

HONG KONG REMOVES ITS DUTY

Just as Britain has raised the import duty on wine, its former Chinese colony has completely abolished its ad valorem tax. Jeannie Cho Lee examines whether this move will turn Hong Kong into Asia's wine hub.

When John Tsang, Hong Kong's financial secretary, announced the abolition of wine and beer duties on 27 February 2008, many people in the wine industry were stunned. Even some members of the Hong Kong Wine & Spirits Industry Coalition (HKWSIC), who had lobbied for the move, were pleasantly surprised. The government's yo-yo policies on wine duty has meant that Hong Kong's ad valorem wine duty has fluctuated from 90% to 60% to 80% to 40% and now to 0% in less than 14 years. The government has been erratic and, to say the least, inconsistent about its wine policy. Interestingly, spirits duty escaped this schizophrenic behaviour, remaining steadfast at 100%.

The duty elimination on wine and beer is expected to cost the government about \$72m (€45m) annual tax revenue in the short term, but according to their calculations, gain nearly \$514m (€326m) in the long run. Much of the gain is expected to come from fine wine transactions, including auctions, convention business, logistics and wine storage businesses over the next several years. Growing consumption and possible spikes in volume from duty reduction were not factored into this gain.

Who buys the wine?

The Coalition's research indicates that Chinese collectors make up approximately 30-40% of London's fine wine brokerage business, with a total revenue estimated at over \$1.2bn (€778m). Most of the revenue from fine wine transactions is not coming into Hong Kong and thus, the argument goes, Hong Kong is losing out on a potential revenue of \$400m. In worldwide wine auctions, where Asian bidders are estimated to make up about 20-25%, revenue again is bypassing Hong Kong since no wine auctions have

been held here for nearly ten years. The Coalition argues that out of the \$300m plus worldwide wine auctions, Hong Kong and China are poised to capture over \$100m of that pie.

No time frame was given as to when these goals might be achieved and



no concerns were raised about whether Hong Kong can manage the increasing volume of fine wine. Paolo Pong, managing director of wholesaler Altaya says, "I am not sure if Hong Kong is equipped to handle and store a much larger volume of fine wine. For the moment we only have Crown [Wine Cellars] and there is no one else." Most importers acknowledge that Hong Kong has plenty of warehouse space; however, the cost of converting that space combined with the high overhead cost and rentals means that warehousing may not be that economical compared to less expensive places like Guangdong or Macau.

Criticisms about the duty elimination came both from within the trade as well as from consumers. Importers, who had based their margins on duty paid prices,

pointed to lower profits and increasing competition. Consumers pointed to the high social cost involved in supporting the wine industry, such as waste, environment and health issues. Critics also point to the lack of consumer benefit from halving the wine duty from 80% to 40% just a year ago. Many hotels and restaurants pocketed the savings rather than passing it down to consumers. For some merchants, such as Altaya and Berry Bros & Rudd Hong Kong, growth was spurred by this move and the lower margins per bottle were made up by a boom in volume. For other merchants, the reduction in duty only meant one had to sell much more volume to generate the same profits. Those who had knowledgeable sales staff could encourage their customers to trade up, but others saw their bottom line decline.

Different impact at different levels

The impact of the recent elimination of wine duty has implications which differ at the various levels: fine wine versus everyday or branded wines, Hong Kong based merchants versus UK, US or EU based subsidiaries operating in Hong Kong and the various players in the Greater China region.

For the very top wines at retail prices of \$50 or higher, competition will likely come from every corner of the globe. For Bordeaux, provenance may be a concern for some consumers, but the vast majority will look toward price, service, trust and relationships in making purchasing decisions. Consumers may order direct rather than go through a merchant. Many European or American merchants may compete purely on price, since their connections and knowledge of the local market may be rudimentary, resulting in a highly competitive market place.

Auction houses such as Bonham and

Acker Merrall have already committed to holding auctions in Hong Kong with the physical stock brought over to Hong Kong in advance. Increasing physical stock in Hong Kong affords greater possibility of re-exports, re-trading and financial transactions taking place within Hong Kong. The region's great disparity in wine import regimes compared to mainland China and, for now, Macau, offer Hong Kong opportunities to be price competitive as well as providing efficient service and a reliable business environment. For fine wine, Hong Kong seems to be well positioned to developing into a regional hub in the near future.

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Paolo Pong

Paolo Pong is managing director of Altaya, one of Hong Kong's leading fine wine merchants.



At the everyday or branded wine level, there is less direct impact. Companies such as Links, who have used Hong Kong as a base, will continue to do so, while China based companies such as ASC and Summergate will continue to use Shanghai. These two prominent China based wine merchants already have successful operations in Macau and use Shanghai as their re-export base for their Macau business. Both are rumoured to be setting up offices in Hong Kong this year and this could mean that orders are consolidated and shipped from Shanghai.

Some view the recent hefty fine imposed on ASC as a clear message from the Chinese government that illegal activities will not be tolerated. With the vast disparity in import policies, with no duty or sales tax in Hong Kong, versus

48% in China, smuggling across the border is seen to become an even more serious issue. However, others view the ASC problem as just part of the routine government inspection carried out annually and not a hidden message from the government.

Hong Kong as wine hub?

The duty elimination has various implications, but whether this move is a prerequisite for Hong Kong to be a wine hub is not that clear. Hong Kong has always possessed many of the key elements to become just that: Dependable infrastructure, good warehousing, an active port, reliable government, international airport and access to buyers and sellers. Hong Kong is already one of the most active trading centres in Asia for finance, other goods and services. It is also geographically and politically well positioned to take advantage of the growth in China and to be a reliable centre for accessing both buyers and sellers within the region.

Wine destined for China, Macau or elsewhere in eastern Asia was kept in bond, so duty was not an issue. The same barriers, which made it difficult for Hong Kong to re-export around the region, still exist: High non-tariff barriers to entry in re-export markets such as China, the lack of large volumes and affordable wine storage. Eliminating wine duty will make Hong Kong an attractive place to access the region; however, for the time being, this will likely be limited to the very top end of the market. Whether a successful fine wine trading hub will have a knock on effect on the lower end of the market remains to be seen.

What is clear is that there is continuing momentum and enthusiasm behind the recent duty elimination. Within an hour of the announcement, wine merchants were emailing their revised price lists. Farr Vintner's Hong Kong slashed their prices by 15-30% for all their fine Bordeaux. Berry Brothers & Rudd cut their prices by 15% across the board. Retail shops such as Ponti and Watson's Wine Cellar continue to take a hit on their duty paid wines by offering deep discounts. Supermarkets such as Park N

Shop announced across the board price cuts by an average of 28%. Within days, Singapore wine merchants sent out new, lower price lists with the option of purchasing wine from bond. At least a dozen new companies are rumoured to be opening up shop and Gregory De'eb, General Manager of Crown Wine Cellars, says within 48 hours of the announcement, his clients had ten container loads full being brought into Hong Kong from the United Kingdom. He says his phone has been ringing incessantly since the announcement from clients who want to reserve space in their cellars for wines being brought in from all over the world.

"Within 48 hours of the announcement my clients had placed orders for ten containers."

Gregory De'eb

Gregory De'eb, general manager of Crown Wine Cellars



The Trade Development Council (TDC) announced that their first International Wine Expo will be held in August this year, catering to both the trade and the general public. Even though Vinexpo will be held in May this year in Hong Kong, the TDC is confident the Expo will be successful. "We have already approached exhibitors and the reaction has been very positive," said Raymond Yip, TDC's assistant executive director.

The real impact of the duty elimination will not be known for another few months. The only certainty at this point is that Hong Kong will likely become a battlefield, with some of the most savvy international wine businesses fighting for a share of the pie, expected to reach \$20bn for the Asian region (excluding Japan) by 2012. ■