SUBMISSION ON THE 2002 BUDGET
from
THE HONG KONG WINE INDUSTRY COALITION

Proposed Increase of the Duty Rate on Wine from 60% to 80%

Introduction

This submission is made by the Hong Kong Wine Industry Coalition (HKWIC), a coalition comprising ten substantial Hong Kong companies which import / or sell wine in Hong Kong.

On 6th March 2002, the Financial Secretary presented his 2002-03 Budget to the Legislative Council. In paragraph 75 he proposed to increase the duty rate on wine from 60% to 80%. The proposal became effective immediately under a Public Revenue Protection Order, which will expire on 6th July. As a result, the government has introduced a Revenue Bill into the Legislative Council on 12th April, to amend the Dutiable Commodities Ordinance to implement the proposed increase in the duty rate.

Purpose

The purpose of this submission is to express HKWIC members' strong opposition to the proposed duty increase and to urge the government to reconsider its proposal. All the major companies involved in the import/or sale of wine in Hong Kong believe that such an increase would severely damage the wine industry and adversely affect the catering, retail and entertainment businesses, all of which still suffer from the impact of the current recession. HKWIC's reasons for such strong opposition are explained in detail below:

1. The proposed duty increase might cause a drop in revenue

When former Financial Secretary Donald Tsang presented his budget last year, he rejected a increase in the duty rates on strong spirits or wine, arguing (in paragraph 111) that ***"Increasing these duty rates might significantly push up retail prices and risk a switch to the consumption of cheaper products, defeating my objective of increasing revenue".*** Members of the HKWIC agree with Mr. Tsang's analysis and are surprised that his successor has taken the opposite view, without giving any explanation for the Government's *volte-face*.

In proposing the current increase, which he describes (in paragraph 74) as "modest", the Financial Secretary stated (in paragraph 75) that he expected to generate additional revenue of HK$70 million in a full year. In the year 2001, the government collected approximately HK$203 million in revenue from the duty on still wine. As the market for wine in Hong Kong has been more or less stagnant since the mid-1990s, and fell by more than 2% in volume in 2001, the government's expectation of an increase in revenue of HK$70 million in 2002-03 is unrealistic.

A duty increase from 60% to 80% will raise retail prices by approximately 12%. Consumers are extremely price-sensitive in the current economic environment: pushing up the retail price of wine will almost certainly lead to a further decline in overall consumption. Moreover, as Mr Tsang realized, such a significant increase in the retail price will encourage consumers to trade down to lower-priced wines, leading to a decrease in the dutiable value of wine purchased. Both these developments, combined with an expected increase in duty free purchases abroad by returning residents and smuggling, will cause a decline in government revenue.

2. **The proposed duty increase contradicts Government policy towards the wine industry**

In 2000, the Secretary for Commerce and Industry, together with the Trade Development Council (TDC), launched an initiative to build Hong Kong into a regional marketing and distribution center for wine. The TDC even commissioned a study from management consultants, Arthur D. Little, and held a seminar on 20 June 2000 to explore prospects and opportunities for the wine industry. In August 2000, the then Financial Secretary, Donald Tsang, together with representatives from AS Watson Wine Group, Ponti Trading and Dah Chong Hong, toured wine producing facilities in South Australia and encouraged them to set up shop in Hong Kong, citing Hong Kong's "business-friendly environment".

The proposed duty increase reverses the government's previous publicly stated policy of developing the wine industry in Hong Kong. Creating a high-tax domestic market environment for their products will not induce wine-making companies and importers to invest in Hong Kong, even if their main market focus is regional.

3. **The proposed duty increase would also harm the catering, hospitality and entertainment industries**

The proposed duty increase would not only affect companies in the wine importing and retail trades. It would also seriously affect the catering, hospitality and entertainment industries, as well as the convention and conference businesses. Revenue from sales of wine is particularly important to the catering industry, which alone buys 45 % of all wine sold in Hong Kong. This industry employs almost 200,000 people, which constitutes about 7-8% of the total labour force in Hong Kong, and over the last few years has generated HK$55 billion in annual turnover. Under current market conditions, the owners of Hong Kong's restaurants, hotels, bars and entertainment outlets are unlikely to pass on to consumers any price increases resulting from the duty rate increase. If the profit margins of businesses in these industries are further eroded, the livelihoods of all those who work in them will also be affected.

4. **Hong Kong's wine duty rate is already significantly higher than in China and Macau**

At the current rate of 60%, the duty on wine in Hong Kong is already extremely high, with the government collecting an average amount of HK$17 per bottle. In China, the rate of import duty on wine is now 34.4%, but this will drop to 14% by 2004, in accordance with China's WTO accession obligations. In Macau, the duty rate currently stands at 15%.

Raising the duty to 80% would further widen the gap. In fact, it would be absurd for Hong Kong to have an import duty rate on wine of approximately six times the rate in China. This would lead to under-declaration from unscrupulous importers and an increase in the smuggling of wine from across the Chinese border.

The HKWIC would like to know the Government's justification for proposing that Hong Kong consumers should endure import duty levels on wine, which are substantially higher than those in China and Macau.

5. People from all walks of life will be affected

There seems to be an underlying assumption behind the proposed duty increase that wine is a luxury product and that an increase in the rate of duty will not affect ordinary people. Indeed, the small amount of revenue that will be raised, even on the Government's own projections, and the fact that this is the only tax increase proposed in the entire budget, suggests that the proposal was made on something of a whim.

While wine is not an essential product, it is nowadays a staple consumer good enjoyed by a wide range of the population. The two leading Hong Kong retail chains have nearly 450 stores throughout the territory. Their top 60 premium stores only account for 25% of all wine sales, while the bottom 390 stores account for 75%, with an average selling price of HK$50 per bottle. Bottles priced at HK$100 and below constitute approximately 90% of the retail market.

As a result, the proposed duty increase affects a large cross-section of the population, not a small group of high-income earners, as is often suggested in the media. The HKWIC urges the Government to recognize that this proposal is opposed by many people from all walks of life. It is not justified by the small amount of revenue, which it might raise.

Review existing "ad valorem" duty system

For the reasons set out above, the HKWIC strongly opposes the proposed duty increase and requests the government to reconsider its proposal. In the long term, the HKWIC also recommends that the Government replace the current "ad valorem" system of duty with a "specific" system, under which a fixed amount of duty would be charged per bottle of wine imported. Such a specific duty would be far less labour-intensive and bureaucratic for the Customs & Excise Department to administer and collect.

Hong Kong Wine Industry Coalition Member companies

AS Watson Wine Group (Park n Shop, Watsons Wine Cellar, Watson's Wine Wholesale)
Clicquot Hong Kong Limited
Jardine Caldbeck Limited
Jebsen & Co Ltd
Maxxium China Limited
Pernod Ricard Hong Kong
Ponti Trading Limited
Riche Monde Hong Kong Limited
Telford International Company Limited
Wellcome Company Limited

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