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Shanghai Wine Brief

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Report Highlights:

Shanghai is the largest market in China for imported U.S. wines. In 2005, the U.S. was the third largest exporter (by value) of wines, after France and Australia (WTA). As the up-and-coming financial center for Asia, Shanghai is now home to a clutch of exclusive 5-star restaurants, wine bars, boutiques and supermarkets that sell imported wine to an increasing number of wine savvy locals. A large potential market for wine exists considering the low level of current per capita consumption of domestic wines (and even lower for imported). China's rapid economic growth has led to the emergence of a middle class with global consumer tastes. ATO Shanghai and the other ATOs in China are here to help with in-market advice to winemakers and exporters interested in the China market.

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Executive Summary



“In Vino Veritas!”

Shanghai is the largest market in China for imported wines. In 2005, global winemakers shipped \$75 million worth of wine to Shanghai (Shanghai Customs).¹ As the up-and-coming financial center of Asia and the keystone to massive foreign investment in the Yangtze River delta, Shanghai is now home to a clutch of exclusive 5-star restaurants, wine bars, boutiques and supermarkets that sell imported wine to foreigners and increasingly to locals as they become more educated about wine. French and

Italian wines have been in the market for years and enjoy high brand recognition amongst Shanghaiese, but in blind taste tests consumers prefer U.S. wines' fruitier, fuller flavor. The large potential market for wine in China remains untapped. The current low level of per capita consumption of domestic wines (and even lower for imported), in combination with the country's rapid economic growth and emergence of a middle class with global consumer tastes, means that the market is set to grow. Some estimate that the average Chinese person consumes only 0.3 liters, or just two glasses of wine, per year. However, the average is slightly higher for urban residents at about one bottle per person. Compared to countries like the USA (12 liters), Japan (3 liters) and France (59 liters), China has a huge potential for growth. For winemakers and wine exporters, the key to success in this market is perseverance in marketing their wines over the long-term.

The China Wine Market

General

The total value of retail wine sales in China is disputed. Estimates range from \$1.25 billion to over \$7 billion in 2005 (China Wine & Liquor Expo, Euromonitor). However, the overall trend in the market is one of growth with indications of increased consumption of wine over the past few years. Most of this comes from domestically produced and blended wine. Anecdotal evidence suggests that 70 percent of wine sales in China occur in restaurants and bars; however, no official figures are available on HRI sales. Total China imports of wine (sparkling, white and red) for 2005 were valued at \$75.1 million, up 42 percent

Quick Facts

- 92 percent of wine imported from the U.S. in 2005 was bottled (FAS)
- In 2005, the U.S. was the third largest exporter of bottled wines to China by value, after France and Australia (World Trade Atlas)
- In blind taste tests, Chinese prefer the taste of U.S. wines over those of France
- Key trade shows in Shanghai featuring wine:
 - Shanghai International Wine and Spirits Fair: July 5-7, 2006
 - Food and Hospitality China: Nov 30-Dec 2, 2006

¹ This report primarily uses data from the USDA's Foreign Agricultural Service (FAS) and China Customs as reported in the World Trade Atlas (WTA). FAS and China Customs records vary widely on U.S. export data for China. In this report, FAS data is used for U.S. statistics, and China Customs data is used for information on all other exporting countries. For more details on the differences in reporting, please see Appendix A.

from 2004. From 2004 to 2005, U.S. imports increased 8 percent in value to almost \$6 million, and 4 percent in volume, to reach over 2,400 KL. (FAS trade data, World Trade Atlas)

China is a wine-producing country with over 500 wineries in operation, 10 or so of which are major producers. Major vineyards are located in China's northeast (Hebei and Shandong provinces) and in its far-flung western province of Xinjiang, which are all about the same latitude as the south of France. With the opening of China's economy, Modern commercial viticulture has developed over the past 30 years. Four state-owned companies (Dynasty, Changyu, Great Wall and Tonghua) control about two-thirds of the market. Joint ventures with foreign wine companies, notably with Illva Saronno SpA and Remy Cointreau, have helped China's wineries procure vines, improve production technology, and use foreign expertise. In the past year, there has been interest from U.S. wineries in forming joint ventures in China. Domestic producers are investing heavily in marketing and brand building, pushing imported wines up the value pyramid.

Domestic brands dominate the mass market in Shanghai. Domestic wines retail at \$4 a bottle on average, and as low as \$1.50, making them attractive choices for consumers that cannot afford imported wines. Although imported wines are interested in trying to enter the market, they cannot compete on price alone. For example, a bottle of Carlo Rossi currently sells for around \$7.50 retail. Similarly in restaurants, the least expensive bottle of domestic wine will be priced \$5 to \$10 lower than the least expensive import.

The Region

China's Yangtze River Delta, which includes Shanghai and its prosperous satellite cities in Jiangsu Province to the north and Zhejiang Province to the south, is a key consumer market. Shanghai's 20 million residents have the highest per capita disposable income in China. The U.S. Consulate estimates per capita income at \$6,500. Urban residents in nearby provinces are not far behind; per capita disposable income for the entire province averaging \$1,300 in Jiangsu Province and \$1,800 in Zhejiang Province (China Statistical Yearbook 2005). Shanghainese are more inclined to try new foods and flavors than other parts of China and lead the nation in food and restaurant trends.

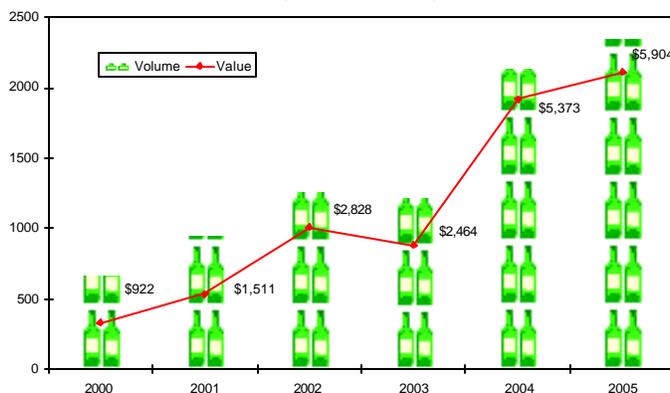
Imported Wines: High Hopes for the High-end Market

The present popularity of U.S. wines in other booming East Asian markets bodes well for the opportunities presented in the China market as its economy continues to expand. In addition to good prospects for U.S. wine in general, there is great potential in the high-end luxury goods market.

The value of U.S. wine exports to China increased three-fold from \$1.5 million in 1999 to almost \$6 million in 2005. Exports have shifted in favor of bottled over bulk, with bottled imports up from 690 KL in 1999 to 2,024 KL in 2005, while bulk shipments have actually declined. Due to their late entry, U.S. winemakers have yet to gain a significant market share relative to their

French and Italian counterparts, or relative to other latecomers such as Australia and Chile. French wine imports had the highest value of all countries in 2005 at \$21.5 million

Chart 1: U.S. Wine Exports to China
(Volume in KL)



No cause for sour grapes: despite a slower year in 2003, U.S. wine exports have achieved new highs.

Source: US Trade Data

(\$3.35/per liter), followed by Spain at \$13.3 million (\$0.58/per liter), and Chile at \$12.5 million (\$1.07/per liter). The evidence points toward Chilean and Spanish wine being mixed with domestic wine before retail sales.

Bulk Imports

China imported 42,800 KL of bulk wine in 2005 (WTA). Chile surpassed Spain as the dominant bulk exporter in 2001, but in 2005, Chilean exports have declined slightly. Blending domestic wine with imported bulk wine and labeling it as “domestic” is standard practice. Despite more than 160,000 acres of vineyards in China and a growth rate in production around 10 percent per year, demand outstrips supply. By

some estimates, wines labeled as domestic often contain 30 percent to 40 percent imported product. Labeling such product domestic is legal under Chinese law. Some U.S. wineries may find joint ventures with Chinese companies useful as a means of finding markets for surplus bulk wine. Blending helps improve the quality of the local product.

Shipping in bulk and bottling in China can also simply be a cheaper alternative to shipping bottled, and wines can keep their foreign brand name and market image. Additionally, it opens up the ability for restaurants and other venues to privately label quality wine at a lower price.

Bottled Imports

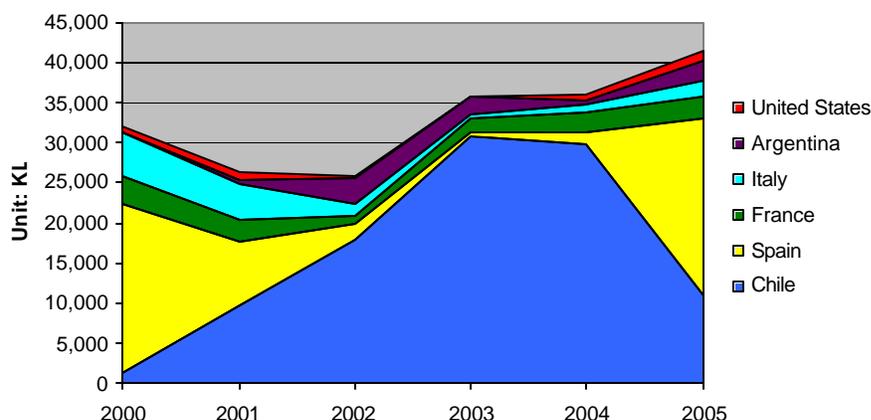
China imported over 10,800 KL of bottled sparkling and still wine in 2005 (WTA). Imported bottled wines comprise less than 1% of the total retail market on a volume basis, due in part to the enormous volume supply of domestic wine available (Euromonitor).² Imported bottled wines set the standard for the high-end market, competing not only with expensive domestic wines, but also with equally pricey imported spirits such as VSOP and Hennessy. Competition among exporting countries for the limited high-end niche is fierce, with France and Australia in the lead. The largest market in Shanghai for imported bottled wine is the hotel and restaurant industry, including nightclubs. Shanghai's 4- and 5-star hotels, western restaurants (from 2-star to world-class) and up-scale local chain restaurants targeting Shanghai's middle and upper classes all carry imported wines. Some local chain restaurants also feature private label imported wines.

These venues' growing popularity presents an increasing opportunity to showcase high quality product in an appropriate environment. The greatest potential consumer group is young-to-middle-age Chinese with higher incomes who drink wine in high-end hotels, restaurants, clubs and bars. Shanghai's Xintiandi (pronounced “shin tyen DEE”), a complex of carefully assembled up-market bars and restaurants frequented by white-collar locals and foreigners, is one such venue. Establishments in Xintiandi, and similar up-scale locations, are carrying increasingly diverse selections (in terms of origin, type and price) of wines. Even after the businesses add their own margins, typically doubling the beginning wholesale

² Does not factor in the amount of imported bulk wine that is mixed with Chinese wine and labeled as “domestic”, even if the domestic wine is actually 30-40 percent from foreign grapes.

Bulk Wine Exports to China, 2000-2005

World Trade Atlas



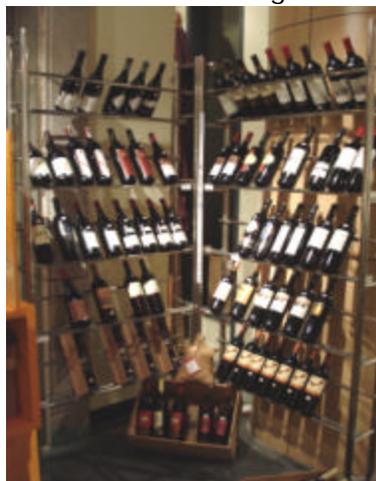
“C” change: within just the last 4 years, Chile and Spain have become dominant forces in the bulk wine import

price, the wines sell quite well. U.S. wines can be readily found at most price-points, alongside the \$12 wines from Chile and Argentina as well as the \$1,000+/per bottle French wine.

Retailers have a growing interest in imported wines and in the past couple of years a new market has opened in Shanghai for specialty wine stores. Xintiandi and other upscale retail shopping areas throughout Shanghai now feature such stores. Right now they cater mostly to expatriates, but have seen an increase in Chinese customer traffic. Stores such as Cheese and Fizz feature wines from Napa Valley that have proven to be among their top selling wines. The focus on the high-end market is not limited to specialty shops but also includes online retailers. These e-retailers are seeing a trend towards online shopping and home delivery. In some cases, the selection offered on-line may be larger than what is available in a store. New offerings like Winespring.com are looking to establish a high-end, online showcase for U.S. wines.

Marketing in a New Culture

One would be hard-pressed to find a commodity with a more positive image in China than wine, which is associated with sophisticated western culture, the social elite and good health. While this positive image of wine has been popularized, however, wine education—how to appreciate fine wine—has not matched this trend. A factor making wine education more difficult is the government's very loose regulation on appellation and grape varieties, which results in Chinese wine labels being less meaningful to consumers. Although the wine industry has debated using the French or German system of classification, no decision has been made (China Wine Online).



**Cheese and Fizz
Napa Valley wines are top
sellers in high-end
specialty wine stores.**

Despite a history of winemaking that extends back to at least 212 B.C., and commercial wineries operating since the end of the 19th century, winemaking has been limited in scope and developed along a different trajectory than the European wine tradition. It is only since China's opening in the 1980's that modern wine drinking has caught on in local drinking culture. It has been quickly embraced as a healthy, new, lower-cost alternative to other high-end drinks such as imported brandy and Scotch or Chinese spirits.

At present, wine purchases by local Chinese fall largely into two categories: banquet dinner purchases and retail gifts. Banquet consumption generally involves competitive drinking among men (and occasionally women) in formal settings in which the ordering of expensive dishes and drinks demonstrates respect for guests or colleagues. Red grape wine frequently substitutes for higher-octane clear spirits (*baijiu*) at official banquets in Shanghai, especially for toasts. This practice has been encouraged by the Chinese government in attempts to improve health and reduce levels of drunkenness.

Chinese wine drinking habits have been known to differ from those in the West. Some of these habits have disturbed Western wine aficionados. Wine is used for toasting several times in the course of a meal, or mixed with lemon, ice or Sprite. The long-time foreign presence in Shanghai has resulted in a familiarity with western wine drinking practices, and local wine lovers are adopting them. For the most part, however, ordinary Shanghainese and their compatriots in nearby cities continue to mix or dilute wine to achieve a sweeter taste. As one distributor commented, "No one likes the taste of wine the first time."

Wine is typically purchased as an elegant and tasteful gift to share or for others to enjoy. Wine conveys the same affection and respect as a gift item as it does at a banquet, to be given on special occasions such as Chinese New Year or a housewarming party. Gift packaging in the form of a sturdy, highly decorated cardboard display box is standard. Larger gift boxes may include 2 bottles of wine and a corkscrew or wineglass, all resting on a “satiny pillow” (a plastic mold covered with attractive fabric).

Even as Chinese consumers gradually assume western wine consumption habits, there are some differences in the Shanghai market that will remain for the foreseeable future:

- About 80 percent of the wine consumed in Shanghai and across China is red wine. This is partly due to positive media on red wine’s health benefits and the growing market for eating out. Interestingly, in blind taste tests, Chinese prefer white; however, because of wine’s function as a symbolic gift and not for personal consumption, red wine sales continue to be strong. Wine pairing with food is as yet uncommon. Most Chinese prefer the appearance of red wines to white (red is also the color of good luck), so they tend to choose reds for all dishes. White wine sales tend to be to foreigners who are attuned to food pairing and to local women, who prefer white wine to beer. Women often drink it straight or mix it with soda, making a type of spritzer. White wine sales increase significantly during the summer because it can be enjoyed chilled.
- Shanghainese prefer the fruitier, fuller tastes of U.S. wine. 65 percent preferred the taste of California wine in a blind taste test against French, Chinese, and Australian wine. However, the participants associated this taste with French wine, indicating a lack of awareness for U.S. wines. Because purchase behavior is so strongly linked with wine’s image, to succeed in the local market U.S. exporters need to promote their product image as quality, prestigious wine.
- Lastly, access to mainstream, middle-class Shanghainese is a long-term goal. At present, only a few imported wines are able to get product in to market at a low enough price level so as to compete with domestic wines, meaning the majority of imported wine is limited largely to foreigners and upper-income urban Chinese. Distributors in Shanghai cite strongest sales in up-scale and/or western bars and restaurants, supermarkets frequented by expatriates, home delivery to foreigners, and corporate or free-flow events. Online sales are also on the rise. As incomes rise and more Shanghainese become familiar with imported wine and learn to enjoy the taste, imported wine consumption will continue to increase in bars and restaurants (western and Chinese) as well as in retail.



State-owned tobacco and liquor store in Shanghai. Very few if any US wines are sold in these stores. Whether foreign wine retailers will enter the market is yet to be seen.

Marketing Assistance

Introducing a foreign wine and creating a brand that suits Chinese consumers takes commitment and a targeted marketing strategy. The Agricultural Trade Office/Shanghai, one

of four FAS offices located in China, provides country market information, market development support and a wide variety of activities designed to strengthen distribution channels for U.S. agricultural products. ATOs are a good place for a winemaker or exporter who is interested in the China market to seek in-market advice.

ATO works with cooperators, including the California Wine Institute (CWI), the Napa Valley Vintners Association, and the Oregon Wine Board to promote U.S. wine in the Shanghai area. Events such as wine tastings for trade professionals, wine dinners, and trade shows are typical ways to introduce wines to hotel and restaurant buyers and distributors. France and Australia, for example, have consistently installed large pavilions at trade shows dedicated to their wines. Today they have the highest market shares for bottled wine. Consumer wine tastings have become prevalent. However, unless the product is very unique or a famous brand, interest is minimal. Establishing a brand is a long-term process and must be properly focused for meaningful results. ATO is happy to work with wineries and exporters new to the market that wish to have custom programs to test market their wines with distributors.



While volume has increased, the average price has declined, most likely through increased shipments of large-volume bottles/containers.

ATO's large umbrella events for U.S. products, such as restaurant and retail store activities and the multi-product Chinese New Year promotion in mid-winter, are good places to begin to increase market awareness directly among end users. To get more bang for their buck, wineries from a particular regional appellation are encouraged to work together to establish a market image for that region. Those who would like first-hand experience with the China market are encouraged to visit or join a trade mission.

Distributors, Import Laws and Regulations

The first step in exporting bottled or bulk wines to Shanghai is to find a good distributor. Although the major wine distributors/importers offer impressive lists of imported labels, most currently do not proactively market new wines. That said, an interested importer/distributor can be useful by: explaining tariffs and labeling requirements, helping a seller quickly register wine so it can be imported, and helping import small quantities hassle-free for trade shows and tastings. With the help of your distributor, arranging annual visits to current and potential buyers in China is a very effective way of staying visible in the market and building relationships, an essential element for success in China. A detailed list of wine importers and distributors in the area can be provided by the ATO upon request.

Imported wine is subject to a total import tax of 48.2 percent for sparkling and still wines in containers less than 2 liters (bottled table wines), and 56 percent for wine in containers over 2 liters (bulk wine)³. This consists of three separate taxes: the import tax rate, consumption tax rate, and VAT rate. The current tax levels are expected to remain constant for the near future, although if imported wine begins to overpower the domestic wine market, the government may consider raising the consumption tax to level the playing field. Imported U.S. wines are retailing on average at 130-300 RMB (\$15.50-\$36) a bottle. Despite the tax disadvantage, China's ability to offer quality facilities at lower costs means shipping bulk and

³ Producers of bulk wine may deduct consumption tax import costs from their general costs. The formula for the import tax, including tariffs, VAT, and consumption tax, is provided in Appendix C.

bottling in China can significantly lower retail prices to 38-70 RMB (\$4.85-8.50) per 750 ml bottle. A number of U.S. companies have recently increased bulk shipments to China.

China's labeling requirements for imported wine require that certain product information on the bottles be in Chinese (see Appendix B, List of Required Product Information on Chinese Labels). Regulation GB 7718-2004 provides the Chinese requirements for labeling. (An unofficial translation is available in the FAS GAIN Report CH4026.) Enforcement is constantly being updated, so before shipping it is helpful to study the regulation carefully and thoroughly.

Previously, distributors for many foreign wineries placed small, adhesive labels over their back labels, leaving the more artistic front labels untouched. These stickers are no longer acceptable, although regional CIQ offices appear to exercise some flexibility in enforcement. Their discretion will reportedly grind to a halt on Oct. 1st, 2006. China's labeling regulations are quite strict about appellation claims. The importer must provide production and sales licenses from the wine maker to prove appellation claims made on the label. It is still a lengthy process to get a label approved and it is beneficial to thoroughly review the regulations.

SWOT Analysis

<p>Strengths</p> <p>Shanghai's per capita GDP and population continue to grow and residents are developing a more sophisticated taste for wine.</p> <p>Shanghai's per capita GDP and population continue to grow and residents are developing a more sophisticated taste for wine.</p> <p>Shanghai's per capita GDP and population continue to grow and residents are developing a more sophisticated taste for wine.</p> <p>Shanghai's per capita GDP and population continue to grow and residents are developing a more sophisticated taste for wine.</p> <p>Shanghai's per capita GDP and population continue to grow and residents are developing a more sophisticated taste for wine.</p>	<p>Imported wine has a positive image as a high-quality, healthy and excellent gift.</p> <p>Distributors/importers in Shanghai have much experience and can cover all details of wine sale and distribution.</p> <p>Wine education is still in its infancy. Few consumers know the advantages of U.S. wines.</p>	<p>Weaknesses</p> <p>Long-term commitment and personal contact is necessary. To achieve its current high recognition, France has marketed it wines heavily for over 10 years.</p> <p>Wine tastings are so common that it is increasingly difficult to attract top buyers.</p> <p>Importers face a high import tax, making them less competitive with domestic wines.</p>
<p>Opportunities</p> <p>HRC sales are a large and still largely untapped market.</p> <p>Listing in Shanghai's mid- to high-end chain restaurants is a good way to develop brand awareness and mass-market sales.</p> <p>Distributors and retailers are developing an online presence and increasingly offering online sales.</p>	<p>Bottling in China is a cheaper alternative to shipping in bottles, and wineries can still keep their foreign brand name and market image.</p> <p>As wine knowledge improves, more specialty stores are opening that offer many high-end wines.</p> <p>Many established and newly established competitors (France, Australia, Chile, Spain) could threaten US potential market share.</p> <p>The Chinese government will enforce its labeling requirements more strictly.</p>	<p>Threats</p> <p>Counterfeiting and IPR violations in China continue to be a problem in all industries. Counterfeit U.S. wines could lower sales and damage reputations.</p> <p>Improving quality of domestic wines make them more internationally competitive.</p>



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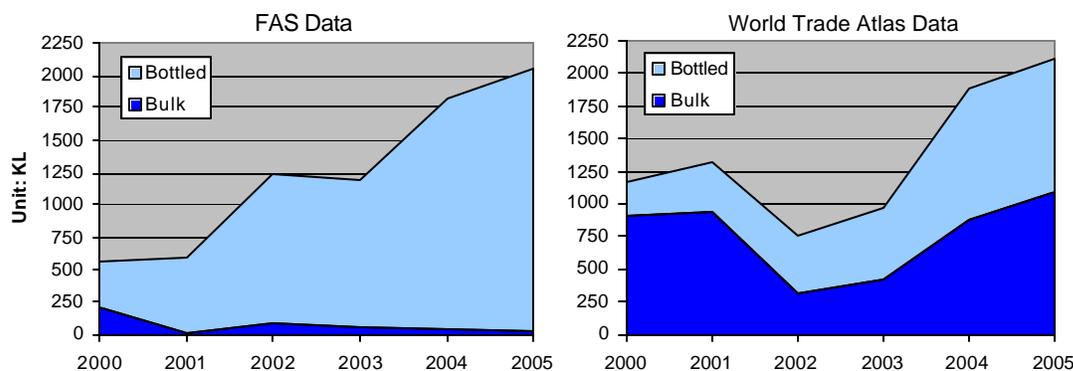
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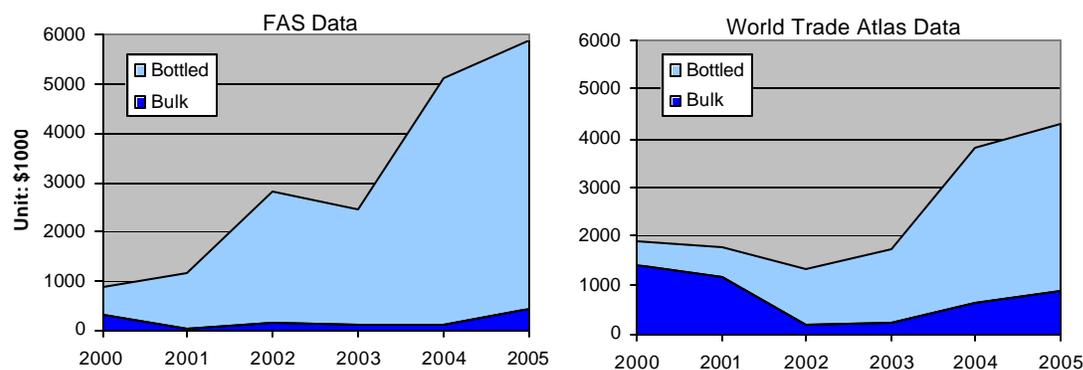
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Appendix A: Discrepancies Between U.S. and China Data

Volumes of U.S. Wine Exports to China. 2000-2005



Values of U.S. Wine Exports to China. 2000-2005



Appendix B: List of Required Product Information on Chinese Labels

- A. Name/Brand
- B. Ingredients
- C. Net volume (ml)
- D. Alcohol content (%)
- E. Production place
- F. Production date (yy/mm/dd)
- G. Packer/distributor/importer (Name and address)
- H. Must content (%)
- I. Country of origin
- J. Quality guarantee or storage period (yy/mm/dd)
- K. Sugar content (g/L)

Appendix C: Formula to Determine Import Tax on U.S. Wine

Total import taxes for bulk and bottled wine factor in an import tax, consumption tax, and VAT:

Import tax rate (ITR)	
Bulk wine	20%
Bottled wine	14%
Consumption tax rate (CTR)	10%
VAT rate	17%

Rather than being the simple sum of these percentages, however, the total import tax is calculated using a compound formula. Using bottled wine for an example, the compound rate is calculated as follows:

$$\text{Total import tax} = \frac{\text{ITR (0.14)} + \text{CTR (0.10)} + \text{VAT rate (0.17)} + (\text{ITR (0.14)} \times \text{VAT rate (0.17)})}{1 - \text{CTR (0.10)}}$$

Simplifying,

$$\text{Total import tax} = \frac{0.41 + 0.0238}{0.9} = \frac{0.4338}{0.9} = 0.482 = \mathbf{48.20\%}$$

Source: 2005 Customs Import and Export Tariff of the People's Republic of China

We can calculate that the total import tax on bottled wine is 48.2 percent and on bulk wine is 56 percent.

Appendix D: U.S. Wine Exports to China, 2000-2005

COMMODITY	HS TARIFF CODE	Value (1,000 U.S. dollars)/Year						% CHANGE '04-'05
		2000	2001	2002	2003	2004	2005	
SPARKLING WINE	2204100000	13	313	18	11	53	22	-58.49
EFFERVESCENT WINE	2204212000	42	23	0	0	194	7	-96.39
WINE, <2L, <14% alcohol	2204214000	541	1,150	2,672	2,354	4,957	5,227	5.45
WINE, <2L, >14% alcohol	2204217000	0	0	8	17	83	228	174.7
WINE, >2L, <14% alcohol	2204290020	318	0	130	60	86	322	274.42
WINE, >2L, >14% alcohol	2204290040	8	25	0	22	0	98	--
	TOTAL	922	1,511	2,828	2,464	5,373	5,904	9.90

Source: U.S. Customs