PHILIPPINES – TAXES ON DISTILLED SPIRITS
(AB-2011-6)

OPENING STATEMENT OF THE UNITED STATES OF AMERICA AT THE ORAL HEARING OF THE APPELLATE BODY

OCTOBER 25, 2011

Mr. Chairman, members of the Division —

1. On behalf of the United States delegation, I would like to thank you for the opportunity to appear before you today.

2. From the beginning of this dispute, the issues have been clear. The United States requested this Panel to examine two specific claims under the *General Agreement on Tariffs and Trade 1994* ("GATT 1994") with respect to particular tax measures of the Philippines. The questions before the Panel were whether the Philippine tax system for distilled spirits is inconsistent with the Philippines' WTO obligations under the first and second sentences of Article III:2 of the GATT 1994.

3. The legal obligations in this dispute are straightforward. Several WTO panels, as well as the Appellate Body, already have reviewed discriminatory taxation systems for distilled spirits in terms of Article III:2. The panel and Appellate Body reports in *Japan – Alcoholic Beverages II, Korea – Alcoholic Beverages*, and *Chile – Alcoholic Beverages* provided a clear, well-worn path forward for performing an appropriate legal analysis of these issues. Indeed, the Parties all agree on the elements of the claims under Article III:2 of the GATT 1994.

4. With this background, it is readily apparent from the basic facts about the measures and the Philippine market for distilled spirits that the Philippine measures are inconsistent with Article III:2.

5. The Philippines does not dispute the essential facts. Philippine distilled spirits producers use local types of raw materials, sugar in particular, to make a variety of distilled spirits including brandy, whiskey, vodka, gin, and tequila. Under the Philippine tax system, all of these spirits enjoy a low tax rate, because they are all made from a local type of raw material. They are taxed at only 14.68 pesos per proof liter.

6. Products not made from the favored raw materials are taxed at much, much higher rates – 158.73, 317.44, or 634.90 pesos per proof liter. The products facing these high taxes include the imported brands that are the counterparts to Philippine brandies, whiskies, and gins, such as imported Fundador brandy, Jack Daniels whiskey, and Bombay Sapphire gin.

7. Notwithstanding the straightforward nature of this dispute, the Philippines has appealed a long list of findings and conclusions by the Panel. The Philippines presented the same arguments to the Panel, the Panel carefully considered and correctly rejected each of them, and the claims on appeal are no more than a repetition of those rejected arguments. In this appeal the Philippines' arguments should once again be rejected.

8. The Panel in this dispute methodically followed the approach set out in the earlier distilled spirits disputes, applying the correct legal analysis to the Philippine measures and the particular facts of the Philippine market. In its report, the Panel details its assessment of the Philippine measures and market issue by issue – the taste and look of Philippine and imported brandies, gins, and other spirits; Philippine consumers' uses for different distilled spirits; and advertisements for imported and Philippine brands of distilled spirits – before reaching its conclusions about the measures as a whole and the treatment accorded by the Philippines to imported products.

9. The Panel's careful and thorough analysis was correct, and none of the Philippines' claims – not its multiple claims of legal error and not the five separate claims that the Panel failed to carry out an objective assessment of the matter before it – are supported by the facts or the law.

10. The Philippines' claims rely on a distorted picture of the facts in the Philippine market, and an incorrect understanding of the legal requirements for Article III:2. These errors and distortions cover two main themes, concerning the products in the Philippine market and the requirements of the GATT 1994, respectively.

11. Concerning the products at issue, the Philippines incorrectly bases its arguments on the idea that its domestic products are defined as "sugar based" or, alternately, as specific to a lower income market segment.

12. Although most Philippine products are made from sugar, and on average Philippine domestic distilled spirits cost less than their imported counterparts, both of these descriptions fail to adequately characterize the products in the Philippine market. They miss the key characteristics of the way the Philippine measures distinguish imported from domestic products, and they do not reflect the diversity of products in the Philippine market.

13. First, the Philippine measures do not distinguish between "sugar based" and "non-sugar based" spirits. To qualify for the low tax rate, a product must be manufactured from one of six different raw materials – nipa, coconut, cassava, camote, buri palm, or sugar cane. As we demonstrated before the panel, about the only thing these materials have in common is that they

are produced in the Philippines.[1]

14. Second, Philippine consumers do not see bottles of "sugar based spirits" in stores in places like Manila. Philippine consumers see brandies, whiskies, rums, gins, tequilas and vodkas – and even specialty products like flavored liqueurs – that look virtually indistinguishable from imported products. Imported distilled spirits are of the same broad types – brandy, whiskey, vodka, gin, etc. The Philippine local regulations, in fact, accommodate this specific market characteristic and allow a product to be labeled as brandy or whiskey even if it is not made with the type of raw material typical for that product.

15. The variety of types of protected domestic products at issue represents the main difference between this case and prior disputes involving taxes on distilled spirits. Whereas in *Japan – Alcoholic Beverages II*, *Korea – Alcoholic Beverages*, and *Chile – Alcoholic Beverages,* the Panel was comparing a specific national specialty such as pisco or shochu to other types of spirits, in this dispute the Panel was comparing local and imported spirits of the same type to see whether they are "like" and "directly competitive or substitutable." The difference in approach reflects differences in the underlying measures at issue in this case as compared to those at issue in the previous disputes.

16. Regarding the prices of products, the evidence presented by the parties showed that both imported and domestic brands of distilled spirits are sold at a range of prices.[2] Although imported products currently sold in the Philippines are, generally speaking, more expensive than their Philippine counterparts in that market, there is considerable variety, particularly among the Philippine products.

17. The diversity in prices and quality of Philippine products is not surprising, considering that domestic products dominate the market with more than 95% market share.[3] In fact, Philippine producers make their own products at different levels of price and quality, such as the premium versions of San Miguel gin.[4] The Panel correctly identified the overlaps in prices between imported and domestic distilled spirits, and rejected the Philippine notion of distinct market segments for the two categories of distilled spirits.

18. The reality is that the Philippine measures do not distinguish between "sugar based" and "not sugar based," nor between lower and higher priced products. Indeed, its own producers go

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[1] Exhibits US-16 to US-21.

[2] Panel Report, paras. 2.36, 2.66, 2.67, 2.72-2.73 and 7.118.

[3] Panel Report, para. 2.34.

[4] Exhibit US-45.

to great lengths to eliminate the differences between Philippine products and those made from more traditional materials. The way distilled spirits are divided in the Philippines measures is as follows: all distilled spirits are in one of into two categories, "A" and "B." If category "A" is a proxy, it is a proxy for "local," not sugar-based or low-price. In fact this is evident from the annexes in the Philippines' own regulations, which repeatedly refer to products classified under category "A" as "local".[5]

19. And where the Philippines relies on a price distinction to claim that its products are not "like" or do not compete with imported products, it simply is not accurate regarding either the measure or the market. Moreover, it is the very discrimination resulting from the Philippine measures that exacerbates and locks in the price difference on which the Philippines attempts to rely to defend its measures.

20. The next significant error in the Philippines' presentation concerns the type of competition that is required for Article III:2.

21. Under the Philippines' approach, its measures should not be found to be WTO-inconsistent because under current market conditions most Filipinos cannot afford more expensive brands of spirits. The Philippines disregards the fact that almost all imported spirits are taxed at a rate at least 10 times higher than all Philippine spirits, that imported products are less than 5% of the Philippine market, and that its measures base tax treatment on whether spirits are made from local types of raw materials.

22. The Philippines draws out several nominally distinguishable arguments on this theme. Each of the issues it raises, according to the Philippines, is sufficient to overturn the Panel's reasoning. The Philippines argues that between imported and domestic products the degree of competition is insufficient, or competition is not direct enough, or the competition does not occur in a representative part or in enough of the Philippine market. It also raises the same issues under Article 11 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU"), claiming that the Panel failed to objectively consider evidence regarding future and potential competition, and market segmentation.

23. More broadly, the Philippines argues that if competition between two goods does not meet any one of these purported requirements, the national treatment commitments of the GATT 1994 would not provide any discipline on a Member's measures which affect those goods. This is not a correct understanding of those fundamental commitments.

24. The Philippines' views on what counts as "directly competitive or substitutable" are far too rigid. There is no requirement for competition of a specific level, scope, or breadth for the

[5] Exhibits US-7, US-8.

purposes of either the first or second sentence of Article III:2. A measure may be WTO-inconsistent even if the products in question are only substitutes for a subset of consumers. For example, suppose only 10% of Filipinos drink distilled spirits at all – for those 9 million plus consumers, WTO rules obligate the Philippines not to discriminate against imported distilled spirits sold in the Philippines.

25. In addition, prior panels have been clear that latent, or potential, demand is a consideration in determining whether goods are directly competitive or substitutable. This is particularly important here, where the measures themselves are part of the conditions of the relevant market. As the Appellate Body stated in *Korea – Alcoholic Beverages*: "Particularly in a market where there are regulatory barriers to trade or to competition, there may well be latent demand."[6] In this regard, we invite you to look at paragraphs 30-43 of the U.S. oral statement at the second panel meeting where we discussed how the Philippine measures prevent imported products from being price competitive.

26. In addition, although the Philippines would make its arguments on the competitive relationship between imported and domestic products almost the entirety of the Panel's analysis, in fact it is only part of the analysis in the Panel Report, and indeed only a part of the analysis in prior disputes regarding taxes on distilled spirits.

27. Specifically, the Philippines' claims of error attempt to isolate a number of findings under one section of the Panel's report, entitled "the competitive relationship between the products at issue." This section of the report discusses just one of the many factors that the Panel analyzed.

28. Other factors were also critical to the Panel's analysis. As the Panel stated, citing *EC – Asbestos* with respect to how to analyze whether products are "like": "The Appellate Body has noted that a panel should examine the evidence relating to each of these four criteria and, then, weigh all of that evidence, along with any other relevant evidence, in making an overall determination of whether the products at issue may be characterized as 'like.'"[7]

29. This approach – taking into account all the evidence before it and how that evidence relates to the particular case – is just what the Panel did in this dispute for its analysis under both the first and second sentences of Article III:2. As the Appellate Body in *Japan – Alcoholic Beverages II* confirmed, the "like product" examination will vary from case to case, and should not be interpreted inflexibly. It stated that in applying the criteria for likeness "to the facts of any particular case, and in considering other criteria that may also be relevant in certain cases, panels can only apply their best judgment in determining whether in fact products are 'like.'. . [i]t is a discretionary decision that must be made in considering the various characteristics of products in

[6] *Korea – Alcoholic Beverages (AB),* para. 116.

[7] Panel Report, para. 7.31, citing *EC – Asbestos (AB)*, para. 109.

individual cases."[8]

30. The factors for whether goods are directly competitive or substitutable focus on the goods themselves – particularly attributes like end use, physical characteristics, and marketing. Under the Philippine proposed interpretation, a Panel would discount the attributes of the goods themselves, whether they are substitutes, how they appear to consumers, how they are marketed, how they taste, or even whether they are "brandy" – in favor of some notion about whether the average Filipino can afford imported distilled spirits today.

31. But there is no requirement for any current quantity of competition, let alone a specific threshold.

32. The legal requirements of Article III:2, both the first and second sentences, avoid such specific quantitative tests. To determine whether a measure is inconsistent with Article III:2, there is no need to assess the extent to which the discriminatory treatment of imported products has succeeded in dissuading Philippine consumers from choosing them. The Appellate Body has been clear in the past that the analysis under Article III:2 is not about actual trade effects, but conditions of competition. And there is no doubt here that the Philippines measures fundamentally alter the conditions of competition to the disadvantage of imported products.

33. And even in terms of actual trade effects, the statistical evidence on the record, such as the Euromonitor International study, support the conclusion that if taxes on imported products were more similar to taxes on domestic products, Filipino consumers would purchase more of the imported products.[9] The other evidence on the similarity among imported and domestic brands of distilled spirits in the Philippines, including their very names, marketing and end use – further supports this conclusion. The fact that the average Philippine consumer may purchase few imported products today does not shield the Philippines from its WTO commitments.

34. The facts in this case are clear: imported spirits are taxed at rates 10 to 40 times higher than domestic distilled spirits.

35. This treatment is not due to a difference in the quality of imported and domestic spirits, the prices of imported and domestic brands of spirits, ensuring that less affluent consumers can afford spirits, or any purportedly neutral "raw material" requirement. It means that if a Philippine consumer buys Philippine White Castle whiskey, he or she will pay taxes of 14.68 pesos/proof liter. But if the same consumer buys an imported American brand of whiskey, the taxes will be *at minimum* ten times higher. Those are the key facts in this dispute.

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[8] *Japan – Alcoholic Beverages II (AB)*, p. 20-21.

[9] U.S. First Written Submission, para. 64 and Exhibit US-40, p. 30.

36. Article III:2 commits WTO Members not to discriminate in taxing imported products. Under the first sentence of Article III:2, a WTO Member is not to tax imported products higher than like domestic products, and under the second sentence, that Member is not to tax imported products in a manner that is not similar to directly competitive or substitutable domestic products. Article III:2 does not contain any of the exceptions that the Philippines seeks to read into it – including no exception for where some consumers cannot afford to purchase more expensive products as frequently as less expensive products.

37. The United States requests that the Appellate Body affirm the findings and conclusions of the Panel in this dispute.

38. This concludes our statement. We thank you for your attention and look forward to answering any questions you may have.