DISTILLED
SPIRITS
COUNCIL

December 10, 2018

Edward Gresser
Chair of the Trade Policy Staff Committee
Office of the United States Trade Representative
600 17th Street, N.W.
Washington, DC 20508

Submitted electronically via http://www.regulations.gov

Re: Request for Comments on Negotiating Objectives for a U.S.-European Union Trade Agreement (USTR-2018-0035)

Dear Mr. Gresser:

On behalf of the Distilled Spirits Council of the United States, Inc. (Distilled Spirits Council) and its member companies, I am writing in response to your request for written submissions (83 Fed. Reg. 57526 (November 15, 2018)) on negotiating objectives for a U.S.-European Union trade agreement. The Distilled Spirits Council is the national trade association representing the leading producers and marketers of distilled spirits in the United States (Harmonized Tariff Schedule (HTS) headings 2208 and 2207.10.30).

In 2017, the EU ranked as the U.S. spirits sector's single largest market with exports valued at $789 million; American Whiskey accounted for 85 percent of the total. In fact, in 2017 the EU accounted for 48 percent of total U.S. spirits exports and 61 percent of total American Whiskey exports. However, the EU's 25 percent tariff on all American Whiskey imports in response to the steel and aluminum tariffs is the biggest constraint affecting the continued growth of American Whiskey exports. The impact of the retaliatory tariff is already being felt across the U.S., and throughout the entire supply chain, from farmers to suppliers.

While the Distilled Spirits Council and its member companies enthusiastically welcome the announcement to launch these negotiations, we urge both parties to resolve immediately the trade disputes resulting in the imposition of retaliatory tariffs on U.S. exports, consistent with the July 25th announcement by Presidents Trump and Juncker. Resolution of these matters is a top priority and should occur as soon as possible, and certainly <u>before</u> comprehensive trade negotiations are launched, as the tariffs are negatively impacting U.S. whiskey exporters (*see* Section I). Our specific objectives for negotiations of a comprehensive trade agreement with the EU are detailed below in Section II.

I. Elimination of the EU's Retaliatory Tariff on American Whiskey Imports

The EU generally has been a very open market for U.S. spirits exports and was the U.S. spirits industry's largest export market in 2017. By way of background, the U.S. and the EU mutually agreed to eliminate tariffs on practically all distilled spirits from all other World Trade Organization (WTO) members as part of the so called "zero-for-zero" agreement resulting from the WTO's Uruguay Round agreements. As countries joined the EU, they are required to adopt the EU's common external tariff, which, in the case of distilled spirits is zero for practically all spirits. This duty-free access has significantly benefitted U.S. spirits exports to the EU, which increased by 265 percent over the past two decades from $216 million in 1997 to $789 million in 2017. American whiskey exports to the EU increased 350 percent in that time, from $148 million in 1997 to $667 million in 2017.

The EU's 25 percent tariff on all U.S. whiskey imports is negatively affecting the continued growth of American Whiskey exports to the EU and may even jeopardize current market share. This may result in European spirits consumers choosing other spirits categories, such as Scotch Whisky, Canadian Whisky, Tequila, rum, brandy, etc. These retaliatory tariffs are being felt across the U.S. In 2017, the following 23 states exported U.S. whiskeys to the EU: [1]

- Tennessee
- Kentucky
- Texas
- Florida
- Illinois
- California
- New Jersey
- South Carolina
- Virginia
- Massachusetts
- Ohio
- Arkansas
- West Virginia
- Washington
- Michigan
- Pennsylvania
- North Carolina
- Alaska
- Minnesota
- Georgia
- Missouri
- Vermont
- Oregon

Below is an illustrative list of small and medium distilleries from across the U.S. describing how their individual companies have already been negatively affected by the EU's retaliatory tariffs:

- **Catoctin Creek Distillery (Purcellville, VA)**: Scott Harris, co-founder and General Manager, reports losing $100,000 in export sales to the EU (i.e., cancelled contracts) due to the tariffs. He was expecting sales totaling $200,000 in the EU in 2018; however, he now estimates to only sell $24,000 this year. Mr. Harris had intended to invest $500,000 in equipment upgrades (new fermenters, mash tanks and pot stills) this year. This is now postponed because of the uncertainty and declining sales in export markets where tariffs have been imposed. Mr. Harris has also been forced to halt pay increases and has instituted a hiring freeze. The company employs 20 people.

[1] State export data is compiled from the U.S. Census Bureau, Economic Indicators Division

- **Cleveland Whiskey (Cleveland, OH)**: Founder and CEO Tom Lix reports losing $100,000 in export contracts to the EU (i.e. cancelled contracts) due to the tariffs. Mr. Lix reported that due to the tariffs he was forced to lay off several employees and cancel planned bonuses. The tariffs have also affected external fund-raising efforts to help finance capital investments which have been put on hold indefinitely.

- **James E Pepper Distillery (Lexington, KY)**: Amir Peay, Owner and CEO, reports losing $250,000 in export sales to the EU (i.e., cancelled contracts) due to the tariffs. The company was established in 2010 and recently invested several million dollars to renovate an old distillery which is now producing American Whiskey. He anticipated exporting 4 full sized containers of whiskey this year, but to date has only shipped one because of the tariffs. He has been exporting to Europe for 5 years and had re-arranged his entire European distribution network last year to execute a plan for export growth in 2018. Planned capital investments of $150,000 have been put on hold indefinitely. He recently let two part-time employees go, whom he was planning to bring on as full-time employees.

- **FEW Spirits (Evanston, IL)**: Established in 2011, the company has approximately 15 employees. Founder and CEO Paul Hletko reports losing $300,000 in export sales to the EU (i.e., cancelled contracts) due to the tariffs. Exports make up about 15 percent of its total revenue and its top export markets are the U.K., France, and Finland.

- **Mountain Laurel Spirits (Bristol, PA)**: Established in 2011, the company increased its production nearly 250 percent in 2016 and now exports to approximately 20 countries, including France, Germany, and the United Kingdom. Co-founder Herman Mihalich says consumers in foreign markets have found American whiskeys to be "tasty and price competitive" to Scotch, but the "tariffs could erode the competitive pricing element in those markets."

- **Dry Fly Distilling (Spokane, WA)**: Established in 2007, the company employs approximately 10 people. Don Poffenroth, Owner, reports losing $75,000 in export sales to the EU. Planned capital investments of $2 million and hiring 5 new employees have been put on hold indefinitely.

In addition, according to a large U.S. whiskey exporter, the impacts of the retaliatory tariffs are as follows:

- The company is currently experiencing a hiring freeze in the U.S.;
- The estimated impact of the tariffs is upwards of $25M annually in 2019 for this company alone;
- The tariffs have shelved all capital projects designed to expand its facilities in Kentucky; and
- The benefits from tax reform have been negated as a result of the retaliatory tariffs imposed by the EU alone.

Thus, we urge both parties to resolve the trade dispute and secure the prompt removal of these tariffs, as discussed in the July 25th joint announcement, prior to the launch of trade agreement negotiations. Resolution of these concerns is necessary in order to permit U.S. whiskey exporters to return to the duty-free access to the EU market, which has contributed significantly to the considerable expansion of U.S. exports over the past two decades and which is needed for the continued future growth of the industry.

II. Objectives for a Comprehensive Trade Agreement

The Distilled Spirits Council's negotiating objectives for a comprehensive trade agreement are provided below.

A. Distinctive Product Recognition for "American Rye Whiskey"

The Distilled Spirits Council seeks the EU's agreement in the context of future trade negotiations to provide explicit recognition and protection of "American Rye Whiskey" as a distinctive product of the U.S. Such recognition will help assure European authorities and consumers that "American Rye Whiskeys" marketed in the EU are produced in the U.S. in compliance with U.S. laws and regulations for the production of rye whiskey.

Over the past decade, "American Rye Whiskey" production in the U.S. 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 U.S. domestic market, from 2009 – 2017, "American Rye Whiskey" sales volumes have grown by an astonishing 934 percent to reach over 912,200 cases. In terms of value, that translates into a 900 percent jump from slightly over $15 million in supplier revenues in 2009 to over $175 million in 2017. This represents approximately $500 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 EU. In the recently completed U.S. – Mexico Canada Agreement (USMCA), Mexico agreed to initiate its domestic process to recognize, for the first time in a U.S. trade agreement, "American Rye Whiskey" as a distinctive product of the U.S.

In 1994, the U.S. and the EU signed the "*Agreement in the Form Of An Exchange of Letters Between the European Community and the United States of America on the Mutual Recognition of Certain Distilled Spirits/Spirit Drinks*." Under the agreement, the EU agreed to recognize and protect "Bourbon," "Bourbon Whiskey" and "Tennessee Whiskey" as distinctive products of the U.S. In return, the U.S. agreed to recognize and protect "Scotch Whisky," "Irish Whiskey," "Cognac," "Armagnac," "Calvados," and "Brandy de Jerez."

In 2009, the EU reaffirmed the 1994 agreement via Commission Regulation No. 936/2009, applying the agreements between the European Union and third countries on the mutual recognition of certain spirit drinks. Protections for "Scotch Whisky," "Irish Whiskey," and "Cognac," are included in the U.S. Standards of Identity for Distilled Spirits (see 27 CFR 5.22).

We note that expanding the 1994 agreement to include other commercially significant distilled spirits products, such as "American Rye Whiskey," is in keeping with the terms of the original agreement, which states:

> *"The USA and the EC agree to meet at mutually convenient time in the future to discuss the possibilities of extending restrictive recognition to additional distilled spirits/spirits drinks products which either Party may propose for such consideration."*

Thus, both parties previously agreed to a make the 1994 agreement a "living" document, in anticipation of the likelihood that other spirits categories might need to be added in the future.

In addition, securing protection for "American Rye Whiskey" by the EU will clarify some confusion regarding use of the term "rye whiskey" that originally arose in the context of the Canada – EU wines and spirits agreement in 2003. Under that agreement the EU recognized "Rye Whiskey" as a distinctive product of Canada (Article 17(2)), but <u>also</u> recognized that rye whiskey may be produced in the U.S. (Article 34(4)). Thus, the agreement clearly recognized that rye whiskey may be produced in both the United States and Canada and that both products could be sold in the EU. However, we remain concerned that format of the 2003 EU-Canada agreement (the two articles are not consecutive) could create some unnecessary confusion about the use of the term "rye whiskey" in the EU. Securing explicit protection for "American Rye Whiskey" by the EU will not only finally clarify the issue but will also ensure a "level playing field" with Canadian Rye Whiskey. It is especially important to secure this recognition at this time when American-made rye whiskey sales are increasing in the United States and abroad.

Accordingly, the Distilled Spirits Council urges the U.S. government to pursue expanding the list of spirits products covered by the 1994 U.S.-EU agreement on the protection of distinctive products to include "American Rye Whiskey."

B. <u>Regulatory Best Practices for the Labeling and Certification of Distilled Spirits Products</u>

The U.S.-EU trade agreement negotiations are an excellent forum for advancing reasonable, science-based regulation of beverage alcohol in EU 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 similar to the Annex on Alcohol in the recently-concluded USMCA.

Securing these commitments on labeling and certification will ensure a U.S.-EU agreement is a model 21st-century trade agreement for the distilled spirits industry, by ensuring that two of the major spirits producing and consuming nations in the world will adhere to an agreed set of regulatory principles. Doing so will reduce potential barriers to trade by providing greater certainty, transparency and efficiencies for distilled spirits producers, importers and exporters in both countries.

C. Elimination of Discriminatory Excise Taxes

Certain EU member states maintain tax regimes that inhibit U.S. spirits exporters' ability to compete on a level playing field. The European Union's excise tax rules and minimum rates for distilled spirits are set-forth in two EU Directives: 92/83 and 92/84. Under the directives, some member states are permitted to provide preferential tax benefits to certain spirits producers under "derogations" from general excise tax rates. Such measures are in contravention of the EU's WTO national treatment obligations.

In addition to the EU-sanctioned tax derogations, several countries have also implemented discriminatory tax policies that are not officially approved under EU law. Regardless of whether these derogations have been approved, these policies cause further distortions in the spirits market in favor of domestic producers. The following derogations are of particular concern:

France: France imposes a reduced excise tax on rum from French Overseas Departments (FODs). The total excise tax on rum from FODs is €871 per hectoliter of pure alcohol (hlpa), while the tax on all other spirits, including rum from other countries, is €1,741.04 per hlpa. In 2014, the preference was extended until 2020 with an annual quota of 120,000 hlpa. In October 2017, the European Parliament approved a decision from the European Commission to retroactively increase the FOD rum quota from 120,000 hlpa to 144,000 hlpa from January 1, 2016 through December 31, 2020.

Greece: Greece imposes a reduced special consumption tax on ouzo of €1,225 per hlpa, compared with a rate of €2,450 per hlpa for all other spirits, which is legal under EU regulations. A "Chemists Fund" and Stamp Duty are applied on top of this, which further exacerbates the differential in the actual tax paid on these products to €1,275.18 per hlpa for ouzo and €2,550.35 per hlpa for all others. Greece further extends this reduced tax rate to spirits called tsipouro and tsikoudia, in violation of EU law as Greece does not have a formal derogation under Directive 92/83 for such products. In September 2015, the European Commission issued a "Letter of Reasoned Opinion" setting out in detail why the European Commission believes the measures for tsipouro and tsikoudia are inconsistent with EU law. Greece was given until the end of November 2015 to remove the discriminatory rate. However, Greece failed to remove the discrimination, and in February 2017 the European Commission referred the case to the European Court of Justice (ECJ). The case is still pending.

Romania: Romania provides a reduced excise tax on small distillers producing for households. Romania charges excise and health taxes on most spirits of RON 3,306.98 per hlpa. In contrast, small distilleries pay a reduced excise rate of RON 1,653.49 per hlpa (maximum quantity 10 hlpa per year). Fruit spirits and brandy produced for household consumption and not sold commercially (maximum 50l per year) pay RON 1,653.49 per hlpa. This preferential tax facilitates illegal production and tax evasion, which distorts the Romanian spirits market as home-produced spirits are sold in the retail distribution chain.

Croatia: In December 2016, the European Commission issued a request to Croatia to amend its excise tax on spirits produced by small producers for their own consumption in a manner consistent with Directive 92/83. Croatia allows a reduced excise rate for small distillers who produce up to 20 lpa per household for their own consumption. A flat rate is applied depending on the capacity of the boiler used for production (i.e. HRK 100 for a boiler capacity up to 100 litres and HRK 200 for any boiler larger than that). Because the reduced rate applied by Croatia is linked to the capacity of the boiler and paid as a flat rate, regardless of the actual amounts produced, it is inconsistent with Directive 92/83.

Slovakia: In September 2018, the Slovak Parliament adopted legislation to legalize home distillation and to apply a reduced excise tax rate of 50 percent on home-distilled products. Directive 92/83 allows Slovakia to apply a reduced rate, of not less than 50 percent to certain fruit growers' distilleries producing ethyl alcohol from fruit supplied to them by fruit growers' households. However, there is no derogation for home distillation in Slovakia. Thus, the derogation is inconsistent with Directive 92/83.

The Distilled Spirits Council believes that the tax policies detailed above are incompatible with WTO rules, including several dispute settlement findings related to spirits to which the EU was a complainant (*i.e.,* Japan (DS8, 10, and 11), Korea (DS75 and 84), Chile (DS87 and 110) and the Philippines (DS396 and 403)), and seeks the U.S. government's continued assistance in urging the EU to end its discriminatory tax regimes and to abide by its WTO commitments to tax all distilled spirits similarly. This will allow bilateral spirits trade to continue the considerable expansion it has enjoyed over the past two decades and will reaffirm both sides' commitment to the rules-based international trading system.

D. Elimination of Remaining Bound Tariffs

As noted above, the "zero-for-zero" agreement has eliminated tariffs on the vast majority of spirits products traded between the U.S. and the EU. However, there are still tariffs on certain spirits, as shown in the table below. The Distilled Spirits Council requests that the U.S. seek to eliminate these remaining tariffs on a bilateral basis in its negotiations with the EU.

Remaining EU Tariffs			Remaining U.S. Tariffs		
HS Code	**Description**	**Tariff Rate**	**HS Code**	**Description**	**Tariff Rate**
2208.40.11	Rum, in containers holding 2 liters or less, with a content of volatile substances other than ethyl and methyl alcohol equal to or exceeding 225 grams per hlpa	€0.6/hlpa + €3.2/hectoliter	2208.40.20	Rum, in containers each holding not over 4 liters, valued not over $3 per proof liter	23.7¢/proof liter
2208.40.39	Rum, in containers holding 2 liters or less, of a value not exceeding €7.9 per lpa	€0.6/hlpa + €3.2/hectoliter			
2208.40.51	Rum, in containers holding more than 2 liters, with a content of volatile substances other than ethyl and methyl alcohol equal to or exceeding 225 grams per hlpa	€0.6/hlpa	2208.40.60	2208.40.60 - Rum, in containers each holding over 4 liters, valued not over 69¢ per proof liter	23.7¢/proof liter
2208.40.99	Rum, in containers holding more than 2 liters, of a value not exceeding €2 per lpa	€0.6/hlpa			
2208.90.91	Undenatured ethyl alcohol of an alcoholic strength by volume of less than 80% vol, in containers holding 2 liters or less	€1.00/hlpa + €6.4/hectoliter	2208.90.80	Undenatured ethyl alcohol of an alcoholic strength by volume of less than 80 percent vol., other	21.1¢/proof liter
2208.90.99	Undenatured ethyl alcohol of an alcoholic strength by volume of less than 80% vol, in containers holding more than 2 liters	€1.00/hlpa			

E. Rules of Origin

To ensure an agreement with the EU facilitates trade in goods manufactured in each country, the Distilled Spirits Council urges the U.S. to secure the rules of origin that were included in the recently concluded USMCA. In specific, Annex 4-B of the USMCA retained the product specific preferential rules of origin for distilled spirits included in the North American Free Trade Agreement (NAFTA). Adopting rules of origin consistent with other U.S. trade agreements will help reduce costs and provide certainty that products currently exported from the U.S. under existing U.S. trade agreements will, in fact, be able to benefit from an agreement with the EU.

In addition, the USMCA included in Article 4.18 important new rules concerning transshipment which provides for minor processing in third countries. Specifically, it provides for unloading, labeling, marking, reloading etc. This would further facilitate trade by allowing U.S. spirits exporters to ship their products to an intermediate location where the shipment may undergo minor processing and retain its preferential treatment under the agreement.

Conclusion

International trade has become increasingly instrumental to the long-term viability of the U.S. distilled spirits sector. By far, the EU is the U.S. spirits industry's single most important export market. As such, securing the removal of the retaliatory tariff on U.S. whiskey exports as soon as possible, and before negotiations of a comprehensive trade agreement are launched, is a top priority for the U.S. spirits industry. As detailed above, the U.S. spirits industry's goals for an eventual trade agreement with the EU are to secure:

- distinctive product recognition for "American Rye Whiskey;"
- commitments on regulatory best practices for the labeling and certification of distilled spirits products;
- elimination of the EU's discriminatory excise taxes;
- elimination of remaining bound tariffs on certain spirits in the U.S. and EU; and
- rules of origin and transshipment provided for in the recently concluded USMCA.

Thank you for this opportunity to provide input and we look forward to working with you. Please do not hesitate to contact us should you require any additional information.

Sincerely,

Christine LoCascio
Senior Vice President
International Issues and Trade