Australian Government

Australian Wine and Brandy Corporation

SUBMISSION TO THE AUSTRALIAN GOVERNMENT DEPARTMENT OF FOREIGN AFFAIRS AND TRADE

AUSTRALIA – REPUBLIC OF KOREA

FREE TRADE AGREEMENT

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BACKGROUND

The Australian Wine and Brandy Corporation (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.

AUSTRALIAN WINE EXPORTS TO SOUTH KOREA

South Korea is an increasingly important export market for Australian wine. In 2008, Australia exported 1.9 million litres of wine valued at A$12.7 million to South Korea. The average price of the wine shipped was a healthy A$6.71 per litre.

Over 73% of Australian exports to South Korea are bottled products. Soft-packs are relatively popular, representing 26% of our exports. Red is the colour of choice, accounting for 73% of Australian shipments.

SOUTH KOREAN WINE MARKET

South Korea is a small market for wine, however it is a market that we believe holds significant growth potential for Australian wine exporters. Total consumption of alcoholic products in South Korea is one of the highest in the world. Although wine consumption is low, consumers have high disposable incomes, and are rapidly moving to wine for health and lifestyle reasons.

South Korea's total wine imports showed excellent growth of 31% by value in 2006 at USD$88.6 million and 22 million litres (*Source: Korea Trade Information Services)*. This has increased significantly since 2000, when total imports were only 8 million litres, and USD$20 million.

Currently Australia is the 5th highest importing nation into South Korea, by value, with a 7.5% share of total imports behind France, Chile, USA and Italy *(Source: Korea Trade Information Services)*, which is a relatively poor result compared to Australia's strong performances in other Asian markets where we are often one of the top three importers of wine. This is believed to be partly due to the following reasons:

- Chile's FTA with South Korea had an immediate positive impact on imports of Chilean wine which have nearly doubled since implementation to USD$15.4 million *(Source: Korea Trade Information Services)*;
- US wine imports continue to perform strongly in part due to the depreciating US dollar and close historical and political ties. The recently concluded US-South Korea FTA which grants US wine duty-free access will further bolster strong demand for US wine;

- The traditional wine producing countries - France, Italy and Spain –still account for more than 50% of the total market due to strong marketing and promotion campaigns.

Grape wine consumption in South Korea is relatively low, with higher alcohol products such as Soju – a common local distilled spirit - and other spirits accounting for the majority of sales. It has been reported that total consumption of alcohol products is as high as 55 litres per capita *(Source: Austrade, 2006)*. Consumption patterns, however, are changing. South Korean consumers are becoming increasingly aware of the health benefits of wine. Wine is not only lower in alcohol compared with soju and spirits, but local media have also widely reported the health benefits of red wine. As a result, 80% of total consumption of wine is of red wine *(Source: Euromonitors, 2007)*.

Australia's exports to South Korea reflect this trend, with more than 70% of total exports in red wine – predominantly Shiraz and Cabernet Sauvignon. Wine is slowly shifting from a perception of something to enjoy for a special occasion, to a beverage to enjoy every day.

As the 12th largest economy in the world, South Korean consumers have an average income of USD$17,000 per annum with relatively high disposable incomes. South Koreans are the 2nd highest income earners in Asia, behind Japan. As a result, sophisticated restaurants, bars, nightclubs and wine shops are a common feature in South Korea, and provide an ideal distribution channel for Australian wine.

This has been reflected in wine consumption statistics with an increase from 0.3L in 2001 to 0.7L per capita in 2005.

In the absence of reliable statistics, industry analysts indicate that the split between on and off premise is approximately 30% on premise and 70% off premise. Supermarkets, hypermarkets, and on premise outlets such as restaurants and bars are experiencing strong growth, while smaller, independent food stores have been consistently declining for the past 10 years (*Source: Euromonitors, 2007)*.

The current distribution split in the off trade is as follows:

	Share (2006)
Supermarkets/Hypermarkets	68.5%
Independent food stores	25.5%
Convenience stores	5.2%
Specialists	0.3%
Other	0.5%

Source: Euromontiors, 2007

TRADE BARRIERS

I. <u>Tariffs</u>

Import duties and national taxes apply to imported wine in South Korea. Although lower rates of tax apply to wine compared with other alcohol products such as beer and spirits, the combined impact of the various taxes and retail mark-ups can make Australian wine imports significantly more expensive than the cost in Australia, and considerably more expensive than local traditional alcoholic beverages. Taxes are collected by Korean Customs at the time of importation. The current duty and tax structure for wine is as follows:

Tax Type	Taxation Rate
Import Tariff	15%[1]
Liquor Tax	30%
Education Tax	10%
Value Added Tax	10%

Example: Import Tariffs and Taxes on CIF AUD $10.00 bottle of wine

A.	CIF Value	$10.00
B.	Tariff (Customs Duty): A x 15%	$1.50
C.	Liquor Tax: (A+B) x 30%	$3.45
D.	Education Tax: C x 10%	$0.35
E.	**Subtotal**: A+B+C+D	**$15.30**
F.	Value-Added Tax (VAT)[1]: E x 10%	$1.53
G.	Fees for Customs Clearance, etc: A x 8%	$0.80
H.	**Customs Cleared Cost of Wine**: E+F+G	**$17.63**

[1]Note: VAT is refunded to the importer because the tax is carried over to the final consumer.

Example: The Common Range of Mark-ups by Importers and Retailers

The mark-up for the following tables is based on the Customs Cleared Cost (H. $17.63) less Value-Added Tax (VAT) (F. $1.53) which = $16.10.

Importer

Importer's price to discount store (30% mark-up)	$20.92
Importer's price to supermarket/liquor store (40-50% mark-up)	$22.53-$34.14
Importer's price to luxury hotel (40% mark-up)	$22.53
Importer's price to wholesaler (15-30% mark-up)	$18.51-$20.92

Retailer

Discount Store Retail Price (8-20% mark-up)	$22.59-$25.10

[1] Across all tariff lines under 2204 – Wine of fresh grapes, including fortified wines, grape must other than that of heading 20.09 – Australian exports face a ad valorem duty of 15% (except 2204.300, other grape must which is 30%).

Supermarket & Liquor Store Retail Price (30-40% mark-up)	$29.29-$31.54
Luxury Hotel Restaurant Retail Price (200-400% mark-up)	$45.06-$90.12

Source: Gain Report 2005

Recommendations:

If FTA negotiations commence, we would advocate the immediate removal of tariffs on all wine product lines, in line with the outcome for US wine under the recently concluded US-South Korea FTA.

In addition, Chilean wine exports will enter South Korea duty-free in 2009 in accordance with its FTA (Chilean wine exports currently face a 5% tariff, reducing to 2.5% in 2008 and zero in 2009.). And, the EU will be seeking duty-free access for its wine exports under its FTA negotiations with South Korea.

The elimination of these tariffs would put Australia back on a level playing field with the other major exporters of wine to South Korea who already have preferential market access (Chile) or are likely to do so in the near future (US and EU). In the meantime, Australian wine exports will be seriously disadvantaged until we are able to match the preferential tariff rates enjoyed by other major wine exporters.

II. Labelling

A given wine label in Korea looks as follows:

In the above back-label, only the area circled in red is in fact marketing information. All other Korean language information is mandatory. In fact, the Korean back-label is required to contain no fewer than **15** different pieces of information (in Korean language):

1. Brand name
2. Type/Category of Product
3. Volume
4. Alcoholic strength
5. Name of producer
6. Name, address and telephone number of importer
7. Country of origin
8. Lot code (or date of bottling)
9. Raw materials and content
10. General Health warning "*excessive drinking is harmful to health*"
11. Specific health warning "*the sale of alcohol to those under 19 years of age is prohibited*"
12. Recycling mark

13. Return and Exchange Office and Information for Consumer Service / Complaints (can be the same reference – as is the case in this example)
14. Warning phrase "*not for sale at restaurants and liquor-selling places*" on products destined for home consumption or discount store sale
15. Standard of Use or Keeping

Recommendations:

Many of South Korea's labelling requirements are unnecessary, costly, inconsistent with standard international practice, and therefore, constitute a barrier to trade. The net effect of these requirements is an information overload on back labels, with little room left to provide product-related information to consumers. This restricts Australian producers' ability to educate consumers better about Western drinks (particularly wine).

The existing Korean labelling regime is clearly onerous, in several respects:

- It is <u>duplicative between front- and back-label</u> : all of the above information is required on the back-label, even though some of it already appears on the English label (items 1 to 5).
- It is <u>duplicative within the back-label</u> : what is the point in having three cumulative statements of contact information (items 5, 6 and 13)?
- It is <u>excessive</u>: some of the required information is arguably of no use to the consumer, especially channel labelling or standards of use (items 14 to 16)
- It results in <u>information overload for consumers</u>, as the label is cluttered with a great deal of information, much of which is unnecessary. It thus defeats the purpose of consumer information.

Of particular concern is the requirement to label for distribution channel which is costly and ineffective. Such labelling limits flexibility as products once labelled for a certain distribution channel cannot be relabelled for another channel. Under the Korean Liquor Act, distributors are prevented from purchasing liquor products for re-sale from another distributor of the same or lower-level. For example a retailer cannot purchase liquor products from another retailer or a wholesaler from another wholesaler. The Korean Government has a 'Liquor Purchase Credit Card' program as a safeguard to prevent black marketing of liquor products between suppliers and trade buyers. The regulation requires buyers to use special credit cards issued by banks for this program exclusively to pay suppliers when purchasing alcoholic beverage products.

We understand this distribution channel labelling requirement is not effective in terms of its alleged objective of avoiding tax evasion, as the relevant authorities do not check or crack down on vendors offering mislabelled products (small shops selling products sourced from "discount stores" and labelled accordingly).

At a minimum, we would advocate that the 'For Discount store sale only' label is withdrawn, and that one retail label only be used, that being the 'Home Consumption' label. We also request that the wording should be required on the back label of the product for both domestic and imported products to avoid consumer confusion. In the long-term, the eradication of the costly and ineffective channel labelling requirements should be pursued.

Another specific labelling concern is the KFDA's restrictive alcohol tolerance of 0.5% alc/vol. Under Australian law (Food Standards Code 2.7.1), the mandatory alcohol statement required to be included on a wine label must be accurate within a limit of +/- 1.5% alc/vol. Similarly in the US, a tolerance of 1.5% applies to wine containing 14% or less alc/vol and 1.0% for wines containing more than 14% alc/vol. And pursuant to our bilateral wine agreement with EC, a tolerance of 0.8% alc/vol applies.

In WTO notification n° G/TBT/N/KOR/196, the Korean Food & Drug Administration is proposing to increase the burden on wine labels even more, by imposing a new requirement that a statement "*Dial 1399 for consumer reports and complaints*" appears on the containers / packages of food products, including wine. Although the justification claims to be better consumer protection, it appears that this new requirement would be entirely disproportionate in the sense of Article 2.2. of the WTO's Technical Barriers to Trade Agreement, as it is unnecessary and duplicative, as it comes on top of the existing requirements for indicating in Korean language the producer AND importer's name and addresses, as well as the contact details for both "Return & Exchange Office" and for "consumer service / complaints". In other words, contact information is already available to consumers should they have a problem with or complaint about a particular product. We would argue that South Korea should conduct a thorough review of its current labelling regime, with a view to simplifying it, as a pre-requisite to any further changes.

In summary, should FTA negotiations commence, we believe it could be the appropriate mechanism to secure commitments from South Korea to:

- repeal the labelling requirements that exceed those prescribed by the Codex Alimentarius labelling standard, including the distribution channel labelling requirement;
- relax the alcohol tolerance limit to bring it in line with international standards;
- develop a greater degree of co-ordination among the various departments and ministries proposing labelling measures for alcoholic drinks, and
- properly comply with the notification and consultation obligations set out in the WTO agreement on Technical Barriers to Trade (TBT) when introducing new labelling changes in the future.

III. Wine Composition Standards

Korean wine composition standards are an important issue for the Australian wine industry. A number additives and processing aids commonly used worldwide are not covered under the Korea Food Additives Code.

In particular, the following additives, legal in Australia (under Food Standards Code 4.5.1) and elsewhere, are not currently permitted under the Korea Food Additives Code and have the potential to cause problems when exporting wines to South Korea:

- Dimethyl Dicarbonate
- Metatartaric Acid

Australian wines made in accordance with the Australian standard are approved for sale in the EU, USA, Canada, Chile, Argentina and New Zealand amongst other countries.

Recommendations:

With the assistance of the Australian Embassy in Seoul we are in the process of confirming details of the approved additives for wine as we suspect there may be other commonly used materials not approved. We propose to shortly initiate the process for approval of any unapproved additives. If difficulties are encountered, the FTA negotiations, if commenced, may assist in resolving this issue.

IV. Import Inspection Procedures

Simplifying certification procedures is another priority for the Australian wine industry.

KFDA's complex import procedures naturally aim to verify that imported products meet the standards and specification of the Food Sanitation Act (see appendix 1).

The importer must submit an *'Entry Report for Foods'* to the regional KFDA. The regional KFDA will conduct a document and label inspection of the product. Each initial shipment of a product will require a laboratory test. This involves testing the physical, chemical and microbiological elements of the product. This process is likely to take 10 days.

The KFDA also carries out Organoleptic Inspection and Random Sampling Inspection. Organoleptic Inspection involves a comprehensive inspection based on the identity, taste, odour, colour, labelling, packaging condition, and history of laboratory tests of the product. Random Sampling Inspection involves a laboratory test which may include physical, chemical or microbiological test methods.

KFDA Inspectors may then carry out a Conformity Assessment which assesses the conformity of the foods in accordance with the Food Code, Food Additives Code and Labelling Guide. Once the KFDA Inspectors assess that the product complies with the Food Sanitation Act, a Certificate for Import will be issued to the importer. The importer may then gain Customs clearance of the shipment.

If the KFDA Inspectors consider that the product fails to comply with the Food Sanitation Act, the importer and the regional Customs Director are notified of the nature of the violation. The importer may correct the violation and re-apply to undergo the inspection process. If the violation is unable to be corrected, the importer must decide whether to destroy the shipment, return it to the exporting country or use it for non-edible purposes.

Recommendations:

We would like to clarify a number of issues with respect to this import inspection procedure as it applies to imported wine products; namely:

- KFDA advice, as at March 2007, was that product from a subsequent vintage to that already imported into Korea is not subject to a comprehensive laboratory test provided the same ingredients have been used and it has <u>exactly the same alcohol level</u>. The last condition is onerous as alcohol levels often vary vintage to vintage depending on harvest conditions.
- During a March 2007 visit to Seoul, AWBC's Trade Manager discussed with KFDA officials a proposal that Australian NATA-registered laboratory tests would be regarded as equivalent to KFDA in-country tests. KFDA indicated that it had procedures for authorising foreign official laboratories and we therefore envisage that this could be addressed in the FTA negotiations. That said, ultimately, we would be looking for this testing requirement to be waived altogether, whether it is carried out in Australia or South Korea, thereby removing one level of cost for industry. We would argue that it is unnecessary given AWBC's stringent export control procedures outlined in Appendix 2. We believe no other wine-producing country has such comprehensive controls on

the export of wine and accordingly an AWBC export certificate should itself provide a sufficient basis for import into South Korea.

VI. Warehousing

Currently domestic liquor producers/manufacturers are permitted to operate as many warehouses as they like to store and distribute their goods. Liquor importers - like domestic manufacturers - can only sell to wholesalers, but are only permitted to operate one warehouse in the area where the import licence was issued, one at the entry port, and one additional warehouse in a location of its choice. All warehouses can be used for storage, but only one, however, can be used for distribution of goods. This arrangement is clearly discriminatory placing unnecessary and expensive restrictions on importers. *(Source: European Union Chamber of Commerce in Korea Wine and Spirits Committee Trade Issues and Requests 2007)*

Recommendations:

- Liquor importers are currently classified in the same category as domestic wholesalers which, we submit, is incorrect. Like domestic producers, liquor importers sell product to wholesalers. Liquor importers should therefore be classified in the same category as domestic liquor producers/manufacturers and allowed as many warehouses as they wish.
- Alternatively, at a minimum, the current arrangements should be amended so that all three permitted warehouses can be used as both storage and distribution facilities.

VI. Maximum Residue Limits for Agrochemicals

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

We are in the process of confirming South Korea's MRLs for grapes to determine whether they are adequate. Some agrochemicals permitted in Australia sometimes do not have a MRL in overseas markets, often because grapes are not grown commercially in these countries, and the agrochemicals 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 agrochemicals 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 agrochemicals altogether, or to restrict their use.

Recommendations:

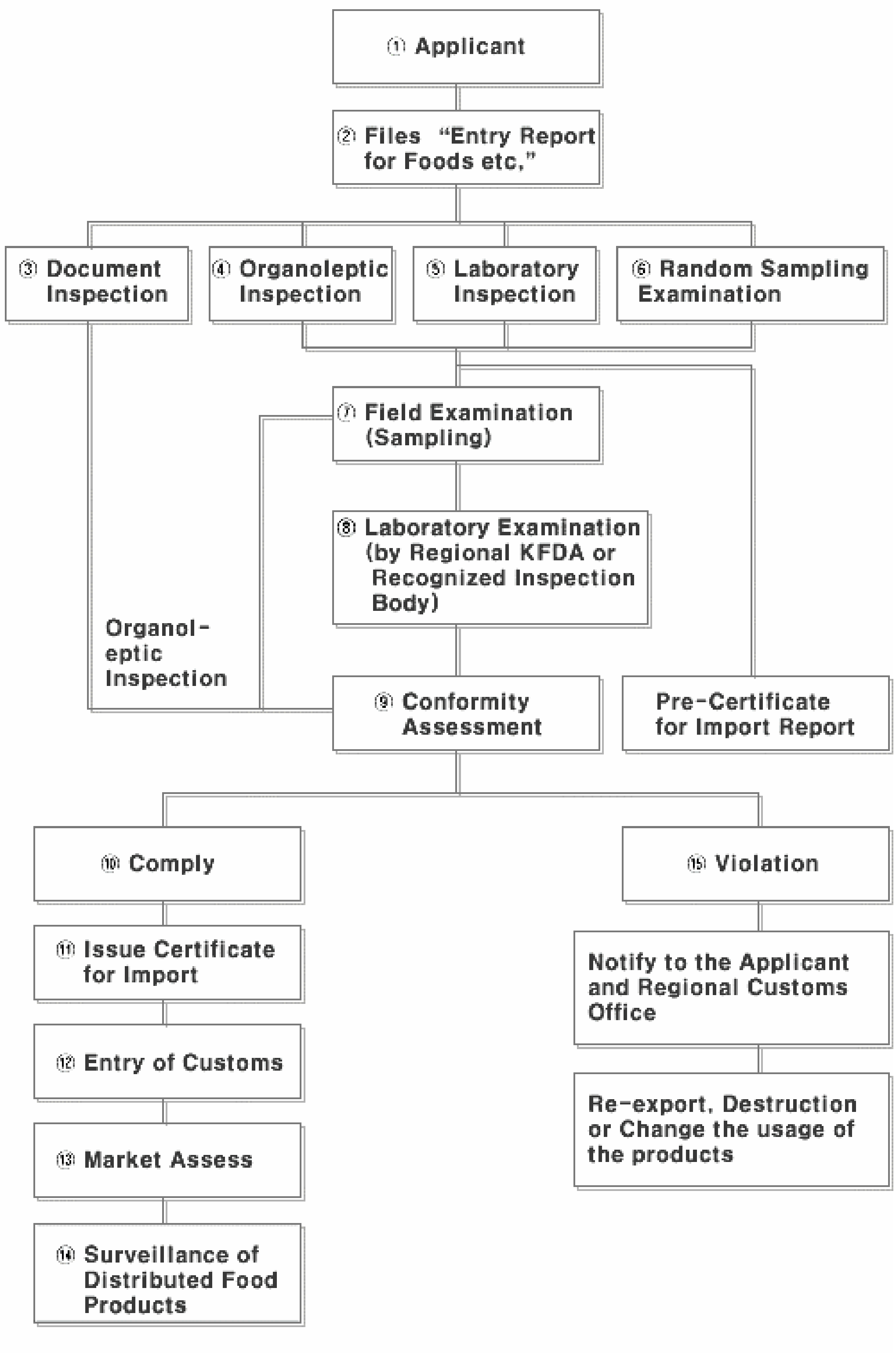
- Given the cost to industry of ensuring different MRLs in export markets are complied with, we believe there is merit in pursuing harmonization of MRLs for agrochemicals commonly used in the production of grapes in accordance with international standards.

CONCLUSION

Given the increased global competition and more difficult trading environment for Australian wine exports, South Korea has the potential to be an important market for the Australian wine industry's continued export success. Securing tariff elimination, especially given the preferential access currently enjoyed by Chile, and duty-free access recently granted to the US (and possibly the EU in the near future), and establishing processes to resolve key non-tariff regulatory and technical barriers is critical to our future prospects in the South Korean market.

The AWBC looks 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: Korea Food & Drug Administration (KFDA) Flow Chart of Import Procedures



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.