SUBMISSION TO THE AUSTRALIAN GOVERNMENT DEPARTMENT OF FOREIGN AFFAIRS AND TRADE

AUSTRALIA – INDIA
FREE TRADE AGREEMENT STUDY

AUSTRALIAN WINE AND BRANDY CORPORATION
WINEMAKERS' FEDERATION OF AUSTRALIA

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Andreas Clark
Trade Manager
Australian Wine and Brandy Corporation

Tony Battaglene
Director, International & Regulatory Affairs
Winemakers' Federation of Australia

W www.wineaustralia.com
Compliance Centre
Level 2, 18 Dequetteville Terrace
Kent Town, SA 5067
PO Box 2733, Kent Town, SA 5071

W www.wfa.org.au
1/24 Bougainville Street
Manuka ACT 2601

INTRODUCTION

Following the 20th January 2008 announcement by the Australian Minister for Trade, the Hon Simon Crean, that Australia and India have agreed to undertake a joint feasibility study on the merits of a free trade agreement (FTA) between the two countries, the Department of Foreign Affairs and Trade has called for submissions and comments on the merits of an FTA with India. This paper briefly outlines the opportunities for Australian wine in India and the key challenges confronting Australian exporters.

BACKGROUND

This is a joint submission from the Australian Wine and Brandy Corporation (AWBC) and the Winemakers' Federation of Australia (WFA).

The AWBC was established in 1981 to provide strategic support to the Australian wine sector. It is an Australian Government statutory authority directed by a board appointed by the federal Minister for Agriculture, Fisheries and Forestry.

AWBC's responsibilities include:

- Export regulation compliance;
- Maintaining the integrity of Australia's wine labels and winemaking practices;
- Defining the boundaries of Australia's wine areas;
- Strategic marketing of the Australian wine sector;
- Negotiating to reduce trade barriers with other countries; and
- Providing high quality wine sector statistics and analysis.

WFA is the national peak body for the wine industry with voluntary membership representing more than 95% of the wine produced in Australia. It develops policies and programs for the whole industry on a range of political, social, environmental, trade and technical issues with both a national and international dimension.

Wine is an important industry in Australia, contributing significantly to a number of regional economies and directly employing some 28,000 people in both winemaking and grape growing (2006 Census), with further downstream employment in retail, wholesale, hospitality and tourism industries. The Australian wine industry is comprised of approximately 8,000 wine grape growers supplying over 2,000 wineries. In 2007, the total vineyard area reached almost 164,000 hectares. Wine grapes are grown in all states of Australia, with South Australia, New South Wales and Victoria accounting for the majority of production.

The rapid expansion of wine production in Australia over the last decade combined with a small domestic market has seen the Australian industry become increasingly export oriented. Australia exports wine to 104 countries, and has an eight per cent volume share of global wine exports. In 2007 wine exports totalled a record 787 million litres with an estimated value of $2.9 billion and accounted for around 10 per cent of Australia's agricultural exports. These wine export volumes currently represent almost 60 per cent of Australian wine sales and make Australia the world's fourth largest wine exporter. This is despite Australia's wine production accounting for only four per cent of total world production. Approximately half of Australia's wineries currently export to overseas markets.

Wine production and exports have also been expanding from other "new world" wine producing countries including: Argentina, Chile, South Africa, and the United States.

This growth has led to global wine production expanding faster than demand and has resulted in a significant decline in world wine prices.[1] As a result, the profit margins for Australia's winemakers has declined in recent years, exacerbated by the increased number of competitors in the market as well as the capital intensive nature of the industry. Accordingly, the Australian wine industry is facing the challenge of maintaining profitability in a global market characterised by flat demand, increasing supply and declining prices.

Maintaining a strong export orientation is imperative to the continued viability of the Australian wine industry. With limited growth potential for the domestic market, future increases in Australia's wine production will require continued export growth. In the face of declining world prices Australia's international competitiveness will depend on continued innovation, product targeting, quality improvement, and cost reduction.

AUSTRALIAN WINE EXPORTS TO INDIA

India is proving to be an important export market for Australian wine with significant potential for future growth. Australian wine exports to India have grown from just over 200,000 litres in 2005 to 1.24 million litres with a value of $3.64 million for the year ending February 2008. In the last 12 months (to February 2008) Australian wine exports to India grew by 99% (see Appendix 1).

Bottled wines make up only 35% of the total volume of Australian wine exports to India with an average price per litre of $6.18 which compares favourably with an average price per litre for all Australian wine exports of $3.86. Another encouraging trend has been the steady rise of exports of Australian wines in the high (A$10 and over FOB) price points. In 2007 Australian wines in this price range accounted for more than one third of the total value of wine exports to India.

INDIAN WINE MARKET

Although still considered small, the Indian wine market has shown steady growth over the last 5 years. The total consumption of alcoholic beverages in India grew by 10% in the fiscal year 2006-07 (Associated Chambers of Commerce and Industry of India-(ASSOCHAM) 2008). Total wine sales in India for 2007 were valued at $300 million (ASSOCHAM 2008) with wine consumption pegged at an estimated 800,000 cases (over 7 Mlitres) in December 2007 (ASSOCHAM 2008). Wine consumption is however low in comparison to beer (240 Mcases) and whisky and other spirits (70 Mcases) as of 2006-07 figures (ASSOCHAM 2008). The growing domestic wine market (which is not subject to the high import duty of 150%) is being credited for expanding the wine market beyond the main cities into rural India with low cost wines. This is a sizeable market considering nearly 70% of the population lives in rural India. Indian consumers of Australian wines are drawn from the affluent upper and growing middle class - an estimated 200 million people in 2006-07. Increasing number of shopping malls, hypermarkets and 5 star hotels and restaurants across India bring greater opportunities for Australian wines.

Australian wines currently only make up 15% by volume of the total Indian wine market. The major importers of wine to India as per 2006 figures were France, Italy and Australia (by total value of imports) and France, Australia and Italy (volume) in that order (Euromonitor 2008). Other competitors include USA, South Africa, Chile, Spain and Argentina. France and Italy have a stronger hold on the premium end of the Indian wine market due to their early entry into the market (AWBC 2006).

[1] Sheales, T., Apted, S., Dickson, A., Kendall, R., and French, S. 2006, *Australian Wine Industry: Challenges for the Future*, ABARE Research Report 06.16, Canberra, October.

In an increasingly liberalised society, the consumer attitude towards wine drinking has changed with wine perceived as a sophisticated and healthier alternative to spirits and therefore more acceptable for women and young drinkers. Increasing awareness and availability of domestic brands has helped wine sales to grow recently at double-digit rates. It is the affordable domestically-produced brands that are the major contributors to the increasing wine consumption in India with domestic wine sales far outnumbering the sales of imported wines. Affordability and extensive promotional activities are driving this growth (Euromonitor 2008 India wine report).

TRADE BARRIERS

(i) <u>Tariffs and Taxes</u>

Onerous import duties and discriminatory excise taxes are the most significant impediment hindering further Australian wine exports to India. . Prior to July 2007 the cumulative application of India's Basic Customs Duty, Additional Duty and Extra Additional Duty for wine resulted in applied duties of up to 264%. In addition a host of other taxes were also applied. For detailed background information regarding the tax regime for imported wine see the European Commission's July 2006 Report to the Trade Barriers Regulation Committee.[2]

In 2007 in response to pressure applied from a number of exporting countries, and in particular the EU and USA through the WTO dispute settlement procedure, India partially reformed its import duty regime for wine and spirits. On 3 July 2007 The Indian Ministry of Finance withdrew the Additional Duty but at the same the Basic Customs Duty was also raised from 100% to 150%.

With respect to the Extra Additional Duty (EAD) of 4%, on 14 September 2007, India issued a Customs Notification which provided that wine imported into India for subsequent re-sale which was subject to the EAD at the time of importation will be entitled to a full refund of this amount if the importers subsequently pay the domestic taxes which India claims the EAD is intended to counterbalance.

It is not clear to us how effectively and quickly such refunds will be available and we have the following concerns and/or comments:

- it would be onerous to claim for each shipment/sale. Perhaps importers could claim periodically;
- if some of a shipment is not sold for a period, the duty will have been paid, but a tax (entitling the importer to a refund for the duty) will not. The time gap between the two would be an unnecessary cost to the importer;
- given that import is almost always for subsequent domestic sale, there should be automacity in the system for reimbursement.

The levying of the EAD and the refund mechanism in Customs Notification no. 102/2007 for imported products was one aspect of India's tariff regime that was recently challenged by the US through the WTO dispute settlement procedure. The WTO Panel Report was released in early 2008 and it is not as yet publicly available but we understand from press reporting that the report was not positive for the US, with the outcome largely favouring India. We therefore assume that EAD and the refund mechanism will remain in place but cannot confirm this until we can review the published report.

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[2] *Report to the Trade Barriers Regulation Committee Examination Procedure Concerning an Obstacle to Trade within the meaning of Council Regulation (EC) no 3286/94 Consisting of Trade Practices Maintained by India Affecting Trade in Wine and Spirits.*

Following the July 2007 decision to eliminate the Additional Duty there has been a number of developments at the state level. Maharashtra - the centre of Indian domestic wine production – has imposed a state excise duty of 200% on imported wine only. We understand that a number of other states are also proposing to introduce similar such taxes which discriminate against imported wine.

We have provided here only a brief overview of the taxation regime that applies to imported wine as the situation is fluid. In short, we believe the taxation of wine in India is highly discriminatory against imported products and the remaining import duty of 150% effectively bars imported wine from competing with domestic product. We would hope that a free trade agreement with India would address these concerns, as far as possible, thereby opening up a significant potential market for the Australian wine industry. We are in the process of putting together a detailed analysis of India's taxation regime for wine and the implications for imported wine and would be pleased to share that with DFAT once completed.

(ii) <u>Non-Tariff Barriers</u>

(a) Labelling

Labelling costs represent a significant component of the cost of Australian wine production, especially for exporters. This is because most export markets have different requirements for the placement of information on the wine container compared to Australia's domestic market requirements. Thus, wineries are required to print separate wine labels according to each importing country's requirements for the placement of mandatory product information. The expense of producing separately labelled wine for different markets is further exacerbated by the need to maintain separate buffer stocks for each market.

We are in the process of reviewing India's labelling requirements for imported wine and will provide a more detailed submission on this issue if formal FTA negotiations are commenced.

(b) Certification

Simplifying certification procedures is another priority for the Australian wine industry. Our position on this issue, in the context of any bilateral FTA negotiations, is that such requirements are unnecessary given AWBC's stringent export control procedures (see Appendix 2) and an agreement to that effect should be covered in the FTA. We believe no other wine-producing country has such comprehensive controls on the export of wine and accordingly the export approval granted by the AWBC should itself provide a sufficient basis for import into India. We acknowledge, however, that it is not always possible to obtain agreement from negotiating partners to this 'no-certification' position so accordingly in the alternative we request that such requirements to be streamlined where possible.

In addition, if necessary, we request that the AWBC be authorised to issue certificates of origin for Australian wine exports. One particular issue that continues to cause frustration for Australian wine exporters concerns certificates of origin. Increasingly, wine exporters complain to the AWBC that, in addition to complying with the AWBC's rigorous export approval process, if a certificate of origin is required they must liaise with another body – the various State Chambers of Commerce. Exporters rightly point out that all of the information included on such certificates of origin has already been provided to the AWBC as required under the export approval process and query why the AWBC cannot issue such certificates. Our response, naturally, is that the AWBC is not authorised to do so but given this concern is regularly raised with us we believe it is an opportune time to review this process to see if it can be improved for the benefit of the Australian wine industry. To that end, we are seeking a formal role for the AWBC with respect to certifying origin if a certificate of origin process is incorporated along the same lines as the SAFTA/TAFTA model.

(c) Maximum Residue Limits for Agrichemicals

Another issue that may require further work within the context of any FTA negotiations concerns maximum residue limits (MRLs) for agrichemicals used in the production of grapes in Australia.

We are in the process of confirming India's MRLs for grapes to determine whether they are adequate. Some agrichemicals permitted in Australia sometimes do not have a MRL in overseas markets, often because grapes are not grown commercially in these countries, and the agrichemicals are therefore not registered for use on grapes. As a result, there is no requirement for an MRL for grapes, or even when a MRL does exist, it often differs in value between countries.

As a result, grapes grown for wine destined for export require carefully planned spray programs and agrichemicals must be selected to ensure that its application will not result in a residue that is unacceptable to Australia's major wine markets. To achieve this, it may be necessary to avoid the use of certain agrichemicals altogether, or to restrict their use.

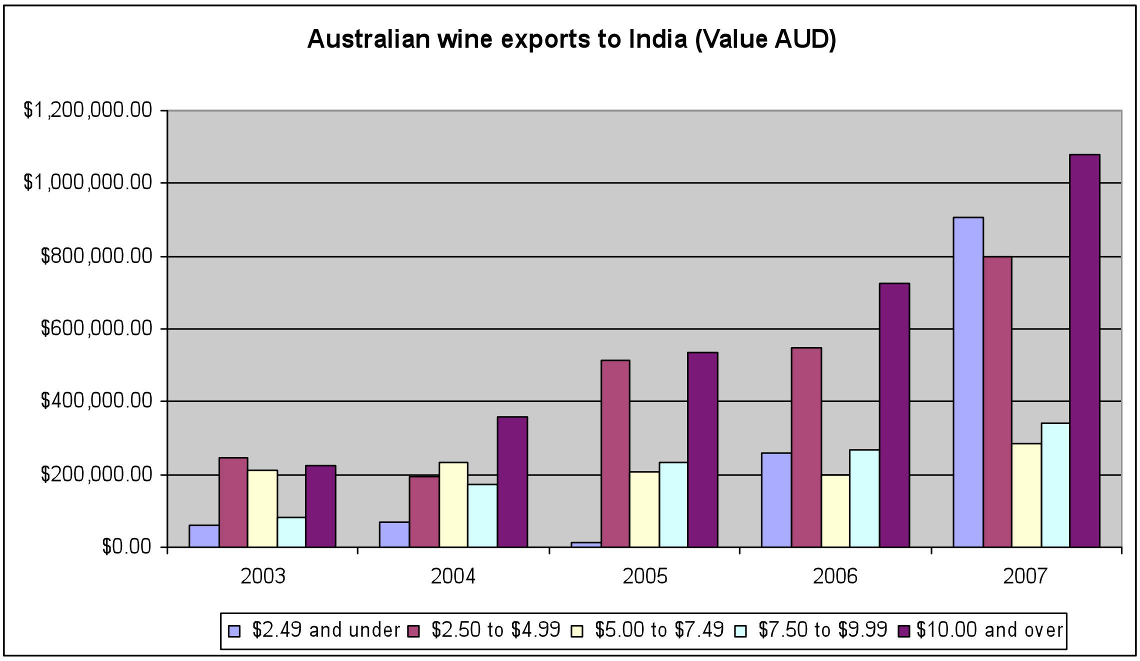
Given the cost to industry of ensuring different MRLs in export markets are complied with, we believe there is merit in pursuing harmonization of MRLs for agrichemicals commonly used in the production of grapes in accordance with international standards.

CONCLUSION

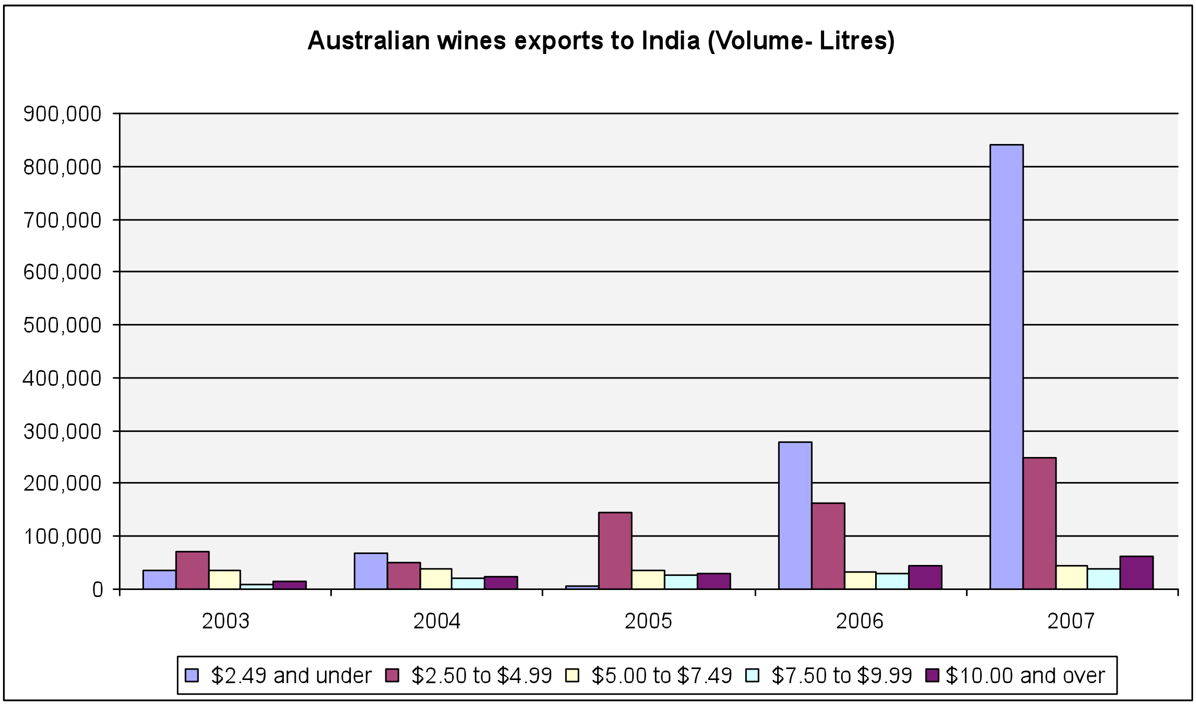
Given the increased global competition and more difficult trading environment for Australian wine exports, India has the potential to be an important and profitable market for the Australian wine industry. We have briefly outlined above some of the key issues of concern for us in the Indian market. Our major overriding interest at the moment is to reform the import duty and taxation regime so imported wine can compete fairly with domestic products.

The AWBC and WFA look forward to working closely with DFAT if formal negotiations commence and would be pleased to elaborate further on any of the issues raised in this paper.

Appendix 1:



Australian wine exports to India (Value AUD)
$1,200,000.00
$1,000,000.00
$800,000.00
$600,000.00
$400,000.00
$200,000.00
$0.00
2003
2004
2005
2006
2007
$2.49 and under
$2.50 to $4.99
$5.00 to $7.49
$7.50 to $9.99
$10.00 and over



Australian wines exports to India (Volume- Litres)
900,000
800,000
700,000
600,000
500,000
400,000
300,000
200,000
100,000
0
2003
2004
2005
2006
2007
$2.49 and under
$2.50 to $4.99
$5.00 to $7.49
$7.50 to $9.99
$10.00 and over

Appendix 2: AWBC Export Control Procedures

1. Export Licence

Firstly, the Australian Wine and Brandy Corporation regulations require exporters of grape products to be licensed where individual shipments exceed 100 litres. The AWBC issues licences for the export of grape products and considers each application against a set of criteria, including the financial standing of the applicant and a range of other matters. The regulations provide for the suspension or cancellation of a licence for breaches of the regulations or in other prescribed circumstances.

2. Product Approval

Secondly, each wine in the export consignment must be approved. Australian wines must be determined to be of "sound and merchantable" quality before they can be exported from Australia. The aim is to maintain the reputation of Australian wine in overseas markets by preventing the export of wines that have faults. An export permit, issued by the AWBC, is required for each wine destined to be exported, unless the total consignment of wine is less than 100 litres. Before an export permit can be issued, the AWBC's wine inspectors must approve the wine.

The AWBC maintains a panel of wine inspectors of the highest integrity, qualification and experience. The inspectors are drawn from the wine industry and ideally have some experience in wine show judging at a regional or state level.

<u>Wine Inspection Procedures</u>

1. Exporters must submit a completed Continuing Approval Application which includes a certificate of analysis and the compositional details of the blend. The analysis covers the following parameters:
   a. Specific gravity
   b. Alcohol
   c. Volatile acidity
   d. Titratable acid
   e. Sulphur dioxide – free
   f. Sulphur dioxide – total
   g. Residual sugar
   h. pH
2. Two samples must be submitted along with a separate copy of the labels. The bottled samples submitted for approval must be the <u>finished product</u> as intended for presentation to the consumer.
3. Labels must be consistent with the product description given on the application.
4. Each grape product to be exported is required to meet the standards and requirements of the AWBC Regulations and the Food Standards Australia New Zealand Code.

<u>Wine Inspection Rejections</u>

Two wine inspectors appointed by the AWBC carry out a sensory evaluation of all export samples. Typical reasons for rejection include the following faults:

- Clarity and condition
- Chemical contamination eg:
    - Sanitation compounds
    - Mechanical oils
    - Burnt rubber
    - Excessive wine additives such as sulphur dioxide
- Oxidation
- Microbial contamination eg:
    - Sulphides
    - Mousiness
    - Mouldiness
    - Volatility
    - Other
- Closure contamination eg:
    - Random oxidation
    - TCA
    - 'Plastic' taint
- Other contaminants or taints

The wine is expected to reasonably reflect the grape varieties and/or wine description claimed on the label. Information with respect to price and quantity is provided to enable inspectors to make commercial judgements.

The sensory evaluation is a masked tasting, however, inspectors are required to view the analysis details and label descriptions to ensure there is nothing on the label or application form which is questionable in light of the sensory evaluation. The inspectors may call for an independent analysis if required.

Where a wine is rejected at the initial inspection, an exporter may resubmit the wine for a second inspection. The second inspection, with the sample masked, will be conducted by a panel of three Inspectors, none of whom were involved in the initial inspection of the wine. If rejected at the second inspection, the product may not be exported although a final review panel process may be initiated subject to certain conditions.

3. Shipping Approval

Finally, exporters must submit a completed shipping application for each consignment of wine leaving Australia that is in excess of 100 litres. The shipping application notifies the AWBC of the intention to export and must be lodged with the AWBC 10 days before the day of departure.

The application must include all shipping details as well as a list of products with their current continuing approval numbers to be shipped. Where the export complies with all necessary requirements, the AWBC will issue an export permit number.