

***PHILIPPINES – TAXES ON DISTILLED SPIRITS***

**(DS396/DS403)**

**EXECUTIVE SUMMARY OF THE  
OPENING STATEMENT OF THE UNITED STATES OF AMERICA  
AT THE FIRST SUBSTANTIVE MEETING OF THE PANEL**

**NOVEMBER 24, 2010**

1. The Philippines does not dispute the essential facts about its measures and how it taxes local spirits compared to imported spirits. The Philippines does not protect just one type of domestic product. Philippine producers use local raw materials, sugar in particular, to make many different types of distilled spirits including brandy, whiskey, vodka, gin, and tequila. Philippine brands like Emperador Brandy, London Gin, and White Castle Whiskey compete directly with imported counterparts like Fundador, Bombay Sapphire, and Jack Daniels. Yet, because the Philippine versions of these products are made with the local type of raw material – sugar – they are subject to a very low excise tax. Excise taxes on locally produced products are a fraction of the taxes on imported products – Philippine products made from sugar presently are taxed at 13.59 pesos per proof liter, and products from other raw materials are taxed at much higher rates – from 146.97 to 587.87 pesos per proof liter.

2. Filipinos overwhelmingly choose the lower-taxed local products. Despite high per capita alcohol consumption and a generally strong market for spirits, barely any imports are sold in the Philippines. Imported spirits are only about 2.4% of the Philippine market, and the top ten local brands comprised almost 96% of the Philippine market for distilled spirits as of 2009. The Philippines does not dispute that its market is dominated by local brands, nor that these brands are taxed at a lower rate than imported brands.

3. As the United States and the European Union detailed in their respective submissions, and the European Union discussed earlier today, the Philippines' taxes are inconsistent with Article III:2 of the *General Agreement on Tariffs and Trade 1994* ("GATT 1994"). Specifically, they are inconsistent with both the first and second sentences of that paragraph.

4. The issues in this dispute are straightforward. Several WTO panels already have applied Article III:2 of the GATT 1994 to discriminatory taxation systems for distilled spirits. Even though the Panel's findings in this dispute will be based on the Philippines measures at issue and information about the Philippine market for distilled spirits, the panel and Appellate Body reports in *Japan – Taxes on Alcoholic Beverages*, *Korea – Taxes on Alcoholic Beverages*, and *Chile – Taxes on Alcoholic Beverages* provide guidance on a clear path forward.

5. Nor are the facts particularly complex – the Philippine tax system specifically singles out distilled spirits made from local raw materials for the much lower tax rate. And Philippine domestic products are made from local raw materials, sugar in particular. Its tax system, favoring products made from local materials, has been in place for more than a century. It has persisted over the years, even as the international trading system has changed, including most critically for today, the creation of the World Trade Organization dispute settlement system. While Filipino policymakers have tried to address the discriminatory nature of the tax system and several reform measures are pending before the Philippine Congress, none of these reform efforts have been successful.

6. While the facts and the law in this dispute are quite straightforward, the Philippines has attempted, through its lengthy first submission, to add confusion and complexity. The United

States will not describe in detail each of the Philippines' attempts to complicate the facts or law before the Panel. Instead, we will respond to several of the main arguments raised by the Philippines.

7. We will address the following points in turn.

- First, contrary to what the Philippines claims, the fact that Philippine producers use different raw material to make brandy, whiskey, and other types of distilled spirits from that used to make the corresponding imported distilled spirit does not permit the conclusion that the products are not “like” or not “directly competitive or substitutable” with imported products. (To the contrary, the different raw material is part of the structure of the Philippines' measures that results in the WTO inconsistency.)
- Second, contrary to the Philippines argument, evidence before the Panel confirms that Philippine consumers would be more likely to purchase imported products, as substitutes for domestic products, if the price difference were smaller.
- Third, alleged segmentation of the Philippine market would not, as the Philippines suggests, preclude the products at issue – Philippine and imported brandy, whiskey, gin, vodka, etc. – from being substitutes for one another.
- Fourth, the United States and European Union have provided the Panel ample evidence to make out their claims against the Philippine measures.

8. In Part D of its submission, the Philippines describes in detail the production process for distilled spirits made from different raw materials. It argues that its distilled spirits – made from sugar – cannot be “like” other distilled spirits because of physical differences. We will address this contention first.

9. To be sure, physical differences are an important part of determining whether domestic and imported products are substitutes, but substitutability also depends on other criteria, including end use, consumers' tastes and habits, and the products' nature and quality, and must be made on a case-by-case basis appropriate to the measures and the market of concern. The Philippines relies heavily on the fact that local raw materials are used in the production of the domestic products at issue to argue that these products are physically distinct from imported distilled spirits. Contrary to what the Philippines asserts, the mere fact that local raw materials are used in the production of domestic spirits does not render the products at issue physically distinct in any meaningful way. Rather, the Philippines measures depend on the use of local raw materials to discriminate against imported products. The United States respectfully requests that the Panel consider the Philippines' evidence on raw materials in that context.

10. Furthermore, all distilled spirits are made from a natural raw material that has sugar

content, whether sugar cane, fruit, grain, or some other product. As discussed in the Philippines' submission, regardless of the raw material, the alcohol production process involves fermentation of the raw material to produce the alcohol, and subsequent distillation of the fermented material to separate out the alcohol product.

11. Scientists can analyze the final distilled spirits to determine the chemical composition of the products. The Philippines cites such technical, laboratory results in support of its argument that its whiskies and brandies are different from imported whiskies and brandies. Gas chromatography, for example, can be used to determine whether a product has isoamyl acetate or isoamyl alcohol. But, a Philippine consumer is very unlikely to know about gas chromatography analysis, nor are such results relevant to determine whether the products are substitutes. Even "like products" need not be identical.

12. More importantly, other aspects of the production process that the Philippines cites as differences between its domestic spirits and imports – distillation process and aging – are directly related to the Philippine producers' efforts to make their brands as much like imported products as possible.

13. For example, the Philippines describes how its sugar-based products may be distilled longer in order to make a neutral spirit that does not retain the flavors of naturally occurring congeners. But, a longer distillation process is not particular to production of spirits from sugar – in fact any raw material can be distilled to the point that it loses its naturally occurring flavors and is just neutral spirit. In the Philippines, the sugar-based spirits are distilled to the point that they lose their natural flavors specifically so that they can be combined with "flavouring extracts or concentrate, or natural, nature identical or artificial flavours and essences" in order to mimic the natural congeners of spirits from other raw materials. In other words, the differences in the distillation process enable production of the same types of spirits from different raw materials.

14. Similarly, the Philippines points to the fact that its producers do not age sugar based whiskey and brandy as a difference between domestic and imported products. However, its sugar-based products, made from neutral spirits, would not necessarily age in the same way and produce the same flavor profile and other characteristics. Instead of aging its sugar-based products, Philippine producers add flavors to mimic aged whiskies and brandies. Like the difference in distillation process, the Philippine producers intentionally do not use an aging process to minimize differences between their products and the imports against whom they compete. In addition, the Philippines' claim that all scotch whiskies must be aged twelve years is mistaken; some whiskies, including Scotch whisky, may be aged for a much shorter period.

15. The Philippines' own regulations are consistent with the fact that their domestic products are like imported products. The Philippines claims that the United States is incorrectly reading its Standard Administrative Orders for brandy and whiskey, because only "compound" whiskey or brandy may be made from sugar. (It makes no such rebuttal argument on vodka, where there is

no “compound” variety identified in the SAO.) But “compound” whiskey or brandy is still whiskey or brandy – it is defined by the standard for whiskey or brandy, respectively, just like other sub-types like “blended,” “malt,” or “straight.” Moreover, “compound” does not appear on labels of many major Philippine brands. The Panel can see this for itself in the examples provided today, as well as pictures already on the record. And any purported difference is likely not apparent or recognized by consumers.

16. In its discussion of physical differences between imported and domestic products, the Philippines points to the standards in the United States and the European Union, under which Philippine sugar-based products could not be sold as whiskey or brandy in those markets. However, these standards simply are not relevant to assessing whether Philippine and imported products are substitutes in the Philippine market. The fact that a Philippine whiskey could not be labeled “whiskey” – compound or otherwise – if sold in the United States could be a factor in understanding how products compete in the U.S. market. But in the Philippines, both sugar-based and other whiskeys are labeled as “whiskey,” sugar-based and other brandies are labeled as “brandy,” sugar-based and other gins are labeled as “gin”, and so on. Moreover, the United States recalls that products may be “like” even if they go by different names. The Panel in *Japan – Alcohol* confirmed this by finding vodka to be like Japanese shochu.

17. The products that result from the Philippine producers’ distillation process are “like” imported products. The colors of the Philippine whiskeys, brandies, and gins are like those of imported whiskeys, brandies, and gins, and the descriptions of their flavors emphasize their physical similarities. These attributes in the final product are the ones on which a consumer will make an assessment – not the details of the distillation process, or a lab report on the chemicals in a distilled spirit. Given the pains to which Philippine producers go to mimic imported brands and market them as comparable, it is not really credible to say that Philippine White Castle whiskey is not a substitute for imported whiskey.

18. The next part of the Philippines’ presentation we will address is their discussion of price elasticity and the evidence before the Panel on the substitutability among imported and Philippine distilled spirits.

19. Like the Philippines’ raw materials arguments, its discussion of price responsiveness also must be put into context: it is just one of several relevant factors, including end uses and physical characteristics, for determining whether products are “like” or “directly competitive or substitutable.” And, as noted above, the appropriate analysis is case-by-case, depending on the particulars of the market concerned.

20. Nonetheless, the evidence of price substitutability does support the fact that imported and domestic products compete in the Philippine market. The United States and European Union provided the Panel a reliable, focused study by Euromonitor on several aspects of consumer views and preferences in the Philippines. Yet, the Philippines suggests that the Panel should

disregard the Euromonitor Consumer Preference Survey as not representative or otherwise not indicative of the substitutability between imported and domestic products.

21. In fact, the participants in Euromonitor's survey were identified using criteria specifically selected to result in knowledgeable, valid responses to questions comparing imported and domestic brands of distilled spirits. As described in the Euromonitor report, the final survey sample was selected based on criteria specifically relevant to answering questions comparing domestic and imported spirits. Participants were asked whether they consumed spirits, and what kinds. The resulting sample was precisely the group with information about both imported and domestic brands in the best position to answer questions comparing the two groups.

22. The Methodology section of the Euromonitor report describes how the population was selected. The respondents were screened to include only those who consumed alcohol, which was necessary to collect useful results. Euromonitor also notes its additional work to assure representativeness of the sample, and that the respondents had access to both imported and domestic brands of spirits.

23. In short, although there may be some differences between the average survey respondents and the average Filipino, Euromonitor sought and collected data specific to the Philippine market precisely from those individuals in the best position to provide the data: Filipinos who consume spirits and have access to both imported and domestic products.

24. As to the results of the Euromonitor survey, they reflect consumers' modest movement to imported products in response to changes in price. The Philippines criticizes the fact that the magnitude of this change is small. But recall: imports were still more expensive in each of the scenarios described in the survey, making it particularly telling that consumers would consider changing their consumption patterns in favor of imports. The respondents in the survey were willing to consider changing brands even if the price differences were not entirely eliminated.

25. The United States is not asserting that imported products would receive a particular share of the Philippine market in the absence of the discriminatory tax system, nor is it required to make such a showing in order to prove substitutability. Rather, the evidence of price substitutability simply demonstrates that imported whiskey, brandy, and gin are substitutes for Philippine whiskey, brandy, and gin. When imports are relatively less expensive, consumers are more likely to choose them over domestic products.

26. The Philippines has prepared its own survey on price substitution, as rebuttal to the straightforward consumer response data from Euromonitor. Specifically, it prepared two reports, the Abrenica and Ducanes Report, and the Clarete Report, which used data from the Abrenica and Ducanes piece.

27. As an initial matter, it should be noted that even the Philippine studies support the conclusion that there is some price substitutability between domestic and imported products. Nevertheless, the United States would like to bring to the Panel's attention several aspects of the studies' methodology that are problematic. For example:

- The survey treated all drinking occasions as homogeneous. That is, the responses were based on whether a consumer would choose a different spirit without regard to the occasion. However, the setting for consuming spirits may affect a consumer's choices. For example, as the Euromonitor Consumer Preference Survey confirms, a consumer in the Philippines might be willing to pay more for an imported spirit for a special occasion. But, he or she might not show willingness to purchase a pricier brand on an ordinary basis. These occasional purchases are lost and are not considered in the Philippines' survey.
- The analysis of the survey questions in the Abrenica and Ducanes report did not account for product quality. More expensive products may be perceived as higher quality and, if so, make consumers more willing to pay more. Lack of accounting for quality may have reduced the willingness to pay more for perceived higher-quality products, including imports.
- The construction of the choices in the Abrenica and Ducanes survey tends to reduce respondents' responsiveness to changes in price. Oddly, the predicted value of liquor sales based on the survey results suggest that the consumption of some products actually *decrease* in response to a reduction in price. This result does not comport with elementary rules of demand theory.

28. In short, the statistics that the Philippines has provided shed little light on consumer attitudes in the Philippines, nor on consumer views on whether Philippine and imported spirits are "like" or directly competitive or substitutable.

29. The next main theme of the Philippines' submission concerns its attempt to divide the Philippine market into two parts: lower income Filipinos who shop at sari sari stores, and more wealthy consumers. Since lower-income consumers would not be able to afford imported products, the Philippines' logic goes, imported and domestic products are not substitutes.

30. The Philippines' specific arguments on sari-sari stores concern whether imports and domestic products are sold in the same channels of distribution, a factor that other WTO panels have used in analyzing the substitutability between imported and domestic brands of distilled spirits. As with elasticity of substitution and physical characteristics, this must be considered in the context of the Philippine market. Given that all imported spirits comprise only about 2.4% of that market, it would be surprising to see imports in most local or smaller shops. If demand shifted – whether because of changes in price, income, or simple consumer preference – a small

sari sari store could quickly adapt and add some bottles of imported spirits to its shelves. In fact, the United States understands that many sari sari stores simply purchase their inventory from larger stores and resell it in the smaller shop where their local customers have better access.

31. In *Korea – Alcohol*, the Appellate Body discussed the issue of possible or latent demand in determining whether products are directly competitive or substitutable. It stated: “the competitive relationship between products is *not* to be analyzed *exclusively* by reference to *current* consumer preferences. In our view, the word ‘substitutable’ indicates that the requisite relationship *may* exist between products that are not, at a given moment, considered to be substitutes but which are, nonetheless, *capable* of being substituted for one another. . . . Particularly in a market where there are regulatory barriers to trade or to competition, there may well be latent demand.” Current conditions of competition in the Philippines are influenced by several factors, including the discriminatory taxes. It would be unfair to complainants to use the lack of current sales as evidence that imported products would not compete if given the opportunity to do so on an equal basis.

32. Instead of focusing on where imported products are not presently sold in the Philippines, it makes sense to pay attention to the market segment in which imported products – products which comprise 2.4% of the market – are sold. And, as the pictures provided by the United States and the European Union show, where imported spirits are sold, they are sold side-by-side with domestic products, completely undifferentiated for the consumer. In fact, it is usual to see domestic and imported spirits of a type, such as brandy, clustered together. The United States would like to draw the Panel’s attention in particular to Exhibit US-30.

33. Moreover, the Philippines’ emphasis on sari sari stores in its argument regarding channels of distribution is misplaced. A channel of distribution is not just one type of store or another, but how the products are distributed and how consumers can access those products. The same consumer who usually purchases local products from a sari sari store might shop for a holiday gift of a higher-end spirit at a different shop. The gift is not a different product by virtue of the fact that it was purchased in a different store – what matters is whether the consumer views it as a substitute for the everyday brand also available through that channel of distribution. For example, if a consumer were offered a choice between two brandies – Philippine and imported – at a party, would the consumer think of them as different products or just alternative drinks? The evidence in this case suggests the latter.

34. Finally, the United States would like to take this opportunity to rebut the Philippines’ assertion that the United States did not present a prima facie case. A prima facie case requires only that a party provide evidence in support of each of its claims sufficient to raise a presumption that the claim is true. By providing the specific facts regarding each element of its GATT 1994 Article III:2 claims, the United States has met its burden.



35. The first and second sentences of GATT 1994 Article III:2 are separate obligations with different elements. The first sentence concerns “like” products, and a finding requires two specific elements: *First*, that the imported products and the domestic products are “like,” and *Second*, that the imported products are taxed “in excess of” domestic products.
36. “Likeness” of imported and domestic products is determined on a case by case basis, using factors such as the products’ physical characteristics. As the panel in *Japan – Alcohol* stated, panels have used factors “such as the product’s properties, nature and quality, and its end-uses, consumers’ tastes and habits, which change from country to country; and the product’s classification in tariff nomenclatures” to determine likeness.
37. These are the same types of factors panels have used to determine whether products are directly competitive or substitutable; accordingly, the Panel may rely on the same information about the Philippine market to determine whether imported products are “like” domestic products and whether they are directly competitive or substitutable products. It is just a question of the extent of substitutability – “like” products are relatively more substitutable than products that are just “directly competitive or substitutable.” In *Japan – Alcohol*, the Panel emphasized physical characteristics over other factors, such as end use, in finding vodka like shochu, but as noted above the analysis of substitutability does vary from market to market.
38. The United States and the European Union provided evidence on relevant factors about the Philippine market to enable the Panel to assess the substitutability of imported brands of distilled spirits in the Philippines compared to domestically produced brands.
39. Notably, in this dispute, the domestic product is not one single national product like shochu, soju, or pisco as in the *Japan – Alcohol*, *Korea – Alcohol*, and *Chile – Alcohol* cases, but many different types of spirits. Philippine producers make brandy, whiskey, gin, vodka – and indeed, could manufacture any type of spirit – and, by virtue of the Philippine measures’ preference for locally produced raw materials, the domestic products would receive favorable tax treatment. Accordingly, the complainants provided information on several different types of spirits, both imported and domestic, to characterize the Philippine market.
40. The United States provided information on:
- *Physical characteristics*: requirements under the Philippines’ own Standard Administrative Orders for whiskey, vodka, and brandy; alcohol content for brands of brandy, whiskey, vodka, gin, rum, and tequila; and pictures and descriptions of brands of tequila, brandy, whiskey, gin, and vodka.
  - *Marketing and channels of distribution*: numerous pictures of stores selling imported and domestic spirits side by side (gin, vodka, rum, tequila, whiskey, brandy), and

advertisements and labels for examples of gin, brandy, vodka, tequila, and whiskey, all showing the striking similarity between domestic and imported brands.

- *End uses:* menus with drinks by type, such as brandy, without differentiation between imported and domestic brands, and survey results directly from Filipino consumers confirming that they use imported and domestic brands for the same end-uses.
- *Price elasticity:* specific survey results from Filipino consumers, showing that even if imported products remain more expensive, a reduction in price would result in relatively more purchases of imported brands compared to domestic brands.
- *Tariff classification:* Information on the tariff classification of distilled spirits, all of which are classified under HS 2208.

41. In its submission, the Philippines takes issue with some aspects of the U.S. evidence, but it cannot wipe away the picture they show: Philippine spirits are made and marketed specifically to compete directly with imported products. The United States has more than met the complainant’s burden of making a prima facie case on the question of “like product.”

42. Regarding the second element of a case under the first sentence of Article III:2, the Philippines offered no rebuttal to the information that the United States provided confirming that imported products are taxed in excess of domestic products. As is plain from the Philippines’ law and regulations, the tax applied to brands not made from local raw materials – namely, imports – is from about 10 to 40 times greater per proof liter than the rate applied to domestic brands. The price information provided in the Philippines’ own exhibits shows that, given the discriminatory excise tax structure, the differential in tax burden between an individual domestic bottle and an equivalent imported bottle of the same type of spirit can be upwards of 60%.

43. For its claim on the second sentence of GATT 1994 Article III:2, the United States presented evidence on three elements.

- *First*, whether Philippines domestic products are directly competitive or substitutable with imported products;
- *Second*, whether Philippines domestic products and imported products are not similarly taxed; and
- *Third*, whether the dissimilar taxation is applied so as to product domestic production.

44. For the first element, whether Philippine brands of whiskey, brandy, and others are directly competitive or substitutable with their imported counterparts, the United States will not recite the evidence again. It suffices to say that the same type of evidence that shows products

are “like” also shows they are “directly competitive or substitutable.” The difference is that “directly competitive or substitutable” is a lower bar.

45. On the second two elements, the difference in taxation and the protection of domestic industry, the United States showed that the minimum difference in taxation between domestic and imported brands is more than ten times – a magnitude of discrimination that dwarfs that found to be inconsistent with the GATT 1994 in prior disputes. By design, the Philippines’ tax system enables local producers to make any product they can to compete with imported products and, so long as they continue to use the protected local raw materials, the distilled spirits producers continue to receive the tax benefit.

46. The Philippines argues that the difference in taxation is insufficient to support the U.S. and European Union’s claims, because even if there were no difference in taxation, imported products would still be much more expensive and it is unlikely that there would be much difference in the market. First, the United States has introduced evidence that a lesser price differential would affect relative market share, so the Philippines’s confidence is misplaced that eliminating the tax difference would not affect the market. In addition, the United States recalls that the tax on higher priced imported spirits is as much as 62% of the bottle price calculated using the Philippines’ own studies – hardly negligible.

47. For all these reasons, the Philippine submission fails to counter the U.S. claims: Philippine products compete with imported products, and the Philippines tax system favors the Philippine products. The United States respectfully requests that the Panel find the Philippines tax system inconsistent with the first and second sentences of GATT 1994 Article III:2.