



**U.S. HOUSE OF REPRESENTATIVES
TRADE SUBCOMMITTEE OF THE COMMITTEE ON WAYS AND MEANS**

“Modernization of the North American Free Trade Agreement”

August 1, 2017

**STATEMENT OF THE DISTILLED SPIRITS COUNCIL
OF THE UNITED STATES, INC.**

I. Introduction

The following statement is submitted on behalf of the Distilled Spirits Council of the United States, Inc. (“Distilled Spirits Council”) for inclusion in the printed record of the House Ways and Means Trade Subcommittee’s hearing on modernization of the North American Free Trade Agreement (NAFTA). The Distilled Spirits Council is a national trade association representing U.S. producers, marketers, and exporters of distilled spirits products.

The Distilled Spirits Council’s member companies export spirits products to more than 130 countries worldwide. Over the past two decades, the U.S. spirits sector has become increasingly reliant on exports to fuel growth. Since 1989, the value of global U.S. distilled spirits exports has increased nearly five-fold, from \$242 million to over \$1.4 billion in 2016. Canada and Mexico are the top and tenth-ranked export markets, respectively, for U.S. distilled spirits exports.

The Distilled Spirits Council strongly supported the negotiation and implementation of NAFTA and enthusiastically welcomes the administration’s efforts to modernize the agreement. To be sure, U.S. distilled spirits exporters have benefitted significantly from the terms of NAFTA. U.S. spirits exports to Canada and Mexico have grown exponentially since the agreement was implemented in 1994, thus supporting jobs in the manufacturing, hospitality, retail, and logistics sectors in the United States. Specifically, total U.S. spirits exports to our NAFTA partners increased from \$34 million in 1995 to \$228 million in 2016. It is therefore critical that the modernization of NAFTA preserve – and build upon – the gains that have already been achieved. The specific provisions of NAFTA that have benefitted the U.S. spirits sector, as well as our specific objectives for negotiations to modernize the agreement are detailed below

II. NAFTA’s Key Provisions Related to Distilled Spirits

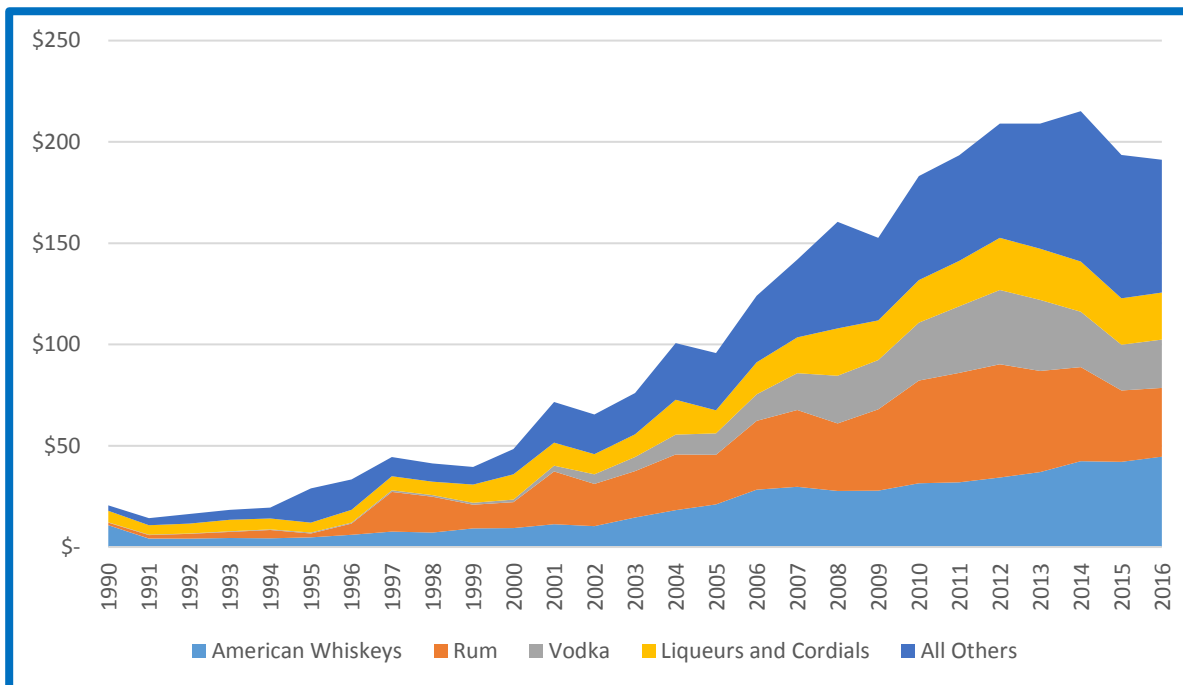
Implementation of NAFTA opened the Canadian and Mexican markets to U.S. spirits exports. As detailed below, these include tariff elimination commitments, recognition of distinctive U.S. spirits, and establishment of certain commitments to ensure the fair and equal treatment of U.S. spirits by Canada’s state-owned beverage alcohol distribution and retail monopolies.

A. All U.S. Distilled Spirits Exports to Mexico and Canada are Duty-Free

NAFTA eliminated tariffs on Bourbon and Tennessee Whiskey exports to Mexico immediately upon entry into force of the agreement. Tariffs on all other U.S. spirits exports to Mexico were eliminated over a five-year phase out period. Tariffs on U.S. exports of whiskey and rum to Canada were eliminated under the Canada – U.S. Free Trade Agreement (CUSFTA) in January 1989. Canadian tariffs on all other U.S.-origin spirits were scheduled to be eliminated over five or ten years, with all U.S. spirits to Canada being duty-free by 1998. In addition, since 1995 Canada has bound at zero its tariffs on whiskey, brandy and Tequila at the World Trade Organization (WTO) on a most-favored nation (MFN) basis. Thus, U.S. exports of “white spirits” such as rum, vodka and gin, have enjoyed preferential access to the Canadian market since the CUSFTA/NAFTA commitments entered into force in the late 1990s.

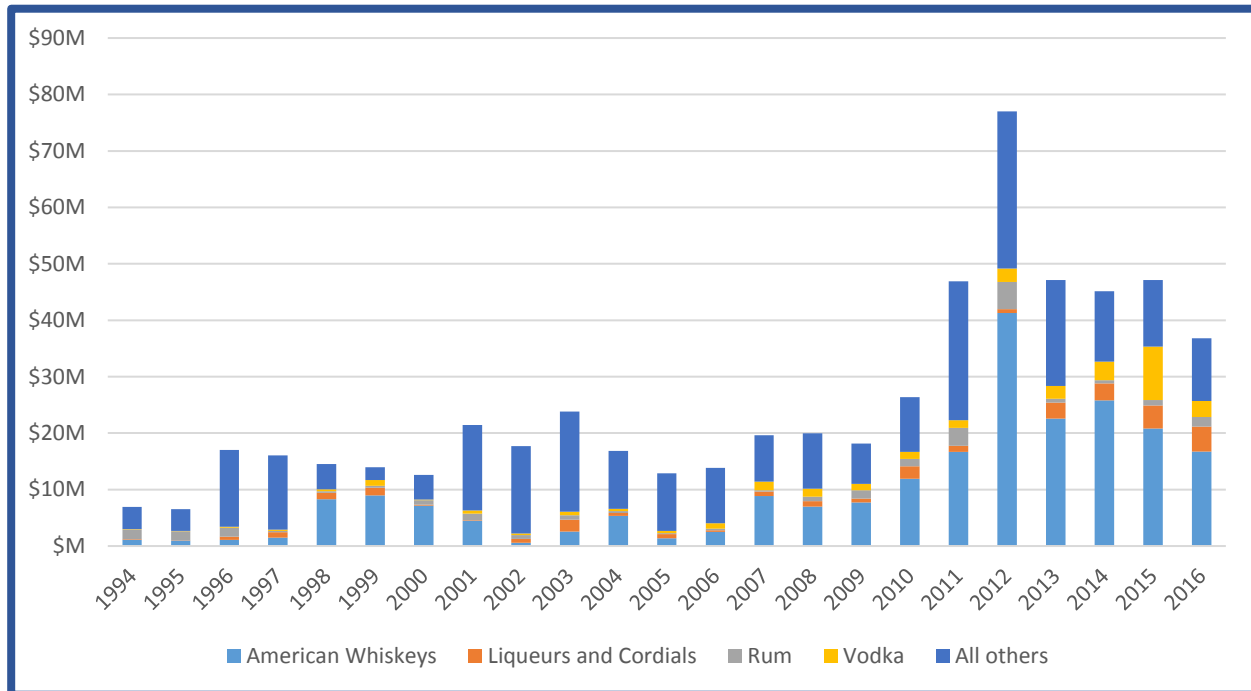
The tariff elimination on U.S. spirits to our NAFTA partners has contributed to the dramatic increase in exports to those markets. For example, U.S. spirits exports to Canada grew nearly 582 percent, from \$28 million in 1995 to \$191 million 2016. Of this, 23 percent is accounted for by American Whiskeys, 18 percent by rum, 12 percent by vodka, and 12 percent by liqueurs and cordials. As noted above, Canada now ranks as **the largest** market globally for U.S. distilled spirits exports.

U.S. Distilled Spirits Exports to Canada 1990-2016
(*\$ millions*)



Similarly, U.S. distilled spirits exports to Mexico grew nearly 470 percent since NAFTA was implemented, from just over \$6 million in 1994 to \$37 million in 2016, making it the tenth largest export market. American Whiskeys accounted for 45 percent of the total.

U.S. Distilled Spirits Exports to Mexico 1994-2016 (\$ millions)



However, Canada and Mexico have not bound all of their tariffs on distilled spirits at zero under the WTO’s General Agreement on Tariffs and Trade (GATT). Specifically, while Canada’s WTO bound tariff for whiskey, brandy and tequila is zero, its bound rate for gin is 4.92¢/liter of absolute alcohol (laa), for rum is 24.56¢ per laa, and for vodka and liqueurs is 12.28 ¢/laa. Mexico’s WTO bound rate is 45 percent *ad valorem* for all distilled spirits categories. In contrast, the United States has bound its tariffs under the WTO’s GATT at zero on all spirits categories (except low value rum (HTS 2208.40.20 and 2208.40.60) and one “other” category (2208.90.80)).

Thus, in order for all U.S. distilled spirits exports to continue to receive tariff free treatment in Canada and Mexico, it is critical that NAFTA retain tariff free trade in distilled spirits throughout the three partner countries.

B. Mexico and Canada Officially Recognize “Bourbon” and “Tennessee Whiskey” as “Distinctive Products” of the United States

“Distinctive product” recognition refers back to the laws in the product’s country of origin and serves as an important tool to assure consumers that the products purchased are genuine. Since 1964, the United States government has officially recognized “Bourbon” as a distinctive product of the United States. The first international agreement explicitly

recognizing “Bourbon” exclusively as a product of the United States dates to 1971 (Agreement between the United States of America and France for the Protection of Names of Bourbon Whiskey and Certain French Brandies). Since then, Bourbon and Tennessee Whiskey have also been accorded distinctive product recognition through trade agreements and other bilateral agreements the United States has negotiated with several other countries, including the 28 members of the European Union, Chile, Korea, Brazil, Colombia, Peru, Australia, Panama, Dominican Republic, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, Canada, and Mexico.

Specifically, under Chapter Three: National Treatment and Market Access for Goods - Article 313 and Annex 313 (1) of NAFTA, Canada and Mexico agreed to recognize “Bourbon Whiskey” and “Tennessee Whiskey” as distinctive products of the U.S. In return, Mexico and the U.S. agreed to recognize “Canadian Whisky” as a distinctive product of Canada, and Canada and the U.S. agreed to recognize “Tequila” and “Mezcal” as distinctive products of Mexico (see Annex 313 (2) and (3)). The United States’ decision to confer such recognition to these distinctive Canadian and Mexican spirits reflects the fact that these products cannot legally be made in the United States.

This recognition, which is implemented primarily through a country’s domestic product marking and labeling laws, is a very important mechanism to ensure that products labeled as “Bourbon” or “Tennessee Whiskey” that are offered for sale in Canada and Mexico are, in fact, legitimate products that were produced in the U.S. in accordance with U.S. laws and regulations regarding the production of these products. Because American Whiskeys, such as “Bourbon” and “Tennessee Whiskey”, account for 69 percent of total U.S. spirits exports globally, it is critical that this recognition be retained.

C. Canada’s Provincial Liquor Board Policies Required to be Transparent and Non-Discriminatory

In Canada, provinces are empowered under its Constitution to establish beverage alcohol supply and distribution monopolies. In the 1980s, Canada maintained closed provincial markets with discriminatory restrictions on the listing and sale of imported spirits. These discriminatory practices were addressed by the provisions contained in Chapter Three: National Treatment and Market Access for Goods - Article 312 and Annex 312.2, which incorporated Chapter Eight: Wine and Distilled Spirits from the Canada – United States Free Trade Agreement (CUSFTA).

Specifically, Chapter Eight (Article 802 (1)) stated that measures concerning the listing policies for the sale of distilled spirits are to be transparent, treat Canadian and U.S. products equally and be based on “normal commercial considerations.” Thus, any distiller applying for a listing is to be informed promptly of the decision and, in the case of a negative decision, a statement of the reason for the refusal. The distiller can appeal the decision through the administrative appeal procedures that were established following CUSFTA.

With regard to pricing/mark-ups, Chapter Eight (Article 803 (4)) specified that all discriminatory mark-ups on distilled spirits were to be eliminated immediately upon entry into

force of the agreement. However, public entity distributors are permitted to charge the “actual cost-of-service differential” between spirits of the other party and the domestic spirits. Any such differential, however, shall not exceed the audited cost of service for the spirits of the exporting party with the audited cost of service for the spirits of the importing party (Article 803 (1)).

Concerning distribution, the agreement stated that any measure related to the distribution of spirits shall conform with national treatment obligations (Article 804 (1)), but indicated that measures limiting on-premise sales by a distillery to distilled spirits produced on its premises would be permitted (Article 804 (2a)).

Finally, Article 312 of NAFTA specified that no party may adopt or maintain any measure requiring that distilled spirits imported in bulk from another territory for bottling be blended with distilled spirits of the importing party.

D. Rules of Origin

NAFTA’s rule of origin for distilled spirits was changed in 2003 to reflect increased efficiencies within the supply chain (Annex 401: specific rules of origin (as amended over time) for HTS 2208). Distilled spirits must comply with these rules in order to receive “preferential” treatment under the agreement. The U.S. spirits sector strongly supported the change and continues to support its retention in a modernized NAFTA.

III. Objectives for NAFTA Modernization

As noted above, the overall spirits trade relationship with Canada and Mexico as a result of NAFTA has been highly successful and beneficial for U.S. spirits exporters. However, there are several areas in which the NAFTA modernization negotiations could improve the agreement and provide further benefits for U.S. distilled spirits exporters to these vital markets.

Protecting and preserving the important gains achieved in NAFTA is paramount. However, targeted improvements to the agreement can be made to help expand opportunities for U.S. spirits exporters. In particular, the U.S. spirits sector is seeking to: 1) preserve the current duty free access for U.S. spirits exports; 2) preserve existing protections for “Bourbon” and “Tennessee Whiskey” and secure distinctive product recognition for “American Rye Whiskey;” 3) adopt a section detailing labeling and certification best practices for spirits; 4) strengthen and update the rules regarding Canada’s Provincial Liquor Boards; 5) eliminate Canada’s discriminatory excise tax on imported beverage alcohol products; 6) preserve the preferential rules of origin for spirits, as well as include new transit and transshipment provisions; and 7) end the prohibition in NAFTA on the use of duty drawback.

A. Preserve Duty-Free Treatment for U.S. Distilled Spirits Exports

The Distilled Spirits Council urges that the U.S. government ensure that the current duty-free treatment for U.S. distilled spirits exports to Canada and Mexico will be retained. As noted above, the United States has bound its tariffs at zero at the WTO on practically all spirits categories on a most-favored nation basis, yet this is not the case across the board for Canada and Mexico. Thus, all U.S. spirits exports to Canada and Mexico will only remain duty-free if the tariff commitments contained in NAFTA remain in place.

B. Affirm Distinctive Product Recognition by Canada and Mexico of “Bourbon” and “Tennessee Whiskey” and Expand Recognition to Include “American Rye Whiskey”

Over the past decade, Rye Whiskey production in the United States has experienced phenomenal growth, with over 100 brands now on the market. This is up from a handful a decade ago. In terms of the United States domestic market, from 2009 – 2016, American Rye Whiskey sales volumes have grown by an astonishing 778 percent to reach over 774,800 cases. In terms of value, that translates into a 900 percent jump from slightly over \$15 million in supplier revenues in 2009 to over \$150 million in 2016. This represents approximately \$450 million in retail sales in the United States alone. Several companies, both large and small, export American Rye Whiskey to a wide-range of markets, including Canada and Mexico.

The Distilled Spirits Council urges the U.S. government to ensure recognition for “Bourbon” and “Tennessee Whiskey” is retained (NAFTA Article 313 and Annex 313 (1)), and secure and incorporate recognition by Canada and Mexico for “American Rye Whiskey” into Annex 313 (1). Securing distinctive product recognition will help assure the producers of this rapidly growing category that only rye whiskeys made in accordance with U.S. laws and regulations will be able to be labeled and sold as “American Rye Whiskey” in Canada and Mexico. In exchange, the Distilled Spirits Council would support the recognition of “Canadian Rye Whisky” by the United States.

C. Incorporate Regulatory Best Practices for the Labeling and Certification of Distilled Spirits Products

NAFTA modernization negotiations are an excellent forum for advancing reasonable, science-based regulation of beverage alcohol in Canada, Mexico, and around the world. To that end, we propose the inclusion of a section detailing regulatory best practices for distilled spirits with regard to labeling and certification requirements, ideally as part of a new chapter on technical barriers to trade.

Securing these commitments will make NAFTA a model 21st-century trade agreement for the distilled spirits industry, by ensuring that three of the major spirits producing and consuming nations in the world will adhere to a set of regulatory principles with regard to labeling and certification. Doing so will reduce potential barriers to trade by

providing greater certainty, transparency and efficiencies for distilled spirits producers, importers and exporters throughout the NAFTA countries.

D. Strengthen and Update Rules Concerning Canada's Provincial Beverage Alcohol Distribution and Retail Monopolies

The NAFTA modernization negotiations provide an opportunity to update and strengthen the rules governing the practices of Canada's provincial state-trading enterprises, importation monopolies and market-dominant state-owned beverage alcohol retailers to ensure that they do not discriminate against U.S.-origin distilled spirits. While many of the provisions are important to retain, several are in need of updating to reflect the current marketplace and to address new barriers that have arisen.

For example, currently the practices of certain provincial liquor boards with regard to product mark-ups appear to run counter to Canada's international trade obligations, which provide for transparent and standardized product mark-ups for all "like" or "directly competitive and substitutable" product. In **British Columbia**, for example, while the wholesale portion of the markup is transparent, published, and standardized, the retail portion, which is applied by the BC Liquor Distribution Branch, is not. **Saskatchewan** has announced its intention to move towards the British Columbia model in the future. In addition, **Nova Scotia** operates a complicated supplier competition for certain subcategories of spirits, such as "economy vodka" or "economy white rum", which can result in certain products not being subject to the posted standardized mark-up. The Liquor Control Board of **Ontario** (LCBO) notified suppliers in June 2016 of its intention to test the concept of "flexible mark-ups" for wine and spirits, a further deviation from the application of standardized and transparent product mark-ups. The LCBO issued a letter on July 11, 2016 announcing an indefinite extension to the timeline to submit supplier quotes under the agency's proposed "flexible mark-up" initiative.

Furthermore, expanded retail access opportunities are provided to local producers in key provinces of British Columbia, Ontario and Quebec. Local beer, wine and spirits are now offered for sale in farmers' markets in **British Columbia** and local wine and cider in **Ontario**. **Quebec's** Bill 88 permits the sale of local artisanal wine, cider and mead products to be sold in grocery and corner stores. **British Columbia** has auctioned new licenses for the sale of local wines on the shelves of grocery stores in violation of the maximum number of discriminatory wine stores established under NAFTA. To address some of these barriers, in January 2017 the U.S. government requested consultations with the Government of Canada under the WTO's dispute settlement provisions raising concerns with British Columbia's decision to expand access to British Columbia wines on the shelves of grocery stores while relegating all other beverage alcohol to a separate "store-within-the-store."

The Distilled Spirits Council requests that the U.S. government seek updated and strengthened rules addressing Canada's provincial beverage alcohol distribution and retail monopolies (*i.e.* discriminatory product markups and retail access).

Specifically, the Distilled Spirits Council supports the retention of:

- NAFTA Article 312 (concerns bulk imports, as detailed above);
- CUSFTA Article 801 (1), which states that this Chapter applies to any measure related to the internal sale and distribution of wine and distilled spirits;
- CUSFTA Article 802 (1) (concerns listing policies, as detailed above)
- CUSFTA Article 804 (1) (concerns national treatment and distribution of spirits, as detailed above);
- CUSFTA Article 804 (2)(a); (concerns on premise sales by distilleries, as detailed above); and
- CUSFTA Article 807 (concerns Parties being able to retain their rights and obligations under General Agreement on Tariffs and Trade (GATT) and agreements negotiated under the GATT.)

However, the Distilled Spirits Council requests the following modifications to other provisions:

- CUSFTA Article 801 (2) (Coverage): This provision, which permits existing measures to be imposed that are not in conformity with national treatment obligations, should be deleted in its entirety. The Distilled Spirits Council specifically seeks the elimination of preferential federal excise duties for certain domestic wines (including ciders) and beers introduced in 2006 (see Section E below for details).
- CUSFTA Article 803 (1) (Pricing): This provision concerning public entity distributors' permission to charge the "actual cost-of-service differential" should be updated and further clarified. For example, Annex 30-B (Section D: 4a-Pricing) to the Comprehensive Economic and Trade Agreement (CETA), a free-trade agreement between Canada and the European Union), includes several important commitments to enhance transparency, efficiency and non-discrimination of pricing policies by public entities involved in the sale and distribution of beverage alcohol. Specifically, "Each Party shall ensure that a cost of service is not applied to a product of the other Party on the basis of the value of the product." Further, "the cost of service differential shall be justified in line with standard accounting procedures by independent auditors on the basis of an audit completed on the request of the other Party..." and "on request of that Party at intervals of not less than four years." In addition, "the audits shall be made available to either Party within one year of a request being made. Competent authorities shall update cost of service differential charges, as required to reflect the commitment made" regarding cost of service differentials. And "Competent authorities shall make available applicable cost of service differential charges through publicly accessible means, such as their official website. Competent authorities shall establish a contact point for questions and concerns originating from the other Party with respect to cost of service differential charges. A Party will respond to a request from the other Party in writing within 60 days of the receipt of the request."

The Distilled Spirits Council supports the inclusion of these enhanced commitments, as provided for in CETA, into a modernized NAFTA.

- CUSFTA Article 803 (5) (Pricing): The Distilled Spirits Council supports retention of an overall commitment to ensure that no discriminatory pricing measures are in force, and that no discriminatory pricing measures will be adopted in the future. Specifically, the Distilled Spirits Council requests that all provincial spirits mark-ups, levies, taxes or other pricing measures are transparent, non-discriminatory and apply equally to all “like”, directly competing or substitutable products sold through any retail sales channels, including private outlets.
- The Distilled Spirits Council is also seeking new disciplines on state-owned enterprises to ensure fair commercial treatment for U.S. spirits exporters and avoid state sanctioned anti-competitive behavior. Specifically, the Distilled Spirits Council requests that provincial state-owned liquor boards commercial activities be restricted to those within their own territorial borders and any extraterrestrial activities be restricted to those solely essential to fulfilling those internal activities. Moreover, the Distilled Spirits Council seeks a prohibition by state-owned alcohol retailers from listing or offering for sale distilled spirits products in which they have any ownership or financial interest.

E. Eliminate Canada’s Discriminatory Excise Tax on Imported Beverage Alcohol Products

On March 22, 2017, Canada’s federal government introduced a 2 percent increase on the federal excise tax on beverage alcohol and a future yearly automatic increase tied to the Consumer Price Index (CPI). However, since 2006 wines made from 100 percent Canadian grown grapes or other fruits, (including ciders made from Canadian apples) have been exempt from any federal excise tax. Increasing beverage alcohol excise duties by 2 percent immediately and by the CPI annually thereafter, while continuing to maintain the exemption from federal excise tax on wines made from 100 percent Canadian grown grapes or other fruits, exacerbates the uneven playing field that exists in the Canadian market for beverage alcohol products. This disparity will grow wider as the tax rate increases on an annual basis. Such a scheme imposes new costs on U.S. spirits and wine imports, thus tilting the playing field even more to domestic wine, to the detriment of imported wines and spirits.

In the context of the NAFTA modernization negotiations, we request that the U.S. work to secure Canada’s commitment to eliminate all of the discriminatory aspects of its excise tax pertaining to beverage alcohol products. This will allow spirits trade to continue the considerable expansion it has enjoyed over the past twenty-five years, and will reaffirm the Parties’ commitment to the rules-based international trading system.

F. Rules of Origin

The NAFTA “preferential” rule of origin for distilled spirits, as described above, should be retained.

In addition, new transit and transshipment provisions should be included to expressly permit minor processing in non-NAFTA members to include unloading, labeling, marking, reloading, etc., without losing the good’s originating status. The goods should, however, remain under the control of the customs administration during this process.

G. Duty-Drawback

The Distilled Spirits Council supports removal on the prohibition on the use of duty drawback currently contained in NAFTA Article 303.

IV. Conclusion

As detailed above, international trade has become increasingly instrumental to the long-term viability of the U.S. distilled spirits sector. The commitments contained in NAFTA have helped to make Canada and Mexico extremely important markets for U.S. spirits exporters. While there is much to be retained in NAFTA, the Distilled Spirits Council and its members support negotiations to modernize the agreement in order to protect and expand upon the important gains already achieved.

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