)	
Dynasty extra dry	28
Great Wall Dry	22
Dragon Seal dry	29
Dragon Seal Chardonnay	46
White (imported)	
Wyndham Estate Bin 222 (Australia)	156
Zonin Sauve (Italy)	68
Gaston Chardonnay	95
Jacob's Creek Chardonnay (Australia)	109
Chateau St. Pierre (USA)	42
Chateau Maine (France)	137
Bois de Graves (France)	119

TARIFFS, REGULATIONS AND QUOTAS

China imposed an import tariff of 65 percent on wine before its WTO membership. This, plus consumption tax and value added tax, made the total tax amounting to 150 percent.

As part of China's WTO agreement, the tariff on wine in bottles under 2 litres will be reduced from 65% to 14% and the tariff on wine in bulk will be reduced to 20%. The

[3] *The Wine Market in China*, May, 2003, The Canadian Embassy, Beijing

following table illustrates the drop from 65 per cent to 14 per cent over a four-year period:

Tariff code	**2001**	**2002**	**2003**	**2004**
22042100 (wine in less than 2L container)	65%	34.4%	24.2%	14%
22041000 (sparkling wine)	55%	34.4%	24.2%	14%

In addition to the above tariff rates, the following **taxes apply** to wine in China:

1. Import duty - 14 per cent
2. Value added tax - levied at 17 per cent
3. Consumption tax **-** levied at 10 per cent

Chinese customs officials have implemented **a minimum value** of A$4.35 per litre of wine since 1 April 1997.

According to Beijing Customs, wine imports soared up this year due to tariffs lowered to 14 percent from 44.6 percent. For the first quarter of this year, Beijing imported 1.175 million worth of 1997 tons of wine, up 46 percent and 25.4 percent respectively.[4] The reduction of the tariff has given foreign wine improved access to Chinese market. This in turn has triggered a price war among domestic wine producers.

LABELING

The **Labelling Law** regulates the content of print on foreign food packages. Although this is a significant expense for companies, labelling is necessary to protect local consumers.

From April 2000, the Chinese Government began to tighten up the **labelling control regulation**, which stipulates: 'All importers and exporters or their agents should submit applications for examination and verification of food labels to the designated inspection and quarantine organisations before conducting imports and exports. The new Chinese food labeling law was designed and promulgated by the State Bureau of Technical Supervision to apply to pre-packaged food and beverage products to be marketed in China including alcoholic beverages, and closely follows standards recommended by the FAO and World Health Organization's CAC (CODEX STAN 1-1991). The law only applies to labels on "delivery units" that are pre-packaged for retail sales, but does not affect "shipping units" and bulk goods. The new law was put into effect on September 1, 1996, which also marked the start of banning the use of temporary adhesive labels (Chinese language stickers.

All the examined and verified labels must be printed on the retail package containing the following information (minimum) in Chinese:

- product and brand name(s)
- ingredients
- net content (ml)
- alcoholic content (%) (V/V)
- production date (yy/mm/dd)

[4] *People's Daily Online, May 27 2004*

- packer/distributor (name and address)
- content of must (%) (sake is exempt from this requirement)
- country of origin
- quality guarantee and or storage period (yy/mm/dd)
- content of sugar (gram/l)

The Chinese label must be **approved and registered** by the State Administration for Entry and Exit Inspection and Quarantine in Beijing before printing and placing on the product. The application for approval of the Chinese label can be arranged through the importer or agent (cost should be covered by Australian suppliers). The cost for applying Chinese label is approximately A$300 for one label/sku. The application and approval time will be longer than three months and often up to twelve months.

Despite the law banning the use of temporary adhesive labels, many foreign wines continue to carry a small and simple label with a Chinese translation that is stuck on the package either before delivery to China or by the Chinese importer under the supervision of a Chinese inspection and quarantine organisation. Austrade recommends, however, that food exporters who are keen to export to China, and who intend to expand their **export businesses should follow the labeling regulations correctly** to ensure that their long-term business runs smoothly.

Import inspection, food hygiene certificate, **and Chinese labeling** are required. The State Administration for Entry and Exit Inspection and Quarantine (CIQ-SA) is responsible for inspecting all imported foods and beverages for the following:

- sanitation and health
- quality
- quantity
- weight
- visible and invisible problems (eg. residues of pesticides, antibiotics, etc.)
- labelling

DISTRIBUTION CHANNELS

Traditionally wine entered the Chinese market via two channels:

- China National Cereals, Oils & Foodstuffs Import and Export Corporation (CEROILS), the state monopoly wholesaler and distributor of alcoholic beverages.
- Joint venture and foreign-owned hotels, as well as duty free stores under China Travel Services (CTS). Generally a limited channel as products were restricted from general distribution.

In addition to the above two import channels, there is the 'grey channel' through Hong Kong[5] and Guangzhou where product is imported in a manner to avoid the high duties and taxes. The significant decline in duty rates together with stronger enforcement by government of Customs regulations is resulting in a decline in volume of smuggled product.

[5] The Hong Kong Special Administrative Region of the People's Republic of China "HKSAR" is a free port and does not levy any customs tariff on imports. There is also no tariff quota or surcharge. There is no value added taxes nor general services taxes. Excise duties are levied on wine at 80%.

Domestic distribution channels for imported wine are still in their infancy. For the most part the importer or brand owner must be directly involved in the actual selling by placing a team to work along side the domestic distributor. Chinese distributors serve mainly as warehouse and invoicing agents who reluctantly devote their own resources to develop their territory customer base for the imported products.

As a result, some of the leading wine importer/distributors now engage in all aspects of sales and marketing in the domestic market, including climate-controlled warehousing, trade education, market promotion, sales, and delivery.

Alcohol distribution companies throughout China range from more tightly controlled government companies like Ceroil in Beijing, to 100% independent private companies who have strong government/police connections but are free from government control/bureaucracy.

WHY CHINA

Many changes have occurred in the Australian wine industry over the last five years. In particular, there has been major growth in Australian export sales and a significant increase in the supply of Australian winegrape. These changes present both opportunities and challenges to the Australian wine industry.

In order to convert these changes into opportunities, a marketing strategy for the Australian wine industry has been developed for the next decade. This marketing strategy titled *The Marketing Decade* focuses on issues such as international competitiveness, market development and the generic branding of wine brand "Australia"[6]. In this document, it is made clear that Australia needs to diversify it exports of wine from its traditional markets. Asia offers major opportunities to its high economic growth and increasing westernization of tastes.

INTERNATIONAL DEVELOPMENTS

China has recently undergone significant change to prepare for accession to the WTO. Clearly it will be difficult for China to accept a rapid reduction in tariff barriers in the context of an FTA with Australia. Therefore, while we should seek elimination of tariffs over the longer term, the major benefits to the Australian wine industry will come from liberalising technical regulations. In particular, these include labelling, certification procedures (to overcome long time frames) and food standards inconsistencies. In addition, Australia needs to ensure that our rights under the WTO Agreement on Trade Related Aspects of Intellectual Property (TRIPS) are maintained, particularly as they refer to Geographical Indications for wine. Negotiations need to ensure, *inter alia*, rights under Article 24.6 are maintained.[7]

[6] www.wfa.org.au

[7] Article 24.6. Nothing in this Section shall require a Member to apply its provisions in respect of a geographical indication of any other Member with respect to goods or services for which the relevant indication is identical with the term customary in common language as the common name for such goods or services in the territory of that Member. Nothing in this Section shall require a Member to apply its provisions in respect of a geographical indication of any other Member with respect to products of the vine for which the relevant indication is identical with the customary name of a grape variety existing in the territory of that Member as of the date of entry into force of the WTO Agreement.

CONCLUSION

WFA believes that there are considerable benefits to the wine industry from commencing negotiations with China on a Free Trade Agreement. The market has great potential and as Australia is increasingly looking to diversify its markets China, with its high economic growth and large wealthy population is an obvious target. Clearly there are some areas of trade impediments which could be addressed through an FTA, which could enhance Australia's export competitiveness in the wine sector.