

# **AUSTRALIA – CHINA FREE TRADE AGREEMENT**

## **AUSTRALIAN WINE AND BRANDY CORPORATION SUBMISSION JUNE 2005**

### **CONTEXT**

The Australian Trade Minister Mark Vaile and the Vice Minister of the Chinese Ministry of Commerce, Wei Jianguo launched the first round of Australia-China FTA negotiations in Sydney on 23 May.

Together with the Head of Australia's China FTA Task Force, Ric Wells, discussions focused on negotiating procedures, laying the basis for future negotiations. It was agreed that the second round of talks would be held in China in August and would involve an in-depth exchange of information.

The China FTA Task Force is also now continuing its program of public and stakeholder consultations.

The China FTA Study Taskforce of the Department of Foreign Affairs and Trade (DFAT) has called for submissions concerning the Australia – China Free Trade Agreement (FTA) with a deadline of 17<sup>th</sup> June 2005.

The Australian Wine and Brandy Corporation (the Corporation) has identified China as a priority emerging market for the Australian wine industry and is strongly supportive of the FTA. The purpose of this paper is to identify the trading opportunities for, and the challenges being faced by, Australian exporters selling wine in the Chinese market. The paper also makes a number of recommendations to improve the trading environment for Australian wine in China.

### **BACKGROUND**

#### ***The Australian Wine and Brandy Corporation***

The Corporation is a Commonwealth statutory body established by the Australian Wine and Brandy Corporation Act 1980. The functions of the Corporation established by the Act are:

- To promote and control the export of grape products from Australia;

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- To encourage and promote the consumption and sale of grape products both in Australia and overseas;
- To improve the production of grape products in Australia;
- To conduct, arrange for, and assist in, research relating to the marketing of grape products; and
- Such other functions in connection with grape products as conferred on the Corporation by the Act or Regulations.

The Corporation performs its functions and exercises its powers for the purpose of achieving the objects specified in the Act. These are:

- To promote and control the export of grape products from Australia;
- To promote and control the sale and distribution, after export, of Australian grape products;
- To promote trade and commerce in grape products among the States, between States and Territories and within the Territories;
- To improve the production of grape products, and encourage the consumption of grape products, in the Territories;
- To enable Australia to fulfil its obligations under prescribed wine trading agreements;
- For the purpose of achieving any of the objects set out in the preceding paragraphs:
  - to determine boundaries of the various regions and localities in Australia in which wine is produced;
  - to give identifying names to those regions and localities;
  - to determine the varieties of grapes that may be used in the manufacture of wine in Australia;
- To advance the objects of the Act by helping to ensure the truth, and the reputation for truthfulness, of statements made on wine labels, or made for commercial purposes in other ways, about the vintage, variety or geographical indication of wine manufactured in Australia; and
- To regulate the sale, export and import of wine:

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- for the purpose of enabling Australia to fulfil its obligations under prescribed wine-trading agreements;
- for certain other purposes for which the Parliament has power to make laws.

### **Consultative Process**

The information provided in this paper is based on comments received directly from Australian wine exporters via a survey in 2004 and further consultations in respect to the development of a Strategic Marketing Plan for China in 2005.

### **DISCUSSION**

#### **Opportunities in China for Australian Wine**

##### ***Wine Market in China***

China is a growing wine market with great potential in the medium to long term. Since 1995 per capita consumption of wine in China has grown by an average of 10% per year although it is still at a modest 0.2 litre per year. It is, however, expected to accelerate over the next five years.

Local wine production is also on the increase. According to the China Alcoholic Beverages Association there are currently approximately 450 wineries in China producing nearly 370,000 tones of grapes although projections suggest that this year's vintage is likely to reach 500,000 tonnes. Large scale production has really only taken off in the past 10 - 20 years and is expected to continue to develop at a rate of 12 – 15 % per year.

##### ***Australian Wine Exports***

Australian exports to China are currently valued at \$9.8 million with a MAT growth rate (as at May 2005) of 51% by volume and 86% by value.

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China is very much an embryonic market for wine, but recent developments have resulted in a growing, sophisticated and competitive market environment.

According to China Customs, overall in the 12 months leading up to December 2004, China imported a total of 43.8 million litres of wine of which 36.7 million litres was in bulk (29.8 million litres from Chile). While bulk sales experienced zero growth compared to the previous year Bottled wine (750ml) imports increased by 54%. Currently, Australia is the second largest exporter of bottled wine to China.

#### ***Australian Wine Export Strategy***

The Corporation through the Australian Wine Export Council (AWEC) ,a committee of the Corporation has recently identified and prioritised China as an embryonic market of future significant potential. AWEC has prepared a Strategic Plan for 2005/08 for China and allocated a budget towards the achievement of that plan. The key performance indicators of that Plan are:

- To establish and broaden market awareness of Australian wines in China
- Provide opportunities for the Australian wine industry to capitalise on market awareness and access activity
- Increase the Australian wine category in China by range, price points and channel distribution in China by 2008.

#### ***Challenges in China for Australian Wine***

##### ***Tariffs and Taxes***

As part of its accession to the World Trade Organization (WTO) China reduced its tariff on sparkling wine and other wine in containers holding 2 litres or less from 65% to 14% and for other wine in containers holding more than 2 litres to 20% on 1 January 2004. It was understood that the tariff was to be phased in yearly, however for 2005 the rate remains at 14% with a further reduction to 10% anticipated by 2006 when China's WTO compliance period expires. While such a reduction in tariffs is

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very positive for the Australian wine industry, we would like to see the removal of all tariffs on wine.

The Corporation is unaware of any preferential arrangements in place between China and other wine exporting countries. However, it is noted that in the report prepared by ABARE Economics in 2002 *World Wine Market Barriers to Increasing Trade* that China has agreements with both the EU and the US on wine trade.<sup>[1]</sup> As part of the negotiations we would appreciate clarification as to whether any preferential arrangements are in place between China and third countries relating to wine and, if so, to what extent these arrangements apply.

In addition to tariffs, Australian wine also faces internal taxes in China - a VAT of 17% and a Consumption Tax of 10%, with Chinese Customs implementing a minimum value of AUD\$4.35 per litre of wine since 1 April 1997 although a more practical methodology appears to be practiced at some ports where taxes are evaluated on actual price/value. Several exporters have experienced a lack of transparency in the implementation of the internal tax system, noting discrepancies between the official published tax rate and the rate applied at the port of entry.<sup>[2]</sup> There is also a concern that China may increase internal taxes to offset the lower tariffs.

#### **Recommendations:**

- **Seek the removal of all wine tariffs for trade between Australia and China;**
- **Remove minimum values for the purposes of calculating tariffs to be replaced with declared value;**
- **Seek clarification on any preferential agreements regarding wine that China may have in place with a third country eg EU, US etc;**
- **Clarify whether China is considering any increase in internal taxes on wine; and**

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<sup>[1]</sup> Abare Economics, *World Wine Market Barriers to Increasing Trade*, September 2002, p. 90.

<sup>[2]</sup> Wine Institute International Wine Trade Barriers Report, 2003, p. 34.

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- **Seek improved transparency in the implementation of the tax system in China.**

#### ***Transparency of Wine Regulations***

As part of its WTO accession commitments China agreed to make available to the public all of its business laws and regulations. The Corporation has experienced difficulty in obtaining copies of all of the Chinese laws relating to wine (including analytical testing and labelling requirements) in English. It is understood that the only standards for wine are those identified in the National Standard of China for Wine (GB/T 15037-94). Changes to the Standard have been proposed for implementation this year. While these changes will hopefully overcome current idiosyncratic practices we should encourage China to adopt internationally accepted practices. The current standards, and lack of clear definitions, This has not only made it difficult to prepare a detailed analysis of Chinese wine laws for the purpose of this paper but has been the source of frustration for many Australian wine exporters.<sup>[3]</sup> We would appreciate clarification as to where we can access copies of China's wine laws in English.

As part of the negotiations and consistent with the standards accepted within the New World Wine Group, Australia should pursue mutual recognition of practices in relation to winemaking and labelling.

#### **Recommendations:**

- **Seek agreement that relevant Chinese wine laws be accessed in English and agreed to by the parties.**
- **Seek acceptance of internationally recognised winemaking and labelling practices as mutually agreed to by the World Wine Trade Group**

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<sup>[3]</sup> Abare Economics, *World Wine Market Barriers to Increasing Trade*, September 2002, p. 90.

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#### *Intellectual Property*

Concerns have been raised by a number of exporters regarding the protection of intellectual property rights in China, particularly their enforcement. Despite many changes being made to Chinese intellectual property laws as a result of its WTO accession, there does not appear to have been any significant improvement in the area of enforcement. This in turn may have a negative impact on Australian wine export growth in China.<sup>[4]</sup>

#### **Recommendations:**

- **Seek further information undertakings from the Chinese Government as to its program for the enforcement of intellectual property laws.**

#### *Distribution*

Traditionally Chinese law has required that all importers of goods (including wine) be Chinese nationals. This has been a major barrier to Australian penetration of the Chinese wine market. Australian wine exporters have faced great difficulty in finding well connected local Chinese distributors who are willing to expand their wine product portfolios to include Australian wine. However, through its WTO accession China has committed to the reform of this law and as from 11 December 2004 foreign companies will be able to own 100% subsidiaries in China to act as their importers/distributors. It is too early to tell what the impact of this reform will be. The Corporation will be in a better position by the end of 2005 to provide further comment on this issue i.e. whether any improvements are being seen to the distribution of Australian wine in China.

#### **Recommendations:**

- **Seek further information undertakings from the Chinese Government as to its program for the opening up of distribution channels to foreign owned companies.**

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<sup>[4]</sup> Ibid., p. 51.

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#### *Labelling*

Wine labels entering China are required to contain the following mandatory pieces of information in Chinese:

- product and brand name(s);
- ingredients;
- net content (ml);
- alcohol content (%) (V/V);
- production date (yy/mm/dd);
- packer/distributor (name and address);
- content of must (%);
- country of origin;
- quality guarantee and or storage period (yy/mm/dd); and
- content of sugar (gram/l).

The law discourages the use of separate adhesive labels containing these mandatory items in the Chinese language (a practice that had previously been widely used by foreign wine exporters). This requirement has been more vigilantly enforced by the Chinese Government since 1 March 2003.

Labels must be submitted for examination, verification, approval and registration by the Chinese State Administration for Entry and Exit Inspection and Quarantine before the label can be printed and placed on the wine. The wine also needs to be tested, chemically analysed and approved by the SAEEIQ. The cost of obtaining such an approval is approximately AUD\$300 per label with exporters having to wait a minimum of three months to have their application processed. Many Australian exporters report even longer timeframes (6 to 9 months from application). There are also issues with consistency in interpretation and enforcement of China's labelling regulations. All of these factors are significant impediments to Australia's wine trade into China.



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#### **Recommendations:**

- **Seek a significant reduction in the time taken and the cost for Chinese label approvals;**
- **Seek the removal of the requirement to register labels in China;**
- **Improve the transparency of Chinese labelling laws eg through the publication of a plain English guide to labelling in China, easily accessible publication of the law in English, publication of a standard documentation package for China etc; and**
- **Facilitate discussions between the Corporation and the Chinese State Administration for Entry and Exit Inspection and Quarantine relating to wine labelling requirements.**

#### ***New Product Registration***

Australian exporters are required to register new products with the Chinese Government. Again lengthy delays are frequently experienced in registering new products - approximately 2 months from the date of application. To obtain registration exporters must provide 2 samples of each new product and pay customs and agent clearance fees for the samples. These fees often amount to more than the value of the samples. The requirement to register new products and the time delays and costs involved are significant impediments to Australian wine exports into China. The Corporation approves all Australian wine exported to China under the provisions of the AWBC Act and Regulations. This process includes the taking of samples and an assessment of its soundness and merchantability.

#### **Recommendations:**

- **Seek the removal of the requirement to register new products in China.**

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#### *Compositional Issues/Sanitary Certificates*

Australian wine exporters have experienced a significant number of problems relating to the acceptance by Chinese authorities of analytical results for wine produced by NATA accredited laboratories based in Australia. These laboratories comply with the international ISO 17025 standard. Furthermore, the Corporation understands that the Chinese authorities have on occasions made requests for Australian wine producers to have alcohol related tests repeated for no apparent reason. Analytical results have also been required to be sent by post which is not an efficient method of delivery. There is uncertainty about the current analytical reference methods/standards used by the Chinese authorities for wine. For example, it is not clear whether the Chinese have any limits on things like alcohol, reducing sugars, malic acid etc or any residue limits for agrochemicals/processing aids used in grape growing and wine making.

China's requirement for Australian wine exporters to obtain a sanitary certificate has also caused problems in terms of the number of certificates that are issued. Normally 5 copies are issued but in many cases this is not a sufficient number. Several producers have had to negotiate directly with the authorities to obtain more copies (closer to 20) which are then provided to provincial authorities, distributors, retail outlets etc.

#### **Recommendations:**

- **Seek clarification as to the laws in China regarding wine composition, additives, processing aids, residue limits, methods of analysis, issue of sanitary certificate etc;**
- **Pursue mutual acceptance of Australia's winemaking practices by China;**
- **Obtain acceptance by Chinese authorities of analytical results for wine produced by NATA accredited laboratories;**
- **Seek Chinese acceptance of more efficient means of the delivery of analytical results; and**
- **Facilitate discussions to improve the administration of the sanitary certificate**

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#### *Certificates of Origin*

China requires that Australian wine be accompanied by a Certificate of Origin. Some exporters have experienced difficulties in producing such certificates and are uncertain as to the appropriate form of such certificate.

#### **Recommendations:**

- **Seek clarification as to Chinese requirements regarding the Certificate of Origin;**
- **Facilitate discussions as to the potential to remove the requirement to have such a certificate.**

#### *Customs*

A number of exporters reported that they have experienced inconsistencies and transparency difficulties when dealing with Chinese Customs.

#### **Recommendations:**

- **Seek improvements in Chinese customs processes.**

### **CONCLUSION**

The Australian wine industry has identified China as an important market for its continued export success. The negotiations present a great opportunity to address some of the current challenges being experienced by Australian wine exporters in China and to improve access to that market.

The Corporation would be pleased to elaborate further on any of the issues raised in this paper and thanks the China FTA Taskforce for the opportunity to make this submission. We look forward to continuing to work with you.

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