ANNEX A

FIRST WRITTEN SUBMISSIONS OF THE PARTIES

ANNEX A-1

EXECUTIVE SUMMARY OF THE FIRST WRITTEN SUBMISSION OF THE EUROPEAN UNION

I. INTRODUCTION

1. The present dispute concerns a blatant violation of Article III:2 first and second sentences. For many decades, the Philippines have applied lower internal taxes to domestically produced distilled spirits than to like or directly competitive and substitutable distilled spirits imported from the European Union (the "EU") and other WTO Members. Regrettably, over the past years, the discrimination against imported distilled spirits has even worsened, as the tax differential between domestic products and imported products has progressively widened.

2. The Filipino authorities have in several occasions publicly acknowledged the WTO-incompatibility of the measures at dispute. In fact, in the past years, several draft bills were proposed to reform the Excise Tax Regime. Some of these draft bills envisaged the creation of a single tax structure for all alcohol products, based on alcohol content rather than on the raw materials used. These proposals met however the strong resistance from the local spirits industry and were never approved.

3. The Filipino market for spirits is currently estimated to amount to ca. 49 million nine litre cases per year, making it one of the largest spirits markets in the Asia-Pacific region. This market is largely dominated by domestic products which together account for almost 98% of total consumption, leaving to imported spirits a share of less than 2,5%. It is also a rather oligopolistic market since three large Filipino corporations enjoy circa 90% of the overall spirits market.

4. The EU is the leading exporter worldwide of spirits, with an annual value of exports of over EUR 5 billion. In the Philippines alone, imports from the European Union amount currently to ca. EUR 18 million per year.

II. LEGAL ARGUMENT

5. The Philippines are in breach of their obligations under GATT Article III:2, first and second sentence, since pursuant to the Excise Tax Regime it applies on imported distilled spirits (i) internal taxes which are in excess of those applied on like products, and (ii) higher internal taxes so as to afford protection to its domestic industry.

6. Preliminarily, the EU points out that the measures at issue constitute "internal taxes" within the meaning of Article III:1 and III:2 of the GATT 1994 since they are levied on all distilled spirits intended for consumption in the Philippines, whether locally produced or imported, and not "on" or "in connection with" importation of distilled spirits.

A. GATT ARTICLE III:2, FIRST SENTENCE

7. It is settled case-law that a tax measure violates Article III:2, first sentence, when: (i) the taxed imported and domestic products are 'like'; and (ii) the taxes applied to the imported products are 'in excess of' those applied to the like domestic products. Importantly, a measure which meets these two requirements can be *ipso facto* considered to infringe Article III:2, first sentence. In fact, the general principle of Article III:1 informs also the first sentence of Article III:2. As such, in order to

establish a violation of the latter provision it is unnecessary to show that the measures at issue are applied "*so as to afford protection to domestic production*".

1. Spirits produced from the designated raw materials and spirits produced from other raw materials are 'like products'

8. In *Japan – Alcoholic Beverages II* and *Canada – Periodicals*, the Appellate Body endorsed the approach previously followed by several GATT panels in deciding that the term "like products" should be assessed on a case-by-case basis. In particular, the Appellate Body held that some criteria for determining whether a product is "like" are: the product's end-uses in a given market; consumers' tastes and habits; the product's properties, nature and quality. Moreover, a uniform tariff classification of products can also be relevant in determining what products are "like". It should be recalled that like products need not be identical in all respects. With regard to alcoholic beverages, the Panel in *Japan – Alcoholic Beverages I* has held that "*minor differences in taste, colour and other properties (including different alcohol contents) did not prevent products qualifying as "like products'*"". The Panel also added that "*"like" products do not become "unlike" merely because of differences in local consumer traditions within a country (…) or differences in their prices, which were often influenced by external government measures (e.g. customs duties) and market conditions (e.g. supply and demand, sales margins)*".

9. The EU submits that the measures at issue have the effect of applying dissimilar internal taxes to several like products. Indeed, domestically produced spirits are subject to lower excise duties than imported spirits which have identical end-uses; respond to the same consumers' tastes and habits; have same properties and nature; fall within the same tariff classification. The EU does not necessarily claim that all spirits under HS code 2208 are "like products". Yet, it is the opinion of the EU that – at the very least – and irrespective of the type and origin of the raw materials used for their production, all gins sold in the Philippines are like products, all brandies sold in the Philippines are like products, all whiskies sold in the Philippines are like products, all vodkas sold in the Philippines are like products, all rums sold in the Philippines are like products, and so on. The EU finds that, in the present case, it would be unnecessary for the Panel to decide what types of spirits are "like" other types of spirits (e.g. whether a gin is like a vodka). Indeed, within the very same type of spirits (gin, brandy, whisky, rum, vodka etc.) the Philippines legislation applies discriminatory taxation against imported products.

10. In the first place, distilled spirits have in general the same end uses. All of them are drunk "straight", "on the rocks", or diluted with other alcoholic drinks or, more frequently, with water or non-alcoholic drinks (e.g. juices, soft drinks). All of them are drunk with the same purpose: thirst quenching, socialization, relaxation, pleasant intoxication. Notably, all drinking styles often co-exist and are used alternatively, depending on the occasion and the whim of the consumer. In fact both Filipino and non-Filipino companies present their products (on their web-sites or through advertisements) in similar ways: e.g. as products that can be drunk straight or in cocktails. The raw materials used for distillation do not affect at all the drinking styles. This is confirmed by the recent Euromonitor Consumer Preference Survey.

11. In the second place, consumers' tastes and habits are not affected by the raw materials used for the distillation. In fact, both local and imported spirits can be purchased by the consumers in the same outlets: on-premises outlets (e.g. pubs, bars, restaurants, clubs, discotheques) and off-premises outlets (e.g. supermarkets). All these spirits (irrespective of the raw materials used for production) can be drunk at home, at friends' place, or in public places such as restaurants and bars. They can be consumed before, after or during meals. Moreover, the occasions in which they are consumed are largely the same, as confirmed by the Euromonitor Consumer Preference Survey. This is further evidenced by company advertisements: many producers (Filipino and non-Filipino) present their

products as "ideal" for some particular moments or circumstances (e.g. to celebrate reunions, important events, birthdays, or successes in business, or ideal for romantic moments). Lastly, evidence demonstrates that all these spirits are widely drunk by all categories of consumers, regardless of age, sex, occupation. Indeed, the same consumers often drink a variety of spirits, depending on the occasion and the circumstances.

12. In the third place, the basic physical properties of all distilled spirits – irrespective of the raw materials used for distillation – are essentially the same: all spirits are concentrated forms of alcohol produced by the process of distillation. Together, ethyl alcohol and water account for more than 99% of the volume of all distilled spirits. At the point of distillation, all spirits are nearly identical, which means that raw materials used in this process have almost no impact on the final product. Post-distillation processes such as ageing, dilution with water and additional flavourings have a relatively more important bearing on the final product. And in fact Filipino manufacturers openly present their products as having been processed and/or having been flavoured in the same manner of the corresponding imported products. For example, local gin brands all highlight the presence of the essence of juniper berries, which is what traditionally gives gin its distinguishing flavour. Furthermore, local vodka brands mention the process of charcoal filtration which is an essential step in the production of vodka. In essence, what is important is that all products at issue are distilled spirits, with high alcoholic content, having similar colours, tastes and smells, bottled and labelled essentially in the same manner. In fact, average alcohol content for both spirits from designated raw materials and spirits from other raw materials ranges from 25% to 40%. Furthermore, spirits of the same category and the same variety have the same alcohol content. Regarding colour, one notes that all products of the same type and variety have the same or very similar colour. Regarding smell and taste, it can be observed that spirits obtained from the designated raw materials obtain, often by employing extracts and flavouring, a similar taste and nose to spirits manufactured from other raw materials.

13. In the fourth place, the physiological and psychological effects of spirits on human beings are essentially due to the presence of ethyl alcohol. These effects are determined by a number of factors: e.g. type and quantity of alcohol consumed; age, weight and gender of the consumer; food in the stomach; situation in which drinking occurs. Yet, the raw material from which the spirit has been distilled does not have any influence in this respect. In fact, countries' legislation which restricts e.g. consumption, manufacture, advertising, sale, use of alcoholic beverages generally do not distinguish between spirits made from certain raw materials and similar spirits made from other raw materials. This is so including in the Philippines: see e.g. regulations on drunk driving or on sale and distribution of alcoholic beverages.

14. In the fifth place, all the products at issue fall within heading 2208 of the HS, which refers to "undenatured ethyl alcohol of an alcoholic strength by volume of less than 80 % vol; spirits, liqueurs and other spirituous beverages". The HS comprises all distilled spirits in the same heading and divides them into sub-groups according to the type of spirit. The raw material used for the production of the different types of spirits is mostly irrelevant: a whisky, a vodka, a gin and a rum always fall within a specific sub-heading, irrespectively of whether they were produced with e.g. sugar cane, coconuts, grapes, wheat, potatoes etc. Data provided by the Philippines and which concern exports of Filipino spirits confirms that local spirits bear the same HS sub-heading of spirits imported into the Philippines, even if made from different raw materials. In this context, it should be remembered that in *Japan – Alcoholic Beverages II*, the Appellate body stressed the importance of HS headings to ascertain the likeness of products.

15. In conclusion, it is manifest that spirits produced from the designated raw materials and spirits produced from other raw materials are "like" products. Should not all distilled spirits be "like" within the meaning of Article III:2, then it is submitted that at least all products falling within the same type

so are. Interestingly, in *Japan – Alcoholic Beverages II*, the Panel found that two different types of alcoholic beverage (shochu and vodka) were "like" products pursuant to Article III:2, first sentence. *A fortiori*, a similar reasoning should, in the case at hand, lead to consider that products are "like" when belonging to the same type of spirit. It can also be pointed out that the facts of the present case are to a certain extent similar to those examined in the *Mexico – Taxes on Soft Drinks* case where Mexico applied dissimilar taxation to two materials (one domestically produced: cane sugar; and one imported: beet sugar) which were both used to manufacture the same products (soft drinks and syrups). In that case, the Panel concluded that beet sugar and cane sugar were "like" products within the meaning of the first sentence of Article III:2.

2. The taxes applied to the imported products are 'in excess of' those applied to the like domestic products

16. According to the Appellate Body in *Japan – Alcoholic Beverages II*, the prohibition of discriminatory taxes in GATT Article III:2, first sentence, is not conditional on a 'trade effects test' nor is it qualified by a *de minimis* standard. Indeed, under this provision, even the smallest amount of "excess" is too much.

17. In the present case, the measures at dispute subject spirits distilled from non-designated raw materials to a much higher internal tax than that applied to spirits produced from the designated raw materials. It is useful to recall that the vast majority of imported products are subject to the higher tax rates whereas all local products enjoy the lower tax rate. It has just to be pointed out that the fact that few imported products may also enjoy the lower tax rate does not exclude that the measures violate Article III:2, first sentence. As the Panel in *Argentina – Hides and Leather* made it clear, "*Article III:2, first sentence, is applicable to each individual import transaction.*" It is thus sufficient to establish a breach of that provision that some imported product is taxed in excess of a like domestic product.

B. GATT ARTICLE III:2, SECOND SENTENCE

1. Imported products and domestic products are 'directly competitive or substitutable products'

18. In *Japan - Alcoholic Beverages II*, the Appellate Body stated that a determination of whether two products are "competitive or substitutable" must be made on a case-by-case basis, and in the light of "*all the relevant facts in that case*". Preliminarily, it should be recalled that the second sentence of Article III:2 is about *imperfectly* substitutable products, since *perfectly* substitutable products fall within the first sentence of the same provision. Moreover, this provision is concerned not only with differences in taxation between products which are *actually* competitive on a given market, but also with differences in taxation between products which are *potentially* competitive. Indeed, whereas consumer tastes and habits may differ from one market to another, tax measures should not be used to "freeze" consumers' preferences for domestic products. For this reason, evidence that two products are not competing in a market at a given point in time is irrelevant if the absence of actual competition is due, at least in part, to the tax measures in dispute. In *Korea – Alcoholic Beverages*, the Appellate Body stressed that competition in the market place is a dynamic, evolving process and thus the concept of “directly competitive or substitutable” cannot be limited to "*situations where consumers already regard products as alternatives*"; adding that "*[i]f reliance could be placed only on current instances of substitution, the object and purpose of Article III:2 could be defeated by the protective taxation that the provision aims to prohibit*".

19. At the outset, the EU wishes to recall that the WTO adjudicatory bodies have in previous disputes found that all types of spirits falling within HS classification 2208 are "directly competitive

or substitutable products". The EU would also like to point out that the Filipino producers themselves publicly acknowledge that competition in the spirits market is intense not only within the various types of spirits, but also between different categories of spirits.

20. In the first place, the basic physical properties of all distilled spirits – irrespective of the raw materials used for distillation – are essentially the same. All spirits are concentrated forms of alcohol produced by the process of distillation. At the point of distillation, all spirits are nearly identical, which means that raw materials used in this process have almost no impact of the final product. Notably, in *Chile – Alcoholic Beverages* the Panel regarded "*the aspect of a product being a potable distilled spirit with a high alcohol content as an important defining characteristic*". On the contrary, the Panel found that even "*post-distillation differences due to filtration, colouring or aging process are not so important as to render the products non-substitutable*". Similarly, in *Korea – Alcoholic Beverages*, the Panel considered sufficient to note that all products at issue "*ha[d] the essential feature of being distilled alcoholic beverages*" and were "*bottled and labelled in a similar manner*". Conversely, the small differences in the filtration or aging process or in colour and flavouring were considered insufficient to render the products non competitive or substitutable. What is crucial in the present dispute is that all products at issue are distilled spirits, with high alcoholic content, having similar colours, tastes and smells, and being bottled and labelled essentially in the same manner.

21. In the second place, all spirits share same end uses and are advertised in a similar manner. In *Japan – Alcoholic Beverages II*, the Appellate Body agreed with the Panel in finding that the decisive criterion in order to determine whether two products are directly competitive or substitutable is whether they have common end-uses. One has however to bear in mind that this commonality of end uses need not be perfect. As the Panel in *Chile – Alcoholic Beverages* noted, "*it is sufficient that there is a pattern that they may be substituted for some purposes at some times by some consumers"*. Moreover, current overlaps between different uses can be limited because of, e.g., protective tariffs or other trade barriers which make price of imported products significantly higher than local ones. Thus, the Panel in *Korea – Alcoholic Beverages*, looked at common end uses in order to establish a competitive relationship between products either immediately or only in the "*near and reasonably predictable future*".

22. Notably, all distilled spirits are drunk in similar ways: "straight", "on the rocks", or diluted with other alcoholic drinks or, more frequently, with water or non-alcoholic drinks. All of them are drunk with the same purpose: thirst quenching, socialization, relaxation, pleasant intoxication. All of them may be consumed before, after or during meals. All of them may be consumed at home or in public places (restaurants, bars, pubs, discotheques etc.).

23. Moreover, the fact that spirits all compete with one another (irrespective of the raw material used for distillation) for the same uses appears in all evidence when one looks at the marketing strategies adopted by spirit producers. It can be recalled that, as the Panels in *Korea – Alcoholic Beverages* and *Chile - Alcoholic Beverages* stressed, marketing strategies are particularly useful in determining whether products are substitutable. Indeed, "*marketing strategies that highlight fundamental product distinctions or, alternatively, underlying similarities may be useful tools for analysis*". In the case at hand, it is particularly remarkable how Filipino manufacturers try and present their products as being similar or equivalent to, or even better than, competing imported spirits. For instance, local brandies are clearly portrayed as similar to either Spanish brandies or French brandies. Many Filipino brandies not only have a Spanish brand, but on their labels they also carry words and images which unmistakably refer to Spain. In their attempt to compare local brandies with imported brandies, Filipino companies even advertise some of them in manners which tend to give the impression that they are produced from grapes (just like imported brandies), which is obviously not the case. Analogous marketing strategies are adopted by Filipino spirits producers also with regard to the other types of spirits: e.g. whisky, gin, rum, vodka, tequila, etc. Finally, it can be noted that several

Filipino producers also adopt advertising campaigns which imply that their products can compete on a worldwide basis, with regard to popularity or quality, with any other spirit.

24. In the third place, an additional indication of substitutability between spirits from the designated raw materials and spirits from non designated raw materials is the fact that they uses the same channels of distribution and sale. With regard to distribution, one can observe that both domestic and imported spirits follow similar distribution networks.

25. As for the points of sale, all of them can be purchased by Filipino customers either in retail outlets or in on-premises outlets. Notably, in retails outlets, they share the same shelf areas, where imported and local products are presented side-to-side. This shelving is clearly responsive to consumers' needs to make choices between competing and substitutable products. Equally significant, on the shelves behind the bar of on-premises outlets in the Philippines, such as pubs and restaurants, one inevitably finds a mix of bottles of local brands and imported ones. Also beverages catering companies offer their customers both local and non local spirits. A brief look at the collection of photos they publish on their web-sites suffices to see the concurrent use of all types of spirits.

26. In the fourth place, it can be noted that although local brands tend to be sometimes cheaper and imported brands to be often more expensive, this is not always the case. Both in supermarkets and in bars one finds that several imported brands and local brands have comparable prices. Competition between different spirits brands in the Philippines therefore does occur also on pricing, and this is true both among the different brands of the same type of spirit and among brands of different types of spirit. This competition based on price is overtly recognised even by local producers.

27. In *Japan – Alcoholic Beverages II*, the Appellate Body stated that the use of cross-price elasticity of demand is one among the criteria for determining direct competitiveness and substitutability, but should not be considered the decisive one. A comparison of the current prices of the spirits marketed in the Philippines should, however, take into account the fact that the actual price of imported spirits is, in all evidence, significantly influenced by the very measures at issue. In fact, if imported spirits were taxed at the same level of domestic products their final resale prices could diminish of as much as 40%. Moreover, one should also bear in mind that the measures at issue seem to have also a perverse effect in that they also impact the valued added tax ("VAT") applicable upon imported spirits in the Philippines. In fact, as the European Union understands it, the taxable basis for VAT is the “total landed cost”: i.e. the total value used by the Bureau of Customs in determining tariff and customs duties, plus customs duties and excise taxes.

28. In addition, it must be noted that, especially in recent years, local producers have developed a number of premium brands so to compete more effectively with imported ones for the relatively more expensive segments of the spirits markets. Filipino spirits producers openly acknowledge this. *Mutatis mutandis*, the situation appears similar to that examined by the Panel in the *Korea – Alcoholic Beverages* dispute, where the Panel considered relevant the fact that Korean companies "*met the potential threat of imports of western-style beverages by creating and selling premium diluted soju*".

2. Spirits are 'not similarly taxed'

29. As the Appellate Body has confirmed in *Japan – Taxes on Alcoholic Beverages II*, two competitive and substitutable products must be considered as "not being similarly taxed" whenever the difference in taxation between them is more than *de minimis*. According to the same report, whether any particular tax differential is or not *de minimis* must be determined on a case-by-case basis.

30. In the Philippines, spirits produced from non-designated raw materials are subject to a tax which may, according to the price band in which they fall, be 10.8 times higher, 21.62 times higher or 43.23 times higher, than that applied to spirits produced from designated raw materials. Notably, this tax differential has also increased in the last years: between 1988 and 2011 the tax rate applied to spirits produced from designated raw materials grew of 84% whereas that applied spirits produced from non-designated raw materials grew of 112%.

31. These tax differentials are extremely significant. Or, paraphrasing what the Appellate Body found in *Canada – Periodicals*, one could say that the magnitude of the dissimilar taxation in the present case is "*beyond excessive, indeed it is prohibitive*". In fact, in the previous alcohol cases WTO adjudicatory bodies have found that less significant tax differentials were more than *de minimis*.

3. Taxation is applied so as to afford protection to domestic production

32. In *Japan – Alcoholic Beverages II*, the Appellate Body laid down the approach for establishing whether dissimilar taxation of directly competitive or substitutable products is applied "so as to afford protection to domestic production". This approach was subsequently further developed and applied in the following cases. In particular, WTO adjudicatory bodies have considered, among other things, the structure of the measures, their overall application on domestic as compared to imported products, as well as the statutory aims pursued by those measures. In the present case, several and important facts and circumstances constitute irrefutable evidence that the Excise Tax Regime is applied "so as to afford protection" to Filipino spirits producers.

33. In the first place, it should be recalled that in the previous alcohol cases, the WTO adjudicatory bodies found that the very magnitude of the difference in taxation between the different distilled spirits was sufficient evidence to conclude that the measures at dispute were applied so as to afford protection to local products. Notably, the tax differentials in those cases were, in each of them, lower (and sometimes much lower) than the differentials which are provided for in the Filipino Excise Tax Regime. In the present dispute, the tax differentials are thus so large that they constitute clear evidence that the measures at dispute are applied so as to afford protection to the domestic producers.

34. In the second place, it must be emphasized that the Filipino Excise Tax Regime distinguishes arbitrarily between spirits produced from the designated raw materials and spirits produced from other raw materials. No objective reason of this differentiation was ever provided by the Filipino authorities. Further, no apparent reason can be discerned from the design and architecture of the measures. There appear to be no rationality or logic in the measures if one excludes the most obvious one: helping local spirits producers. Indeed, *all* designated raw materials are indigenous to the Philippines. Therefore, local distillers can buy locally the raw materials used for distillation, and manufacture products which are be taxed less than most of the products manufactured elsewhere and subsequently shipped to the Philippines.

35. In the third place, all spirits produced in the Philippines are subject to the lower tax rate (being produced from the designated raw materials) whereas the vast majority of imported spirits (being produced from other raw materials) are subject to the higher tax rates. The protectionist application of the measures at issue is further evidenced by the fact that, in some cases (e.g. 'Malibu' rum) even imported spirits produced from the designated raw materials are applied the higher tax rates instead of the lower rate, which they are in principle entitled to. Notably, in *Korea – Alcoholic Beverages*, the Appellate Body found that the fact that the tax at dispute operated in such a way that the lower tax brackets covered almost exclusively domestic products whereas the higher tax brackets embraced almost exclusively imported products was supporting the conclusion that the measure was applied as to afford protection to domestic production. Importantly, the fact that some imported spirits may be applied the lower tax rate is irrelevant. In *Canada – Periodicals*, the Appellate Body held that

"*dissimilar taxation of even some imported products as compared to directly competitive or substitutable domestic products is inconsistent with the provisions of the second sentence of Article III:2*". Similarly, in *Chile – Alcoholic Beverages*, the Panel emphasized: "*it does not save a measure from running afoul of Article III:2, second sentence, merely because there are domestic products taxed at the same level as the imported products*".

36. In the fourth place, Filipino authorities openly acknowledged the WTO incompatibility of the measures at issue and their discriminatory effect vis-à-vis imported spirits in many official statements. For instance, Sen. Ralph G. Recto (who sponsored Senate Bill 1854, later to became RA 9334) during the Senate deliberations in 2004. More recently, the Department of Finance in two letters to the Spanish Ambassador in the Philippines (December 2007) and to the 'Consejo Regulator del Brandy de Jerez (March 2009). Again, on 11 May 2009, the Department of Trade and Industry when, writing to the Chairman of the Committee on Ways and Means of the Filipino House of Representatives, it recommended adoption of the proposed amendments to the Excise Tax Regime. Lastly, Senate President Mr Enrile in the hearing of 15 September 2009 before the Committee on Ways and Means.

37. In the fifth place, it is significant that there exist also one piece of legislation (Revenue Regulation 2-97) which, in relation to the measures at issue, explicitly distinguishes "imported distilled spirits" from "domestic distilled spirits". In the EU's view, this sort of "slip of the pen" of the Filipino legislator is very revealing of the aim of the measures at dispute.

III. CONCLUSION

38. The EU respectfully requests the Panel: (i) to find that, by applying lower taxes to distilled spirits "produced from the sap of nipa, coconut, cassava, camote, or buri palm or from the juice, syrup or sugar of the cane, provided such materials are produced commercially in the country where they are processed into distilled spirits", the Philippines have acted inconsistently with its obligations under Article III:2 first and second sentence, of the GATT 1994, thereby nullifying and impairing the benefits accrued to the European Union under that Agreement; and (ii) to recommend the Philippines adopt the necessary measures to bring the Excise Tax Regime into conformity with its obligations under the GATT 1994.

ANNEX A-2

EXECUTIVE SUMMARY OF THE FIRST WRITTEN SUBMISSION OF THE UNITED STATES

I. FACTUAL BACKGROUND

1. The Philippines protects its domestic production of distilled spirits by applying very low tax rates to spirits produced from a limited set of local raw materials, while applying much higher tax rates to other spirits which are largely imported. It does so despite the fact that there is a great deal of substitutability among all types of distilled spirits, and specifically between imported brands and Philippine domestic brands. By arbitrarily applying a very low tax rate to products produced from local raw materials and a much higher rate to imported spirits, the Philippine measures protect domestic spirits production, very much like the measures found to be WTO-inconsistent in the disputes *Japan – Alcoholic Beverages II*, *Korea – Alcoholic Beverages*, and *Chile – Alcoholic Beverages*.

2. The Philippine tax system for distilled spirits is set out in Section 141 of the National Internal Revenue Code, as enacted by Republic Act 8424 of 1997 and amended by Republic Act 9334 of 2004. Section 141 sets out the tax rates, the categories of products to which the rates apply, and procedures for calculation of the applicable tax for each product.

3. Section 141 divides spirits into two broad categories, reflected in sections 141(a) and 141(b) of the statute. A single low rate applies to all spirits under section 141(a) and one of three possible higher rates applies to spirits under 141(b), depending on the net retail price of a 750 milliliter bottle of the spirit. Section 141 further provides that the rates on spirits shall be adjusted upward over time.

4. The low tax rate under Section 141(a) applies to products distilled from nipa, coconut, cassava, camote, buri palm, or sugar cane. In addition, for a distilled spirit made from one of these materials to qualify for the low rate, the raw material must be produced commercially in the country where it is processed into the distilled spirit. All of the raw materials listed in Section 141(a) are produced in the Philippines.

5. In fact, the Philippines has acknowledged that lower taxes on products distilled from these raw materials means lower taxes on products from indigenous materials. The Department of Trade and Industry Development Plan 200[4] stated, "Excise taxes on distilled spirits impose a lower tax on products made from materials that are indigenously available (*e.g.*, coconut, palm, sugarcane)."

6. All spirits not produced from one of these typical Philippine raw materials fall into the second category under its tax system, provided for in Section 141(b) of the National Internal Revenue Code. Products in this second category are subject to one of three tax rates, depending on the retail price of a 750 milliliter bottle of the spirit. All of the rates under the second category are significantly higher than the low rate levied on products produced from indigenous materials. The lowest rate in the second category is 146.97 pesos/proof liter and the highest is 587.87 pesos/proof liter.

Spirit Tax Category by Raw Material & Price (per proof liter)

		Tax as of 1/1/2009	Tax as of 1/1/2011 (8% scheduled increase)
141 (a) – Local Raw Materials		13.59	14.68
141(b) – Other Raw Materials	Price for 750 ml bottle		
	From P0 to P250	146.97	158.73
	From P250 to P675	293.93	317.44
	More than P675	587.87	634.90

7. All the rates are set in pesos per proof liter. The tax on a particular distilled spirit may be calculated using a standard formula. For example, the tax on a 750 ml bottle of local White Castle Whisky (80 proof, or 40% alcohol) with the 2009 tax rate of 13.59 pesos/proof liter, would be calculated as follows:

$$13.59 \times (40/100) \times 2 \times (750/1000) = 8.15 \text{ pesos}$$

The tax on a 750 ml bottle of imported Jim Beam black whiskey (86 proof, or 43% alcohol), with the 2009 tax rate of 293.93 pesos/proof liter, would be:

$$293.93 \times (43/100) \times 2 \times (750/1000) = 189.5 \text{ pesos}$$

8. In the Philippines, regulations promulgated under the distilled spirits tax law which specify a "net retail price" for each brand and the applicable tax. The regulations list brands sold in the Philippines, specifying for each brand the net retail price per bottle and resultant amount of applicable tax. These regulations separate products eligible for the low tax rate ("local" products) from those subject to the higher tax rate.

II. LEGAL ARGUMENT

A. THE PHILIPPINE MEASURES ARE INCONSISTENT WITH GATT 1994 ARTICLE III:2

9. Article III:2 of the GATT 1994 applies to internal taxes, such as the domestic excise tax at issue in this dispute. Article III:2 of the GATT 1994 provides that:

> "The products of the territory of any contracting party imported into the territory of any other contracting party shall not be subject, directly or indirectly, to internal taxes or other internal charges of any kind in excess of those applied, directly or indirectly, to like domestic products. Moreover, no contracting party shall otherwise apply internal taxes or other internal charges to imported or domestic products in a manner contrary to the principles set forth in paragraph 1."
>
> Paragraph 1 in turn states that:
>
> "The contracting parties recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production."

10. An Ad note to paragraph 2 provides that "A tax conforming to the requirements of the first sentence of paragraph 2 would be considered to be inconsistent with the provisions of the second sentence only in cases where competition was involved between, on the one hand, the taxed product and, on the other hand, a directly competitive or substitutable product which was not similarly taxed."

11. The Philippine excise tax measures on distilled spirits are inconsistent with the obligations of both Article III:2, first sentence and Article III:2 second sentence, because they subject imported products to internal taxes in excess of those applied to like domestic products, and because they are applied to imported products so as to afford protection to domestic production. Article III:2, second sentence is examined first below, followed by the first sentence of Article III:2.

B. PHILIPPINE MEASURES ARE INCONSISTENT WITH GATT 1994 ARTICLE III:2, SECOND SENTENCE

12. The Philippine tax system on distilled spirits is inconsistent with the second sentence of GATT Article III:2. Consistent with the approach used by prior panels and the Appellate Body, to demonstrate that a measure is inconsistent with Article III:2, second sentence, a complaining party must show that:

- The imported products and the domestic products which are in competition with each other are "directly competitive or substitutable";
- The directly competitive or substitutable imported and domestic products are "not similarly taxed"; and
- The dissimilar taxation of the directly competitive or substitutable imported products is "applied . . . so as to afford protection to domestic production."

1. Philippine distilled spirits are directly competitive or substitutable with imported distilled spirits

13. Several previous panels and the Appellate Body have considered the issue of whether certain distilled spirits are "directly competitive or substitutable" within the meaning of the second sentence of Article III:2 of the GATT 1994. The WTO panels that examined this issue all used a similar approach, evaluating factors including physical characteristics, channels of distribution, and end-uses, and to determine whether the products at issue are "directly competitive or substitutable."

14. Philippine distilled spirits and imported spirits share similar physical characteristics, end uses, channels of distribution, substitutability, and tariff classification. Following the approach of prior WTO panels, these similarities demonstrate that Philippine distilled spirits are directly competitive or substitutable with imported distilled spirits in the Philippine market.

Physical Characteristics

15. Philippine and imported distilled spirits have similar physical characteristics, including attributes such as appearance, color, and alcohol content.

16. Exhibit US-38 contains pictures of Philippine and imported products, along with descriptions of these products drawn from advertising, other company representations, and consumer statements. As is evident from these materials, the Philippine products are similar in color to the imported products – for example, both Philippine whiskeys and imported whiskeys are brown spirits and Philippine vodkas and imported vodkas are clear.

17. Manufacturers, distributors, and retailers use similar terms to describe domestic and imported products in local advertising. For example, advertising for both imported and domestic brandies emphasizes the aroma and smoothness of the brands concerned.

18. Descriptions and photos by Philippine companies squarely place them as substitutes with international products, having similar attributes to their foreign competitors. Domestically produced Ginebra San Miguel is a "dutch-type" gin for which the "predominant flavor emanates from juniper berries that are imported from Europe." Gran Matador Solera Gran Reserva is made with "carefully selected Solera Gran Reserva brandy concentrates from Spain." St. George Premium Whisky "approximates the taste, aroma, and alcohol kick of imported whiskies."

19. Domestic and imported brands are not distinguishable from one another on the basis of alcohol content, which is another important physical characteristic. For example, under Philippines standards, all whiskies, regardless of raw material, must have an ethyl alcohol content of at least 32.5%.

20. Thus, based on physical attributes such as appearance, taste, color and alcohol content, distilled spirits made of indigenous materials in the Philippines are directly competitive or substitutable with imported distilled spirits.

Channels of Distribution

21. Philippine and imported brands are sold in the same channels of distribution. Rules and regulations concerning distribution and sales of spirits apply to all types of spirits, supporting the conclusion that they are sold by the same retailers and wholesalers in the same places of business. Regulations on sales and distribution do not distinguish between domestic and imported spirits, nor do they separate spirits products by the raw material used in production. For example, the "Checklist of Requirements for Food Establishments," though applicable widely to wholesalers, importers, and exporters, does not apply different rules for different products. Similarly, the authority to apply municipal taxes applies to all liquors, spirits, and wines regardless of the raw material, or whether products are imported or domestic.

22. In addition, photographs from stores in the Philippines show imported and domestic brands available to Philippine consumers side by side, frequently on the same shelves. Exhibit US-30 provides concrete examples of domestic and imported products sold in the same channels of distribution in the Philippines, including multiple examples of store displays showing domestic and imported distilled spirits sold side by side in the same stores.

23. As these examples demonstrate, domestic and imported brands are sold in the same channels of distribution, providing further evidence for the fact that they are directly competitive or substitutable.

End Uses of Spirits

24. The end uses of products produced from indigenous materials and those produced from non-indigenous materials also demonstrate that domestic distilled spirits are "directly competitive or substitutable" with imported distilled spirits. Data collected directly from consumers, as well as evidence depicting how products are presented to consumers in stores, restaurants, and bars, all support the conclusion that these products have similar end uses.

25. Euromonitor International undertook a study of consumers in the Philippines, in order to understand consumers' perceptions of different brands of distilled spirits, both domestic and imported.

The resulting study provides detailed information on end uses of spirits in the Philippines, including end-use as it concerns the drink itself (*e.g.*, whether the spirit is consumed straight) and end-use as it concerns the setting for consuming drinks (*e.g.*, home or elsewhere).

26. The results of this study confirm that domestic and imported brands have comparable end uses. Survey respondents indicated that they consume both imported and domestic brands straight, with water, or in a mixed drink. Respondents also indicated that they consume both domestic and imported brands in a similar range of places, such as bars, discos, restaurants and sporting events. Consumers drink domestic versus imported brands at similar times and in similar settings (*e.g.*, both imported and domestic products are consumed after work, before dinner).

27. Photographs from stores and restaurants in the Philippines are consistent with consumers' responses to the Euromonitor Consumer Preference Survey, and confirm that end-uses for imported and domestic brands are the same. Domestic and imported brands are displayed together in bars and supermarkets, and they are sold together on drinks menus.

28. Thus, information from consumers as well as evidence from the marketplace demonstrates that the end uses of domestic and imported brands are the same.

Price Substitutability

29. Evidence also suggests that products produced from indigenous materials and products produced from non-indigenous materials are substitutable depending on price. If the Philippines removed the discriminatory aspects of its tax on imported spirits, the price difference between imported and domestic products would be reduced. The results of the Euromonitor Consumer Preference Survey of Philippine consumers regarding whether they would replace some purchases of domestic products with imported products if the difference in price between them were smaller demonstrate that price changes result in consumers purchasing more imported spirits and fewer domestic spirits.

Harmonized Tariff System Classification

30. Regardless of raw material, distilled spirits products are classified under heading 2208.

31. In summary, Philippine distilled spirits are "directly competitive or substitutable" with domestic distilled spirits. Philippine producers of distilled spirits produce spirits from local raw materials, which are then regulated, marketed, and sold side-by-side with imported products and consumed for similar reasons in the same types of places. These products are directly competitive or substitutable with the products produced by their international competitors, yet, are subject to a significantly lower tax rate.

2. Philippine products and imported products are not similarly taxed

32. Under the second sentence of Article III:2 of the GATT 1994, a complaining party must show that the domestic products and the imported products are "not similarly taxed." In Philippine regulations listing brands of spirits and applicable taxes, products are divided into two groups: "local" and "imported." Products made from local raw materials and eligible for the low tax rate under Section 141 (a) are included in one list, and all other products – those subject to the higher tax rates – are another list.

33. Revenue Regulations 12-2004 is the most recent regulation listing products and the taxes applied to different brands. For "local" products taxed at the lower rate, listed at Annex A of the

regulation, the tax per bottle (as adjusted for proof liters) is very low. As to 2009, taxes for 750 ml bottles range from 6.35 pesos (for a 750 ml bottle of Tanduay rum) to 9.24 pesos (for the same size bottle of local Gordan's gin).

34. By contrast, taxes are significantly higher for all products listed in Annex B, "Imported Distilled Spirits Brands Produced from Grains, Cereals and Grains covered by Section 141(b)." The products are divided by price into three categories, reflecting the three tax rates under Section 141(b). The maximum and minimum tax (in pesos) per 750 ml bottle for imported products, as listed in the Annex, are:

	Maximum 2009	Minimum 2009	Maximum 2011	Minimum 2011
Premium	379.17	352.72	409.51	380.94
De-Luxe	189.59	154.31	204.75	166.66
Standard	99.21	79.36	107.15	85.71

35. In other words, the minimum tax per 750 ml bottle for an Annex B product, P79.36, is nearly nine times the maximum tax per 750 ml bottle for an Annex A product.

3. The taxation of distilled spirits protects domestic Philippine production

36. The third element of the second sentence of GATT Article III:2 requires that the differential taxation is applied "so as to afford protection" to domestic production. In this case, the Philippines itself has acknowledged that the measures are structured to favor products made from local raw materials, and an objective examination of the measures' structure leads to the conclusion that they protect domestic products.

37. The sheer magnitude of difference in the tax rate for products made from typical local materials compared to that for all other products supports the conclusion that the measures operate to afford protection to domestic production.

38. The *lowest* tax rate in the Philippine system for products not made of typical local materials is 146.97 pesos/proof liter, *more than ten times* the rate applied to local products. The highest tax rate is *more than 40 times* the low rate. The extent of discrimination under the Philippine tax regime dwarfs the tax differentials found to afford protection to domestic production in prior disputes.

39. The Appellate Body in *Japan – Alcoholic Beverages II* noted that in some cases, the difference in taxation itself will be enough to establish the protection of the domestic industry. Given the magnitude of discrimination in the Philippines, this alone supports the conclusion that the measures "afford protection to domestic production."

40. Although the magnitude of the difference in taxation between domestic and imported brands is sufficient to show that the Philippine measures protect domestic industry, other facts also support this conclusion.

41. The Philippine measures divide distilled spirits into two broad categories, based on the raw material from which the individual spirits are distilled. As explained above the Philippine and imported products are substitutable, and the raw materials that are designated as inputs for products eligible for the low tax rate all thrive in the Philippines. The Philippine system, like the system analyzed in *Korea – Alcoholic Beverages*, "operates in such a way that the lower tax brackets cover almost exclusively domestic production, whereas the higher tax brackets embrace almost exclusively imported products." Moreover, the Philippine law requires that for a product distilled from the

typically local raw materials to receive the low tax treatment, not only must the raw material used to produce the spirit be among those on the select list of indigenous products, but also that raw material must be produced commercially in the country where the spirit is produced. This imposes an additional barrier to low tax treatment on par with Philippine products.

42. In summary, the Philippines measure is structured to favor domestic products, by virtue of the separation of products made from typical Philippine raw materials and all other products.

C. FIRST SENTENCE, GATT 1994 ARTICLE III:2: IMPORTED DISTILLED SPIRITS ARE LIKE PHILIPPINE DISTILLED SPIRITS AND TAXED IN EXCESS OF DOMESTIC PRODUCTS

43. To establish that a Member's internal tax is inconsistent with the first sentence of Article III:2, one must demonstrate that (1) the taxed imported and domestic products are "like"; and (2) the taxes applied to the imported products are "in excess of" those applied to the like domestic products. As explained below, the measures in question are also inconsistent with the first sentence of Article III:2.

1. Philippine distilled spirits are "like" imported distilled spirits

44. As with determining whether products are "directly competitive or substitutable," in order to determine whether imported and domestic distilled spirits are "like products" previous panels have assessed factors such as the products' physical characteristics, channels of distribution, end uses, consumer tastes and habits, and tariff classification.

45. Rather than specifying a particular type of spirit for preferential treatment, the measures discriminate by specifying the raw materials used to produce the product – raw materials that are largely used to produce Philippine "local" spirits, not imported products. This is similar to the facts in *Mexico – Taxes on Soft Drinks*, where both cane sugar and beet sugar were used to produce the soft drinks affected by Mexico's measure. These two materials were both used to manufacture the same products. Examining the characteristics and uses of the two materials, the panel determined that the downstream products were "like" products.

46. The Philippines produces a range of products from the local materials designated in the statute. The Ginebra San Miguel Company alone produces brandy, vodka, gin, tequila and whiskey. For the Philippines, the evidence supports the conclusion that local products made from typical local raw materials (e.g., gin, whiskey, vodka, brandy) compete with, and are "like," their imported counterparts.

47. For brandy, whiskey, and vodka, the Philippines has promulgated Standard Administrative Orders (SAOs) on product standards that very plainly state that different raw materials can be used to make the same "type" of spirit. This supports the conclusion that, for purposes of the Philippine measures, the "local" product is "like" the imported product.

48. With respect to whiskey and brandy, the SAOs explicitly provide that "whiskey" and "brandy" can be made from different raw materials. Specifically, "compounded" brandy and "compounded" whiskey can by made from "neutral spirits." The SAO for vodka does not mention raw material at all in the definition of vodka, but simply states that it is obtained from "neutral spirit" from "fermented grain, potato, or any other source." By the Philippines' own standards, Philippine vodkas, whiskeys, and brandies are "like" imported vodkas, whiskeys, and brandies.

49. Not only are Philippine products directly competitive or substitutable with imported products, based on both physical characteristics and how the products are marketed and sold, Philippine products are "like" domestic products

50. Each type of Philippine distilled spirit is virtually identical to its imported counterpart in terms of color, packaging, and alcohol content. For example, gin and vodka are clear, whether imported or domestic, and that whiskies and brandies are golden. Advertising uses similar terms to describe the color and taste of imported and domestic brands.

51. Other factors (end uses, channels of distribution, substitutability) also support the conclusion that the Philippine products subject to the lower tax rate are "like" imported products subject to the higher rate. For example, with respect to channels of distribution, imported and domestic brands of the same type are grouped together in stores and displays, demonstrating that the raw material is irrelevant to how the brands are sold. The second photograph in Exhibit US-30 depicts imported whiskies (Maker's Mark, Jack Daniel's, J&B) and domestic White Castle on the same set of shelves.

52. The labels of the individual brands also emphasize the "likeness" of Philippine and imported products. For example, the local White Castle whisky and imported Jim Beam whiskey both use red, gold, black and white in their label designs, as well as seals and natural images. Don Enrique tequila features a sombrero, signaling association with Mexico.

53. Evidence from the Philippine market (the survey results prepared by Euromonitor) shows that imports are no different – from a consumer perspective – than locally manufactured distilled spirits made of local raw materials. In short, for every variety of distilled spirit available, the Philippine product – made from local raw materials – is "like" the imported product. As such, these products are "like" domestic products within the meaning of the first sentence of Article III:2 of the GATT 1994.

2. Imported products are "taxed in excess" of Philippine products

54. As noted above, a measure is inconsistent with the first sentence of GATT 1994 Article III:2 where (1) the domestic and imported products are "like" products; and (2) the imported like product is taxed in excess of the domestic product. The difference in taxation between domestic and imported products in the Philippines is so large that the lowest tax rate per bottle for imported products is nearly nine times above the highest rate per bottle applied to domestic products in recent regulations. Thus, imported products are clearly "taxed in excess" of domestic products.

III. CONCLUSION

55. For the reasons set out above, the United States respectfully requests the Panel to find that the Philippine measures with respect to the taxation of distilled spirits are:

- inconsistent with Article III:2 of the GATT 1994, second sentence, as a tax applied on imported distilled spirits which are directly competitive or substitutable with domestic distilled spirits which are "not similarly taxed"; and

- inconsistent with Article III:2 of the GATT 1994, first sentence, as a tax on imported distilled spirits "in excess of those applied to like domestic products."

ANNEX A-3

EXECUTIVE SUMMARY OF THE FIRST WRITTEN SUBMISSION OF THE PHILIPPINES

I. INTRODUCTION

1. This case involves the right of a developing country WTO Member to impose a tax regime that is best suited to achieve the fiscal objectives set out in its Constitution in light of the administrative and enforcement constraints it faces with respect to tax collection.

2. An important tenet of the Philippines' fiscal objective is equitable taxation. Article VI, Section 28(1) of the Constitution of the Philippines provides that "the rule of taxation shall be uniform and equitable. The Congress shall evolve a progressive system of taxation." This means, among other things, that taxation should be based on the taxpayer's individual ability to pay. Therefore, higher-priced goods, typically bought by wealthier consumers, should bear a higher absolute tax than lower-priced goods, typically bought by less affluent consumers. In the Congressional deliberations at the time of the adoption of Section 141 of the National Internal Revenue Code, it was stated that the proposed tax system would be fair as "It will be based on the ability to pay … because the tax will depend on whether the product is high priced or low priced … [This] will accommodate or answer the constitutional requirement of equitable taxation."

3. The jurisprudence of the WTO has long recognized the right of WTO Members to establish and apply their own tax policies. As WTO Members are "free to tax distilled alcoholic beverages on the basis of their alcohol content and price", they are equally free to tax distilled alcoholic beverages on the basis of the raw materials used.

II. FACTUAL BACKGROUND

4. The materials-based excise tax system for distilled spirits in the Philippines is non-discriminatory, in law and in fact. It applies a specific tax on distilled spirits produced from designated raw materials, and a three-tiered tax on spirits produced from other materials. The distinction in tax rate is based on the objective criterion of raw materials and not on whether the products are domestic or imported. The language of the statute is clear on this point: Section 141(a) states that the specific rate applies to distilled spirits produced from the designated raw materials "provided such materials are produced commercially in the country where they are processed into distilled spirits."

5. The raw materials identified in Section 141(a) are grown in numerous countries in various parts of Asia, Australia, Africa, North America (United States), Central America and South America. According to the United Nations Food and Agriculture Organization, the Philippines ranked 10th in the world in terms of production of sugar cane in 2008. Given the global availability of all of these materials, particularly sugar, the measure does not favour domestic producers. Thus, whether on a de jure or a de facto basis, the measure is origin-neutral.

6. The raw materials-based distinction in Section 141 can be traced to the American colonial period in the Philippines. The US colonial administrators imposed a specific tax on distilled spirits "produced from sap of the nipa, coconut, or buri palm, or from the juice, sirup, or sugar of the cane." Nearly a century later, Section 141 of the NIRC uses almost identical language, providing for a specific tax on distilled spirits "produced from the sap of nipa, coconut, cassava, camote, or buri palm or from the juice, syrup or sugar of the cane". It is undisputed that the complainants in this case carry

the burden of proving their claims that the Philippines has violated its obligations under GATT Article III:2. They cannot merely assert a violation; they must prove the elements of a violation. Both the United States and the EU have failed to discharge this burden in relation to all their claims concerning the products in question.

III. THE PHILIPPINES' EXCISE TAX REGIME FOR DISTILLED SPIRITS IS CONSISTENT WITH ARTICLE III:2, FIRST SENTENCE

A. NON-SUGAR-BASED DISTILLED SPIRITS ARE NOT "LIKE" SUGAR-BASED DISTILLED SPIRITS[1]

7. The concept of "like products" under Article III:2 must be examined on a case-by-case basis, and the Appellate Body has stressed that this concept "must be construed narrowly so as not to condemn measures that its strict terms are not meant to condemn." A very important element of "likeness" relates to the physical characteristics of the product in question. Market segmentation based on price is also a very important aspect in the determination of likeness under Article III:2, first sentence.

1. Physical Characteristics

8. The non-sugar-based distilled spirits originating in the EU and the United States are not "like" the sugar-based spirits produced in the Philippines. The physical differences are substantial and in turn affect the quality, price, brand reputation and other characteristics of the products.

9. The difference in raw materials causes differences in the production processes for sugar-based and non-sugar-based distilled spirits. The most important differences are found in fermentation, distillation and aging.

10. For sugar-based spirits, fermented sugar-cane molasses is subjected to continuous distillation so that it is completely stripped of congeners, which are the chemical compounds responsible for giving alcoholic beverages their taste, flavour and aroma. The resulting alcohol is a neutral spirit that does not retain any of the attributes (taste, colour or odor) of the raw material from which it came. Neutral spirits rely on flavouring extracts or concentrate, or natural, nature-identical or artificial flavours and essences, for their taste, flavour and aroma. Thus, for sugar-based spirits, ***the end goal of distillation is to come up with a neutral spirit, i.e., a spirit that is tasteless, odorless and colourless, and that is devoid of the attributes of the raw material from which it came***.

11. For non-sugar-based spirits, on the other hand, the fermented raw material is distilled in a way that permits retention of the congeners unique to the raw material, thus giving the resulting alcoholic beverage its distinctive taste, flavour and aroma. For these non-sugar-based spirits, the fermented raw material (*i.e.*, grape or fruit wine, or fermented mash of grain) is distilled only up to the point where the level of flavour desired by the distiller is achieved. ***The end goal of distillation is to balance, enhance, highlight, combine and/or contrast the different flavours naturally occurring in the raw***

[1] Section 141(a) of the NIRC refers to specific materials, *i.e.*, "sap of nipa, coconut, cassava, camote, or buri palm or from the juice, syrup or sugar of the cane." Because this phrase is cumbersome to use throughout the text, we refer to the spirits and liquors produced from the Section 141(a)-enumerated materials as "sugar-based" spirits and liquors. We believe that adopting such a convention will enhance the narrative discussion of the tax structure and the distinction between Section 141(a) and Section 141(b) without creating the misimpression that Section 141(a) refers only to sugar as a raw material, which it clearly does not. At other times in this submission, the use of the phrase "sugar-based" spirits and liquors will be restricted to those products produced from sugar as a raw material. This should be clear from the context, and should not cause confusion.

material. Finally, while non-sugar based spirits undergo an aging process of differing duration, sugar-based spirits do not.

12. Physical differences are more specifically described as follows:

- ***Whiskey:*** EU and US whiskey use grains or cereals as the primary basis for this product. By contrast, Philippine "whiskey", like all other distilled spirits produced in the Philippines, is a sugar-based neutral spirit (ethyl alcohol) to which flavouring is added. ***Philippine sugar-based whiskey would be prohibited from being marketed as "whiskey" under both EU law and United States law.***

- ***Brandy****:* is a spirit based on wine, grape or other fruit – not sugar. There is a fundamental difference in the physical characteristics of sugar-based brandy produced in the Philippines and non-sugar-based brandy produced in the EU and United States. Once again, the sugar-based brandy is made from ethyl alcohol derived from sugar, stripped of practically all congeners, to which the flavourings are added. ***Philippine sugar-based brandy would not be permitted to be marketed as "brandy" under the domestic laws of the EU or the United States***.

- ***Vodka*** produced from sugar molasses cannot be considered "like" vodka produced from grains or cereals. The Panel in *Japan – Alcoholic Beverages II* found that shochu and vodka were like products because they were "both white/clean spirits, ***made of similar raw materials*** and the end-uses were virtually identical." Sugar-based vodka and grain-based vodka are not made from "similar raw materials." The difference in raw materials affects the taste and flavour of the product.

- ***Gin:*** Gas chromatography tests performed on non-sugar-based gin and sugar-based gin yielded results supporting the conclusion that gin made from different raw materials cannot be considered the same.

- ***Tequila*** is a distilled spirit made from agave, a plant that grows chiefly in Mexico. It is not "like" the tequila-flavoured spirits that are produced by Filipino distillers.

- ***Rum:*** The Philippines does not contest that imported rum and locally produced sugar-based rum are made from the same raw material: sugar. Accordingly, the Philippines taxes all imported rums, properly declared to be made from sugar, at the tax rate under Section 141(a).

2. Consumer tastes and preferences

13. In considering the perceptions and behaviour of consumers, it is important to stress that the market in the Philippines for non-sugar-based distilled spirits and sugar-based distilled spirits is highly segmented. The purchasing power of the vast majority of Philippine consumers is very low. This means that the tastes and habits of consumers are objectively determined and constrained by the amount of disposable income available to be spent on alcohol consumption. This important factor is critical to assessing the tastes and preferences of consumers in the market segments in the Philippines. There exists at least two different groups of "consumers" in the Philippines, each with a different set of tastes, habits, perceptions and behaviour and levels of disposable income. Neither the United States nor the EU has presented any credible evidence to suggest that the distilled spirits sold in these different market segments in the Philippines are interchangeable. Indeed, the United States did not make any arguments regarding consumer tastes and preferences.

3. Tariff classifications

14. The Philippine Tariff and Customs Code (TCC) distinguishes between each category of distilled spirits. More specifically, it uses individual categories for each of the non-sugar-based distilled spirits; and, uses a ***separate category*** for sugar-based liquors. Thus, each type of distilled spirit, internationally distinguished and identified by the different raw materials used in their production, has its own individual tariff line. The EU has misunderstood the TCC when it asserts that "[a] whisky, a vodka, a gin/geneva and a rum fall always within a specific sub-heading, irrespectively of whether they were produced with *e.g.*, sugar cane, coconuts, grapes, wheat, potatoes etc." It is only when they are made from sugar that they will fall within heading 2208.40. The United States did not offer any evidence on tariff classification in support of its argument that certain distilled spirits are like products.

4. End-uses

15. The end-use of the products at issue is objectively the same in that they are alcoholic beverages that will be ingested for the same purpose, *i.e.*, relaxation. However, that does not mean that they are "like products." The Panel in *Japan – Alcoholic Beverages II* stressed that "the term 'like products' suggests that for two products to fall under this category they must share, apart from commonality of end-uses, essentially the same physical characteristics." Thus, any overlap in end-use for non-sugar-based distilled spirits and sugar-based distilled spirits is insufficient to overcome the clear differences in physical characteristics.

16. When the elements of "likeness" are considered in their totality, including physical characteristics, consumer tastes and habits, market segmentation, tariff classifications and end-use, non-sugar-based distilled spirits cannot be considered "like" sugar-based distilled spirits.

B. LEVEL OF TAXATION

17. The Philippines considers that as the first part of the test under Article III:2, first sentence, has not been met, *i.e.*, the products are not "like", there is no need to proceed to the analysis of the second part of the test, namely, whether one group of distilled spirits is taxed "in excess of" another group of distilled spirits.

IV. THE PHILIPPINES EXCISE TAX REGIME FOR DISTILLED SPIRITS IS CONSISTENT WITH ARTICLE III:2, SECOND SENTENCE

A. NON-SUGAR-BASED DISTILLED SPIRITS AND SUGAR-BASED DISTILLED SPIRITS ARE NEITHER "DIRECTLY COMPETITIVE" NOR "SUBSTITUTABLE"

18. The ordinary meaning of the term "directly" is "completely, absolutely, exactly." Thus, products can only be regarded as "directly competitive" if the "degree of proximity" in the competitive relationship between the sugar-based and non-sugar-based products is such that they could be considered to be in "complete, absolute, or exact" competition with one another. Moreover, the appropriate place to examine whether products are "directly competitive or substitutable" is the marketplace. The need for a case-by-case examination, based on the peculiarities of the individual marketplace means that prior cases are of limited relevance in determining whether non-sugar-based distilled spirits and sugar-based liquors can be considered as directly competitive or substitutable. ***In none of the three prior WTO alcohol cases were the Panels presented with the type of highly segmented market that exists in the Philippines, in which sugar-based spirits are produced for low-income consumers, and where high cost non-sugar-based spirits are priced out of reach for the vast majority of the population***.

1. The Philippine market

19. In the specific context of the Philippine market, sugar-based domestic liquors, which are sold at very low prices, do not offer an "alternative way[] of satisfying the same consumer demand in the marketplace" as that offered by high-priced non-sugar-based spirits. There is no "close", "direct" or "proximate" competitive relationship between these products. Non-sugar-based spirits cannot offer such an alternative even for the foreseeable future, given the magnitude of the gap in purchasing power in these different market segments. ***Such non-sugar-based distilled spirits are simply too expensive to be an affordable option for the vast majority of Philippine consumers – regardless of any tax.***

2. Price and elasticity of substitution

20. The Philippine market for alcoholic beverages is stratified in such a way that non-sugar-based distilled spirits at their pre-tax prices are simply not an affordable option for the vast majority of consumers, given their low income. This means that non-sugar-based distilled spirits and sugar-based spirits are not in direct competition in the Philippine market.

21. The gap between the average pre-tax price of non-sugar based spirits and sugar-based spirits is simply insurmountable for the vast majority of Filipinos. This gap is so great that the price of non-sugar-based spirits prevents their purchase, as indicated in the Euromonitor Consumer Preference Survey which found that "[e]ven at a 40% price decrease of imports and a 100% to 200% price increase in domestics, imported brands are typically more than twice as expensive as domestic ones."

22. The University of the Philippines econometrics study shows very low price elasticity and a very weak degree of substitutability. The United States points to the Euromonitor survey as an indication of price elasticity. However, these findings reflect that any competitiveness between sugar-based and non-sugar-based distilled spirits is limited to a very small and highly unrepresentative segment of the Filipino market. Moreover, even for these individuals, it took dramatic decreases in the prices of non-sugar-based spirits, coupled with even more significant increases in the prices of sugar-based products, to affect consumer choices. Thus, even for the class of Filipinos who have the option of buying non-sugar-based spirits, there was very weak elasticity of substitution.

3. Distribution channels

23. That sugar-based spirits and non-sugar-based spirits are sold in structurally different markets, and are not directly competitive or substitutable, is also reflected in their manner of distribution. In the Philippines, non-sugar-based distilled spirits and sugar-based spirits are sold through distribution channels that ***are almost entirely different***. Periodic retail trade audits show that *sari-sari* stores consistently accounted for roughly 85% of off-premise sales of sugar-based spirits. By contrast, non-sugar based spirits are almost ***never*** sold in *sari-sari* stores. Another price survey which covered 43 *sari-sari* stores located all over Metro Manila, revealed that ***not a single sari-sari store carried non-sugar-based spirits***. ***No market exists for non-sugar-based spirits through this principal distribution chain.***

24. Distribution channels for sugar-based and non-sugar-based spirits also differ when it comes to on-premise sales. Sugar-based spirits are generally not sold in hotels, high-end restaurants and bars where non-sugar-based spirits are sold. Instead, they are sold in *carinderias*, *lugawans* and *gotohans*, and in beer gardens, beer houses and *ihaw-ihaws* (grilled meat stalls), where, in turn, non-sugar-based spirits are not sold.

4. Physical characteristics

25. The products in the present case are indeed "physically quite different", as described in the section on "like" products, and this places a "higher burden" on the EU and the United States to establish that, despite these differences, there is a competitive relationship between them.

5. End use and advertising

26. Any overlap in end-uses cannot by itself overcome the clear physical differences in the products, or, more significantly, market segmentation caused by very material price differences. It follows that any overlap in advertising strategies is also of limited relevance. The EU points to instances where the producers of sugar-based products have sought to market their products by making references to the country where the spirit is traditionally made, or referring to traditional appellations or ingredients. However, this only confirms that the marketing campaigns are attempting to overcome differences in perceptions affecting economic decisions held by consumers between non-sugar-based distilled spirits and sugar-based distilled spirits.

6. Tariff classification

27. The classification of these products under the Philippine Tariff and Customs Code tariff schedule also supports the conclusion that these products are not directly competitive or substitutable. As noted above, the TCC uses individual categories for each of the non-sugar-based distilled spirits, but a separate category for sugar-based liquors.

28. In sum, the complainants have failed to prove that the products in question are directly competitive or substitutable in the Philippine market.

B. NON-SUGAR-BASED DISTILLED SPIRITS AND SUGAR-BASED SPIRITS ARE "SIMILARLY TAXED"

29. Should the Panel find, despite compelling evidence to the contrary, that non-sugar-based spirits and sugar-based spirits are directly competitive or substitutable, the *de minimis* difference in the relative tax burdens borne by the products at issue is permissible under Article III:2, second sentence.

30. The comparison to be made is not between the nominal tax rates applied to non-sugar-based and sugar-based products, but rather their relative tax burdens.

31. The concept of *de minimis* for the purposes of Article III:2, second sentence, is defined by the extent to which the tax burden affects the competition of products in the market in question. If the difference in tax burden has little or no impact on consumer decisions, it is appropriately deemed to be *de minimis*. As noted above, the average net retail price of the non-sugar-based spirits indicates that, regardless of the tax rate imposed, the vast majority will not be able to afford these products. In other words, the difference in the level of taxation has no effect in the Philippine market on the decision to purchase or not to purchase, as affirmed by both the complainants' Euromonitor Consumer Preference Survey and the University of the Philippines econometrics study.

32. Moreover, as there is "no set level of tax differential which can be considered *de minimis* in all cases" the Panel has a certain amount of discretion in determining where the line for *de minimis* taxation will be drawn. In exercising this discretion, a Panel must take into account the particular market situation. In the case of the Philippines, weight should be given to the fact that the Philippine

taxation system has the effect of taxing those who can afford what are effectively luxury goods at higher levels than those who cannot.

C. THE EXCISE TAXES ARE NOT APPLIED "SO AS TO AFFORD PROTECTION" TO DOMESTIC PRODUCTION

33. Should the Panel find, despite compelling evidence to the contrary, that the products in question are directly competitive or substitutable and the difference in taxation is more than *de minimis*, both the history and the current use of the materials-based excise tax system refute the notion that it has been applied "so as to afford protection."

34. Section 141(a) provides this designated rate for all distilled spirits made from sugar, whether they are imported or locally produced. If the legislators had intended to "protect" the domestic distilled spirits industry, this preferential rate would not have been accessible for imported products. The significance of the fact that both imported and distilled spirits can access the preferential tax rate is illustrated by the fact that rums constitute one of the most popular distilled spirits in the Philippines, making up over one-fourth of the total distilled spirits market.

35. More importantly, ***none of the materials eligible for the lower tax rate are found exclusively in the Philippines***. Indeed, as noted, the raw materials listed in Section 141(a) are grown all over the world.

36. GATT Article III protects equality of competitive conditions. This logically means that if the measure does not in fact impact on competitive conditions, it cannot violate GATT Article III. The competitive opportunities for non-sugar-based distilled spirits in the Philippines are determined by the high price of such products and the low purchasing power of the vast majority of consumers – not the excise tax. This is a "real fact in a real case in the real world." Thus, the Philippines submits that any dissimilarity in the level of taxation is not imposed "so as to afford protection" to domestic producers of sugar-based liquors.

V. CONCLUSION

37. For the reasons set forth above, the Philippines requests the Panel to reject all of the complainants' claims under GATT Article III:2.

ANNEX B

SUBMISSIONS OF THE THIRD PARTIES

ANNEX B-1

EXECUTIVE SUMMARY OF THE WRITTEN SUBMISSION OF AUSTRALIA

I. INTRODUCTION

1. The proceedings, initiated separately by the European Union and the United States in relation to the Philippines' distilled spirits excise tax regime, raise systemic issues concerning the application of the national treatment principles contained in Article III:2 of the General Agreement on Tariffs and Trade 1994 (GATT 1994).

II. THE GENERAL AGREEMENT ON TARIFFS AND TRADE (GATT 1994)

A. ARTICLE III:2, FIRST SENTENCE

2. A key issue raised in the dispute is whether spirits which fulfil the raw materials requirement[1] and those that do not are "like products" under the first sentence of Article III:2 of GATT 1994. The Appellate Body has previously construed the term "like products" narrowly and undertaken a case-by-case analysis through the application of criteria such as the product's end-uses in a given market and its properties, nature, and quality.[2] Australia notes that no one criterion is determinative and the evidence as a whole must be examined.[3]

3. The complaining parties' argument in respect of "like products" raises three possibilities for the Panel to determine on the facts: firstly that all distilled spirits are "like products"; secondly that distilled spirits falling within the same "type" (i.e. imported and domestic vodka) are "like products"; and lastly that spirits of a different "type", but which utilise the same raw materials are "like products" (e.g. would Philippines brandy be considered "like" imported rum as both are made from the same raw material?[4]).

4. Australia notes that the Philippines' submission emphasises the differences in the physical characteristics of the distilled spirits under examination, primarily based on the different raw ingredients used in their production. Australia notes that the panel in *Japan – Alcoholic Beverages II* found that shochu and vodka were "like products" although they contained "similar" and not identical raw materials.[5] Australia observes that the present facts appear to indicate that the raw material used does not materially alter consumer perception of the product; rather such perception appears to be affected by the addition of flavouring and the marketing of the end products as brandy, gin, etc.

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[1] Section 141 of *National Internal Revenue Code of 1997* (Philippines) applies a lower rate of tax to spirits made from specified raw materials which are commercially produced in the same country where they are processed into distilled spirits. Australia refers to this requirement as the 'the raw materials requirement'.

[2] Appellate Body Report, *Japan – Alcoholic Beverages II*, pp. 20-22.

[3] Appellate Body Report, *EC – Asbestos*, para. 109.

[4] The Philippines claims that all rum would be afforded the lowest tax bracket under the excise tax measure (although presently this is not the case in practice) (see Philippines' first written submission, paras. 172-175). Australia notes that in addition to requiring that the distilled spirit be made from the specified raw materials, the raw material requirement requires that the raw ingredient be commercially produced in the same country in which the alcohol is distilled.

[5] Panel Report, *Japan – Alcoholic Beverages II*, para. 6.23. Similarly, the panel in *Mexico – Soft Drinks* found that beet sugar and cane sugar are "like products" within the meaning of Article III:2 (para. 8.36).

5. The qualifying issue is whether the taxes are applied to imported products "in excess of" like domestic products. The Appellate Body has indicated that 'in excess of' is to be interpreted strictly and "even the smallest amount of 'excess' is too much" and that further such an assessment is not conditional on a trade effects test or *de minimis* standard.[6]

6. Australia notes that the measures at issue do not directly discriminate between imported and domestic goods. However Australia notes that the Appellate Body in *Korea – Various Measures on Beef* confirmed that a measure which appears on its face to be origin-neutral may nevertheless give rise to *de facto* discrimination[7]. Australia submits that a measure which does not expressly apply different tax rates based on whether a product is imported or domestic may nevertheless be inconsistent with the first sentence of Article III:2 of GATT 1994 on the basis that the actual tax burden applied results in an economic impact on the competitive conditions for imported compared with like domestic products[8].

B. ARTICLE III:2, SECOND SENTENCE

7. The second sentence of Article III:2 applies to a broader range of products than the first sentence[9]; however each panel must consider on a case-by-case basis how broad the scope is.[10] Previous panels have developed criteria which may be applied to determine whether products are "directly competitive" under the second sentence of Article III:2 including "physical characteristics, end-uses, channels of distribution and prices".[11]

8. Australia's view is that a "directly competitive" relationship should be determined in the context of the particular market conditions. The Philippines submits that its consumer market is driven by price and is segmented into at least two different groups with different tastes, habits, perceptions and behaviour.[12] Australia notes that previous panels have found that products with different net retail prices can be "directly competitive" within the context of a segmented market driven by price, on the basis that the impact of the price on the market can be affected by the nature of the product itself as well as the relative competition within and across specific market segments.[13]

9. In contrast to the characterisation of "like products" under the first sentence, Australia notes that the panel in *Japan – Alcoholic Beverages II* found that "the term 'directly competitive or substitutable' does not suggest at all that physical resemblance is required... [T]he decisive criterion... is whether they have common end uses, *inter alia*, as shown by elasticity of substitution".[14] Australia further notes the complaining parties' assertions that domestically produced and imported spirits are marketed as the same "type" of spirit, often using similar packaging and branding[15] and that the nature and content of the products' marketing strategies seem to indicate that they are competing for a similar market segment.[16] In assessing such assertions, the Panel may again wish to consider the relationship

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[6] Appellate Body Report, *Japan –- Alcoholic Beverages II*, p. 23.
[7] Appellate Body Report, *Korea – Various Measures on Beef*, para. 137.
[8] Panel Report, *Argentina Hides and Leather*, paras. 11.182-183.
[9] Appellate Body Report, *Korea – Alcoholic Beverages*, para. 118.
[10] Panel Report, *Korea – Alcoholic Beverages*, para. 10.38, citing EPCT/A/PV/9, p. 7; E/Conf.2/C.3/SR.11,p. 1 and Corr.2; and E/Conf.2/C.3/SR.40, p. 2.
[11] Panel Report, *Korea – Alcoholic Beverages*, para. 10.43; Panel Report, *Chile - Alcoholic Beverages*, para. 7.30.
[12] Philippines' first written submission, para. 179.
[13] Panel Report, *Korea – Alcoholic Beverages*, para. 10.74; Panel Report, *Chile – Alcoholic Beverages*, para. 7.37.
[14] *Japan – Alcoholic Beverages II*, Panel Report, para. 6.22; Appellate Body Report, p. 25.
[15] United States' first written submission, para. 97.
[16] European Uion's first written submission, para. 77.

between all distilled spirits, between types of distilled spirits, or across types with different names, but made from the same raw materials[17] (see paragraph 3 above).

10. The term "not similarly taxed" in the second sentence of Article III:2 of GATT 1994, requires more than a *de minimis* standard[18]. Under the excise tax measure the lowest tax on spirits which do not meet the raw materials requirement amounts to more than ten times the tax which is applied to spirits which meet the requirement. Australia notes that while the determination must be made on a case-by-case basis[19], the comparative difference in this dispute is in excess of what has been considered as reaching the *de minimis* standard in previous panel decisions.[20]

11. The second sentence of Article III:2 of GATT 1994, also requires that the measure is not "applied... so as to afford protection to domestic products". The Appellate Body has stated that "protective application can most often be discerned from the design, the architecture, and the revealing structure of the measure".[21]

12. In Australia's view such an analysis should include consideration of:

- the legal and historical development of the excise tax measure;
- comparison of the Philippines' stated objective of the excise tax measure[22] and the application of the measure;
- the difference in the scale of the tax rates;
- the growth in annual sales in domestic spirits in the Philippines compared with the decrease in imports of spirits into the Philippines[23];
- that imported spirits account for less than four per cent of the market share in 2006, but accounted for 36 per cent of tax revenue raised from spirits;
- some imported spirits made from the same raw material as domestic spirits are not afforded the lowest tax rate[24]; and
- the requirement that the raw materials be produced in the country in which the spirit is manufactured.

III. CONCLUSION

13. Australia considers that there are two critical questions in this dispute. First, whether spirits which meet the raw materials requirement and those that do not can be classified as "like products" and/or "directly competitive or substitutable products" (whether between or across types of spirits, or between all spirits). Second, whether the measure is "applied... so as to afford protection to domestic products", for the purposes of the second sentence of Article III:2, based on a consideration of not only the application of the excise tax measure, but also its design and architecture.

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[17] In *Japan – Alcoholic Beverages II*, the panel found that the range of spirits "shochu, whisky, brandy, rum, gin, genever, and liqueurs were 'directly competitive or substitutable products' " for the purposes of Article III:2 (para. 7.1). See also Panel Report, *Korea –Alcoholic Beverages*, para. 10.67.

[18] *Japan – Alcoholic Beverages II*, Panel Report, para. 6.33*;* Appellate Body Report, p. 27.

[19] Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 27.

[20] Panel Report, *Japan – Alcoholic Beverages II*, para. 6.33.

[21] Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 29.

[22] Philippines' first written submission, para. 32.

[23] United States' first written submission, paras. 32-33.

[24] United States' first written submission, para. 30; Philippines' first written submission, para. 175.

ANNEX B-2

WRITTEN SUBMISSION OF MEXICO*

I. GENERAL

1. These proceedings arise out of the continued enforcement by the Philippines of a special tax regime on distilled spirits, if produced from the sap of *nipa*, coconut, cassava, *camote*, or *buri* palm or from the juice, syrup or sugar of the cane, provided that such materials are produced commercially in the country where they are processed into distilled spirits, in which case a specific tax is imposed. Furthermore, if the distilled spirits have been produced from raw materials other than those mentioned above, they are subject to a different tax.

II. LEGAL ARGUMENTS

A. LIKE PRODUCTS WITHIN THE MEANING OF ARTICLE III:2, FIRST SENTENCE, OF THE GATT 1994

2. The United States indicates that the measures applied by the Philippines are inconsistent with the provisions of Article III:2, first sentence, of the GATT 1994, inasmuch as they establish internal taxes in excess of those applied to "like domestic products". Regarding product "*likeness*", the Panel in *Korea –Alcoholic Beverages*, noted that:

> "… the concept of "likeness" in Article III:2, first sentence, is to be narrowly construed. The question is whether the products are sufficiently close in nature that they fit within this narrow category."[1]

3. According to various WTO Panel and Appellate Body precedents, the criteria that have been taken into account to determine whether products are "like" are the following[2]:

(i) The physical properties of the products;

(ii) the extent to which they may be destined to serve the same end-uses or similar end-uses;

(iii) the extent to which consumers perceive and treat them as different possible means of fulfilling certain functions in order to satisfy a specific need or demand;

(iv) the international tariff classification of the products.

4. The Philippines argues that the products in the instant case cannot be considered to be like products if account is taken of the raw materials from which the distilled spirits were produced and the terms used by the manufacturers to describe each product. It also points out that likeness cannot be measured on the basis of the four-digit tariff classification in the Harmonized System.

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* Original Spanish.

[1] Panel Report on *Korea – Taxes on Alcoholic Beverages*, para. 10.103.

[2] See Appellate Body Report on *Korea –Alcoholic Beverages*, *supra* and Appellate Body Report on *Japan – Taxes on Alcoholic Beverages II*.

5. As has been indicated, various precedents in this matter show that, in order for a product to be considered "like" another product, account must be taken, *inter alia*, of: the physical properties of the products; the extent to which they may be destined to serve the same end-uses or similar end-uses; the extent to which they are perceived and treated by consumers as serving to fulfil certain functions with a view to satisfying a specific need; and the international tariff classification of the products.

6. Accordingly, the Panel should pay particular attention to the possibility that the products are to be considered as "like" products. In this connection, in accordance with Article III:2, first sentence, of the GATT 1994, Mexico considers that the analysis of this matter requires a narrow determination to be made as to whether the domestic products are products sufficiently close in nature that they fit within this narrow category.

7. Given that the burden of proof rests on the (complaining or defending) party that asserts the affirmative of a particular claim or defence, it will be for the complaining party to demonstrate that the domestic products are like the imported products within the meaning of Article III:2, first sentence, of the GATT 1994.

B. DIRECTLY COMPETITIVE PRODUCTS WITHIN THE MEANING OF ARTICLE III:2, SECOND SENTENCE, OF THE GATT 1994

8. If the Panel determines that the products in question are not like products, Mexico considers that, in any case, they would be directly competitive or substitutable products within the meaning of Article III:2, second sentence, of the GATT 1994. In the *Korea – Alcoholic Beverages* case, the Appellate Body held that:

> "The term 'directly competitive or substitutable' describes a particular type of relationship between two products, one imported and the other domestic. It is evident from the wording of the term that the essence of that relationship is that the products are in competition. This much is clear both from the word 'competitive' which means 'characterized by competition', and from the word 'substitutable' which means 'able to be substituted'. The context of the competitive relationship is necessarily the marketplace since this is the forum where consumers choose between different products. Competition in the marketplace is a dynamic, evolving process. Accordingly, the wording of the term 'directly competitive or substitutable' implies that the competitive relationship between products is not to be analysed 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 by consumers to be substitutes but which are, nonetheless, capable of being substituted for one another".[3] (Emphasis added. Footnotes not included.)

9. It is also important to note that the Appellate Body, in *Korea –Alcoholic Beverages,* held that "like" products are a subset of directly competitive or substitutable products. Similarly, it stated that "… all like products are, by definition, directly competitive or substitutable products, whereas not all 'directly competitive or substitutable' products are 'like'.".[4] (Emphasis added. Footnotes not included.)

10. For its part, the Philippines in its written submission states that the differences between the various beverages or distilled spirits lie in the raw materials from which they are made (fruits,

[3] Appellate Body Report on *Korea –Alcoholic Beverages*, *supra*, para. 114.
[4] Appellate Body Report on *Korea –Alcoholic Beverages*, *supra*, para. 118.

grains, etc.), as well as whether or not sugar is used in their production, and points out that, for the production of every beverage or distilled spirit, different production processes are carried out, including the processes of fermentation, distillation and ageing of each of the beverages. The Philippines argues that non-sugar-based distilled spirits are not in competition with, and cannot therefore be viewed as substitutes for, sugar-based spirits. Moreover, they are consumed by different publics.[5]

11. In accordance with the foregoing, the Appellate Body in *Canada – Periodicals* found that products are competitive or substitutable when they are interchangeable[6] or if they offer alternative ways of satisfying a particular need or taste.[7] In other words, contrary to what is stated by the Philippines, if the products in question cover a specific need and are interchangeable or substitutable, Mexico considers that they are directly "competitive" products, regardless of the raw materials from which they have been produced, the production processes or the type of consumers of the products. Likewise, the Appellate Body, in *Chile – Taxes on Alcoholic Beverages*, held that Article III:2, second sentence, of the GATT 1994 provides for equality of competitive conditions of all directly competitive or substitutable imported products, in relation to domestic products.[8]

12. Mexico is of the opinion that the Panel should carefully analyse the possibility that the distilled spirits referred to by the Philippines are directly competitive or substitutable products, in accordance with Article III:2 of the GATT 1994 and the aforementioned precedents of the various panels and the Appellate Body.

13. In the light of those precedents, the products that are the subject of this dispute, namely "distilled spirits", must be considered as directly competitive products, since they satisfy the criteria established in previous WTO disputes (*Korea – Alcoholic Beverages*, *Japan – Alcoholic Beverages II*, and *Chile – Alcoholic Beverages*). In other words, the following criteria are to be taken into account:

That both the domestic and the imported products compete with each other and are substitutable in the marketplace;

that the domestic and imported products are subject to a different tax regime and, therefore, that the taxes applicable to domestic products are lower than the taxes applicable to imported products, making it appear that the domestic industry is being protected.

III. CONCLUSION

14. In view of the foregoing, Mexico requests the Panel to carry out an objective assessment of the issue placed before it, taking into account the precedents that have been established by the Panels and the Appellate Body in the cases cited.

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[5] Written submission of the Philippines, presented on 14 October 2010 in *Philippines – Taxes on Distilled Spirits*, supra, para. 283.

[6] Appellate Body Report, *Canada – Periodicals*, WT/DS31/AB/R.

[7] Appellate Body Report on *Korea – Alcoholic Beverages*, supra, para. 115.

[8] Appellate Body Report on *Chile –Alcoholic Beverages*, para. 67.

ANNEX C

ORAL STATEMENTS OF THE PARTIES AT THE FIRST SUBSTANTIVE MEETING

ANNEX C-1

EXECUTIVE SUMMARY OF THE OPENING ORAL STATEMENT OF THE EUROPEAN UNION AT THE FIRST SUBSTANTIVE MEETING

I. INTRODUCTION

1. Preliminarily, the EU emphasizes that in their first written submissions, the EU and the US have provided extensive evidence that the excise tax regime in the Philippines has been, and still is, conceived and applied so as to shield Filipino spirit producers from the competition of imported products. It then observes that, in its first written submission, the Philippines simply re-runs old arguments which, however, have already been rejected by WTO adjudicators in very similar cases. Moreover, the Filipino authorities also make some statements which are factually wrong.

2. The EU notes that previous jurisprudence makes it quite clear that "like products" are a sub-family of "directly competitive and substitutable products". The idea behind both these concepts is that of ***similarity*** between goods. Basically, there are three categories of products under article III:2: "like products", "directly competitive and substitutable products", and finally (what could be called) "dissimilar products". However, there is no bright line to distinguish between these categories. The more two products are similar, the more they can be considered "like" products, the lesser the similarities, the more these two products could only be regarded as "directly competitive and substitutable". Eventually, when similarities are not deemed sufficient, the products are neither "like" nor "directly competitive and substitutable" and, thus, fall outside the scope of Article III:2. Moreover, there is no precise and closed check-list of aspects to compare. Similarly, there is no single and specific aspect or piece of evidence which determines (or excludes) 'likeness' or 'substitutability'. An adjudicator called upon to evaluate the similarity of two (or more) goods, needs to make an overall and global assessment of all the elements which may be relevant to establish if, and to what degree, these products are similar. The jurisprudence is consistent on these points.

II. THE BURDEN OF PROOF

3. The EU stresses that if one looks at the EU first written submission, one finds a very extensive and thorough examination of why spirits made from the designated raw materials and spirits made from the non-designated raw materials are similar. The EU has submitted over 50 exhibits on these issues. Further elements – if necessary and in response to the arguments advanced by the Philippines – would be provided in the course of this hearing as well as in the remainder of these proceedings.

4. Given that the idea behind both concepts is that of *similarity* between products, all the elements put forward in the whole of the first written submissions of the EU and US should be examined to see whether they demonstrate similarity, and to what extent.

5. Looking specifically at the first written submission of the EU, one needs just to compare the arguments and evidence with previous case-law to realise that in the present case the EU has examined far more aspects of similarity than what has been considered sufficient to establish likeness or substitutability by the WTO adjudicators in previous cases. For each type of spirit, the EU has duly illustrated: the commonality of end-uses, how they satisfy the same consumers' tastes and habits, the similarity of their properties, characteristics and nature, the comparable advertising campaigns, the identical physiological effects on human beings, the analogous legal regulations applying to them, the identical tariff classification, the largely similar systems of distribution and sale, the comparable pricing policies.

III. LIKENESS AND SUBSTITUTAIBILITY/COMPETITIVENESS OF SPIRITS FROM THE DESIGNATED RAW MATERIALS AND FROM THE NON-DESIGNATED RAW MATERIALS

6. In the first place, when reading the Philippines' first written submission one has inevitably the impression that the Filipino authorities try to present their products as lower quality products, cheap products for low-income people, sort of replicas of the original products distilled elsewhere. However, it is clear that this is not the case, at least for several local spirits. The EU takes as an example 'Gran Matador Brandy' and 'Tanduay 1854 Rum' which, as stated on their labels, have won several awards, not only in the Philippines, but also in the rest of the world, including in Europe.

7. In fact, the existence of fierce and growing competition between local and imported brands is openly admitted by the Filipino companies themselves, for instance in their Annual Reports. Importantly, Annual Reports are official documents which must be truthful and transparent, which are checked by independent firms, and which are then submitted to public authorities of control. Indeed, the incorrectness or incompleteness of Annual Reports is subject to various types of sanctions, which may even include criminal sanctions. So, statements made in this context should be taken seriously.

8. Then, the EU observes that there is a second feeling which one inevitably has upon reading the first written submission of the Philippines. It concerns the extraordinarily narrow reading they suggest for Article III:2 of the GATT 1994. In substance, the interpretation put forward by the Philippines would reduce Article III:2 of the GATT to apply only where goods have virtually no difference at all (e.g. commodities). In fact, for manufactured goods, it is the very name of the game that products are – to a certain extent – different. A minor product differentiation (e.g. in quality, organoleptic properties, price etc.) is evidence of healthy competition, not of a lack of competition. In a free market-based economy, different companies try and manufacture goods which can compete with the existing products, thanks to the fact that they have been improved or differentiated in one or more respects. This is recognised by a wide body of well-established economic literature, including, *inter alia*, the models relied upon by the Philippines' economic experts

9. Minor differences, which – according to the Philippines – would prove that products do not compete are, therefore, not only absolutely normal but even necessary in a healthy market-place based on free and fair competition. The EU emphasizes that the reading of Article III:2 proposed by the Philippines cannot be retained. And it is in fact not the interpretation relied upon by the WTO adjudicators thus far.

10. As a next point, the EU deals with the Philippines' argument according to which Filipino and non-Filipino spirits would not compete because price differences would be so large that for most consumers imported products would not constitute real alternatives to local ones. The EU notes that this argument is circular and has been rejected by both panels and the Appellate Body in the past. In practice, the Philippines is trying to justify the existence of the measure by pointing to the negative and discriminatory effects that the measure itself produces.

11. In any event, not only has the EU provided various examples of actual and direct price competition between local products and domestic products (e.g. in shops, bars, restaurants), but even the Philippines itself has provided evidence that before taxes (i.e. without excise tax and value added tax), several domestic products and imported products are comparably priced. In this context, the EU refers the Panel to the Price Survey annexed as Exhibit PH – 19. The EU underlined that what is most relevant when comparing prices is that there exist a significant number of instances of competition. Average prices calculated on the basis of a limited sample are irrelevant: in the real world, when consumers go to the supermarket or to the restaurant, they find a variety of products offered at different prices, they do not find average products offered at average prices.

12. In order to properly assess the prices of the products at issue, the EU prepared a table with the data taken from this Exhibit PH-19 in which it has compared the Net Retail Price (NRP) of a number of spirits: for each type of spirit, one can find some domestic as well as some imported brands (Exhibit EU-80.) A brief look at this list shows that the NRP of many imported products is comparable to the price of some domestic ones. This is so before taxes, because once the excise tax is included, and the VAT is added on top of it, all imported products inevitably become significantly more expensive.

13. The EU gives first as an example a comparison of Filipino 'Brandy Gran Matador Gran Reserva' (700 ml) with Spanish 'Brandy Alfonso I Solera' (700 ml) since both products have almost the same NRP (between 164 and 166 P.). The EU goes on to observe that the final price of these products does not mirror any longer the NRP: the taxes collected are almost four times higher on the imported product. Subsequently, the EU compares two products, with the local product having a NRP far higher than the imported one (almost triple): 'Tanduay 1854 Rum' (700 ml) and 'Bacardi Superior' (750 ml). It then notes that, in spite of the fact that the imported product is much cheaper before taxes, it is subject to taxes which are more than four times higher then those applied to the more expensive domestic product. In conclusion, the EU emphasizes that imported products are not always more expensive than their domestic counterparts but it is rather the discriminatory fiscal treatment that they receive which often makes them more expensive.

14. Incidentally, the EU remarks that this Exhibit PH-19 is revealing in two other important respects. In the first place, it demonstrates the fallacy of the argument put forth by the Philippines that the Excise Tax Regime is designed to implement a progressive taxation system whereby the more expensive products are subject to higher taxes. Lastly, this Exhibit also proves that many rums (12 out of the 13 listed) are not being taxed at the level of domestic products, even if produced from sugar cane.

15. Next, the EU indicates that the distinction made by the Philippines between sugar-based spirits and non-sugar based spirits is both untrue and misleading. In the first place, a very typical spirit produced in (and even exported by) the Philippines is 'Lambanog'. This is a spirit made from coconut (see Exhibit EU-81) which is subject to the low excise tax rate (like all other domestic products). In the second place, the measures at issue notably distinguish between spirits produced from the so-called "designated" raw materials (not only sugar cane but also nipa, coconut, cassava, camote and buri palm) and those produced from other raw materials. This shows that all the arguments relating to the alleged differences between sugar based products and non sugar based products made by the Philippines (e.g. on the methods of productions) are thus irrelevant insofar also some non sugar based products benefit from the low tax rate.

16. The EU turns next to some other arguments made by the Philippines and which concern similarity. The Philippines contends that Filipino brandies and whiskies are, according to Filipino own legislation, not real brandies and whiskies but only c*ompound* brandies and c*ompound* whiskies. In its view, the sales of these products would be prohibited in the EU. However, the EU observes the following: (i) nowhere on the labels, packaging, web-sites, advertisements of these products is it indicated that they would not be, technically speaking, brandies and whiskies, but only *compound* brandies and *compound* whiskies; they are indeed sold to customers as brandies and whiskies *tout court*; (ii) these products are, in fact, exported to the EU as their marketing and sale are *not* prohibited in the EU [see Exhibits EU-54 and EU-82], (iii) most importantly, Filipino products are not discriminated against in the EU, and instead receive the same tax treatment as local products.

17. Then, the Philippines contends that local brands are traditional drinks, typically bought by farmers and low-income people, people that are allegedly not interested in imported drinks. However, the EU stresses that this argument has been already rejected by WTO adjudicators more than once.

The case-law tells us that discriminatory measures should not be used to "freeze" or "crystallize" consumers' habits. Furthermore, the Panel in *Chile – Alcoholic Beverages* correctly noted the circularity of such an argument: it amounts to a difference in perception that is reinforced by the tax system and then used as justification to maintain the favourable tax system itself. Moreover, Filipino producers themselves in their annual reports emphasize how consumers' habits and traditions are rapidly, and continuously, changing.

18. Next, the EU notes that the arguments made by the Philippines regarding the outlets for spirits have been already dismissed by previous WTO adjudicators: it is irrelevant if one or the other group of spirits is not sold in some outlets insofar as in several other outlets these products are indeed offered side-by-side on the shelves as well as in the beverages lists. And, indeed, ample evidence shows that this is the case in the Philippines. Furthermore, with regard to *sari-sari* stores, the EU underscores that the measure at issue, by raising the costs of the imported alcohol, and by working to freeze the habits of Filipino consumers, certainly plays a major role in the choice of supplies made by sari-sari shop owners.

19. Then the EU points out that it is incorrect what the Philippines tells us about sugar-based Filipino spirits being always exported to other countries under tariff heading 2208.40. The EU observes first that the Philippines does not submit any other piece of evidence to support this allegation. It also notes that Exhibit EU-54 positively demonstrates that each type of Filipino spirit, in spite of being distilled from sugar cane, is exported to third countries under the specific tariff heading relating to that type of spirit. In the light of this, it appears barely necessary to add that the fact that all spirits fell under the four-digit tariff heading 2208 was considered a positive indication of likeness/substitutability by previous WTO adjudicators.

20. Then the fact that a large portion of the population has a low income can hardly be considered an element which justifies higher taxation *only* for imported products, when local products (irrespectively of their price) pay a flat and low tax rate. Furthermore, the Philippines itself acknowledges that in the country there is an "uneven distribution of resources". Thus, if there exist part of the population which perhaps cannot afford the priciest products on a regular basis, there are conversely other parts of the population which can indeed regularly pay for them. In addition, the EU recalls that a similar argument was rejected by the Panel in *Korea – Alcoholic Beverages* (incidentally, rejecting a comparison identical to that suggested by the Philippines regarding automobiles).

IV. DE MINIMIS

21. The EU stresses again that the tax on imported products is, depending on the tax tier, more than 10 times higher, or more than 20 times higher or more than 40 times higher that that applied to local spirits. The EU also underscores that it is not correct to calculate the *average* tax burdens, as the Philippines does: averages would always be significantly influenced by the existence of some particularly cheap local products as well as by some particularly expensive imported products. What a Panel is required to do (as the case-law makes very clear) is to look at the actual tax burden on the like/competing products. Lastly, the EU invites the Panel to carefully look at the previous alcohol cases: contrary to what the Philippines states, the tax differential examined in past cases (and considered above *de minimis*) were smaller than those provided for in the Filipino Excise Tax Regime.

V. SO AS TO AFFORD PROTECTION

22. As a preliminary note, the EU observes that, in their submission, the Philippines does not really develop many arguments on the issue of whether the measure is applied "so as to afford

protection". The main argument advanced appears to relate to the fact that the system is, on its face, origin neutral. However, the EU points out that the notion that tax regimes which are not overtly discriminating on the basis of the origin of the goods cannot breach Article III:2 has been rejected by constant jurisprudence. It would in fact allow WTO members to easily circumvent their obligations. Indeed, the vast majority of measures which have been found to be inconsistent with Article III:2 in the past were origin-neutral.

23. The EU stresses that it is irrelevant that the designated raw materials can be produced also outside the Philippines and reminds the Panel that, in any event, there are several imported spirits which are made from the designated raw materials but which are still subject to the high tax rates. The EU then notes that the scope of Article III is to ensure equal competitive opportunities to imported goods after customs duties have been paid. This principle of affording equal competitive opportunities would be hardly compatible with the idea that foreign producers should switch to different raw materials and different methods of production – incurring large and unnecessary costs – only to benefit from a lower tax rate in the Philippines. Such an argument was in fact dismissed by previous panels, e.g. in *Chile – Alcoholic Beverages*.

VI. CONCLUSION

24. The EU concludes by noting that – contrary to what is argued by the Philippines - the measures at issues do not appear either necessary or capable to meet the objectives of uniformity, equity and progressivity, enshrined in Article VI, Section 28(1) of the Constitution of the Philippines. In fact, the level of taxation of spirits does not depend on prices but on the raw materials used. Even when local products cost 5 or 10 times more than a corresponding imported product, they still are subject to a tax which is more than 10 times less than that applied to imported products. In addition, the EU emphasizes that the measures at issue are severely trade restrictive.

25. The EU notes that if the Philippines really wanted to develop a uniform, equitable and progressive system of taxation it could do it in a number of other ways which would, while genuinely pursuing the objectives listed in its Constitution, be far less restrictive with regard to international trade (e.g. *ad valorem* system, taxation based on alcohol content, etc.) and which, if applied correctly, be compliant with Article III:2 GATT.

ANNEX C-2

CLOSING ORAL STATEMENT OF THE EUROPEAN UNION AT THE FIRST SUBSTANTIVE MEETING

1. The EU believes that this has been a useful hearing, with a frank, animated and interesting exchange of views between the Parties.

2. We listened with attention to the statements made by our distinguished Filipino colleagues. Yet, we did not hear any new argument. Their main line of defence seems to be that concerning prices. According to the Philippines, imported products are more expensive and thus are legitimately subject to higher taxes.

3. However, there is ample evidence before the Panel that also on this aspect, as for all other aspects examined in the course of these proceedings, there are several and important overlaps. Many imported products have comparable prices to domestic products. This is so in spite of the severely discriminatory taxation they face. And it would be even more so were this discriminatory taxation to be removed.

4. And the undeniable existence of these overlaps is a sufficient element to establish a violation of Article III:2 – as per settled jurisprudence

5. Exhibit EU-83 (bottles of several Filipino and EU spirits) will shed further light on a number of other reasons of similarity which have not been discussed during this first hearing (e.g. labels, colour of the spirits, packaging).

6. The only new element we heard yesterday seems to relate to the efficiency of the fiscal system in the Philippines. Yet, this defence has not been elaborated and remains – to date – pretty unclear. We have several important doubts on this point. In the first place, there is no evidence on this issue before the panel, and we wonder whether – according to the rules of procedure – there would be still a possibility for the Philippines to submit any evidence. In the second place, we fail to understand why removing discrimination and thus subjecting all products to the same taxation rules would complicate the system rather than simplify it. Thirdly, we believe that such an argument would be – in this case – examined under Article XX, not under Article III:2, insofar as it would not exclude discrimination between imported and domestic products. Yet, the Philippines has not raised any Article XX defence so far.

7. Distinguished Members of the panel: the facts are clear, the applicable law is uncontested, and the case-law is ample, constant, and unambiguous.

8. This concludes our closing statement. We take the opportunity to thank again the panel and WTO secretariat and we look forward to continuing to work with you, the Philippines and the US, towards the settlement of this dispute

ANNEX C-3

EXECUTIVE SUMMARY OF THE OPENING ORAL STATEMENT OF THE UNITED STATES AT THE FIRST SUBSTANTIVE MEETING

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 – Alcoholic Beverages II*, *Korea –Alcoholic Beverages*, and *Chile – 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 US market. But in the Philippines, both sugar-based and other whiskies 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 – Alcoholic Beverages II* 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 whiskies, brandies, and gins are like those of imported whiskies, 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 – Alcoholic Beverages*, 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 – Alcoholic Beverages II* 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 – Alcoholic Beverages II*, 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 – Alcoholic Beverages II*, *Korea – Alcoholic Beverages*, and *Chile – Alcoholic Beverages* 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 US 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 US 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 US 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.

ANNEX C-4

CLOSING ORAL STATEMENT OF THE UNITED STATES AT THE FIRST SUBSTANTIVE MEETING

1. On behalf of the United States delegation, I would like to thank you for your time and attention during the first substantive meeting of the Panel in this dispute, and also extend our thanks and appreciation to the Secretariat. We had a lively discussion. We hope it has been useful to the Panel, and provided clarification that the Panel sought on the claims by the United States and the European Union. We appreciate the opportunity to respond to the Panel's questions during this meeting, and look forward to providing additional responses in writing.

2. The co-complainants in this dispute, the European Union and the United States, have presented copious evidence demonstrating that Philippine distilled spirits (whether whiskey, gin, brandy and the like made from local raw materials) compete with their imported counterparts. A Filipino consumer, like most consumers worldwide, considering what product to buy, is likely to consider whether he or she wants a brandy or a gin, and is not thinking about whether one brand was produced from a sugar-based neutral spirit and another was produced from another raw material – particularly since Philippine producers go to great lengths to make their products as similar as possible.

3. The consumer is likely, however, to notice the prices of different brands, and here we can see the result of the discriminatory taxation measures challenged by the co-complainants. In the Philippines, as a result of the discriminatory tax system, imported products are subject to significantly higher taxes that make imported products notably more expensive than they otherwise would be. Philippine products are subject to excise taxes of 13.59 pesos per proof liter, and other spirits are subject to taxes from 146.57 to as high as 587.87 pesos per proof liter. The taxes protect domestic industry and are in violation of the Philippines WTO commitments under Article III:2 of the GATT 1994.

4. Mr. Chairman, members of the Panel, again thank you. This concludes our closing statement. We look forward to responding to your written questions.

ANNEX C-5

EXECUTIVE SUMMARY OF THE OPENING ORAL STATEMENT OF THE PHILIPPINES AT THE FIRST SUBSTANTIVE MEETING

1. The Philippines is a developing country that does not have the luxury of an efficient direct tax system. Instead, faced with a messy reality with a large informal economy, chronic smuggling along thousands of kilometers of coastline of more than 7,000 islands, and a stretched tax administrative apparatus facing severe enforcement challenges, the Philippines uses indirect taxes and excise taxes to collect revenue. In order to ensure the progressiveness of this tax system, and to avoid unduly burdening the 80% of Filipinos whose average *family* income is 278 pesos per day (approximately 7 US dollars), the excise tax system is structured to ensure that higher taxes are collected on higher-value products.

2. The raw material-based distinction of Section 141 of the National Internal Revenue Code reflects both the functioning of the Philippine market as well as the Constitutional mandate for a progressive tax system. Lower taxes are imposed on sugar-based liquors, which are lower-priced and within the economic reach of the Filipino consumers; higher taxes are imposed on non-sugar-based liquors, which are higher-priced and are essentially luxury goods consumed by only the most economically-privileged part of Filipino society. The progressiveness of the system is reinforced and enhanced by a tiered system under Section 141(b), where the range of prices is much wider than under Section 141(a).

3. This is the important factual context in which this Panel must consider the allegations made against the Philippines in this case. Article III:2 requires an inquiry of whether the products are "like" each other ***in the Philippine market***, and/or whether they are "directly competitive or substitutable" ***in the Philippine market***. As the Appellate Body has acknowledged, these analyses must be done on a case-by-case basis. The peculiarities of the Philippine market make this analysis different from the analysis that other panels and the Appellate Body have done in other cases. The Philippines respectfully submits that the complainants have failed to meet their burden of providing evidence and relevant legal argument to support their claims in relation to the Philippine market.

4. Sugar-based and non-sugar-based spirits are not "like" each other for the purposes of Article III:2. There is no treaty-defined list of factors to be taken into account in characterizing two discrete products as "like" or "not like" in a particular market. Nor is there a closed list of factors to consider in making a determination of likeness for the purposes of Article III:2. The Appellate Body has stated that "there can be no one precise and absolute definition of what is 'like' ", and that likeness *"**must be determined by…the context and the circumstances that prevail in any given case to which that provision may apply***".

5. The products in question are not made from the same raw materials. And, the difference in raw materials has consequences throughout the production and commercial chain: the different raw materials are processed differently, these different processes cause differences in physical properties of the final products (including a different chemical composition and organoleptic properties), and these different physical properties in turn affect the marketing, sales, and consumption of the spirits. These are real world effects of the differences in raw materials.

6. The European Union and the United States have recognized these differences in their domestic regulatory regimes. They themselves distinguish between the products based on the raw material from which the spirits are made, which is precisely the criterion used in the Philippine excise tax system. It is also the basis of distinction in the Explanatory Notes to the Harmonized Commodity

Description and Coding System. The Philippines agrees that this is a relevant basis for distinguishing spirits, and it applies the same logic to all distilled spirits.

7. The Appellate Body in *Chile – Alcoholic Beverages* noted that "Members of the WTO are free to tax distilled alcoholic beverages on the basis of their alcohol content and price."[1] It follows that Members are also free to tax distilled alcoholic beverages on the basis of the universally-recognized, accepted criterion of the raw material base used to produce the beverage.

8. The Philippines believes that the differences in physical properties alone may be sufficient for the panel to conclude that sugar-based spirits and non-sugar-based spirits are not like products. However, mindful that the "like product" analysis can take into consideration many factors, we submit that the manner in which these products compete in the Philippine market is also relevant to the like product analysis. The Filipino public does not treat these products as "like" each other. In fact, there are at least two different groups of "consumers" in the Philippines, defined and separated by their relative purchasing power, each with a different set of habits, perceptions and behaviour. This price difference relative to purchasing power of the consuming public is a critical component of the relevant "context" and "circumstances that prevail" in the market under examination. The market segmentation is so pronounced in the Philippines that it affects the question of whether the products can be considered "like" products for the purposes of Article III:2, first sentence. After all, if the products do not compete in the same market or market segment, then the objective of Article III: 2 – to provide "equality of competitive conditions" – is meaningless. "Likeness" for goods under the GATT Article III:2 cannot be assessed in the abstract; it must be framed in relation to the market in which the goods are being sold and in which they compete.

9. The EU and the US emphasize the common end-uses of non-sugar-based spirits and sugar-based spirits to argue their case of "likeness". However, this fact is insufficient to render the products "like" – after all, beer, wine and soft drinks are also consumed for enjoyment and relaxation purposes. The Appellate Body has also recognized the limited value of the end-uses criterion in determining likeness. It stated, in *EC – Asbestos* that "although the *end-uses* are . . . '*equivalent*', the physical properties of the products are not thereby altered; they remain different."[2]

10. The products at issue in this case do not meet the high standard for being considered "like" products. As the first part of the test under Article III:2, first sentence, has not been met, there is no need to proceed to the analysis of the second part of the test, namely, whether one group of distilled spirits is taxed "in excess of" another group of distilled spirits.

11. The determination of whether two products are directly competitive or substitutable under Article III:2, second sentence, requires the consideration of two important elements. The first is whether there is direct competition: the complainants have failed to show that that the products compete in any meaningful way. The Philippines has produced evidence showing that the competition between sugar-based and non-sugar-based spirits – measured through an analysis of the cross-price elasticity of the products – is extremely low, reflecting the significance of what economists refer to as an "access cost" barrier separating the market segments. Thus, the relationship between the products at issue is outside the parameters of what Article III:2 seeks to regulate.

12. Second, the assessment of the direct competition must be conducted in the context of the specific market in question. The Appellate Body stated that this must be so because "this is the forum where consumers choose between different products".[3] Thus, the question in this case is whether non-

[1] Appellate Body Report, *Chile – Alcoholic Beverages*, paras. 59-60.
[2] Appellate Body Report, *EC – Asbestos*, para.112.
[3] Appellate Body Report, *Korea – Alcoholic Beverages*, paras. 114-115.

sugar-based spirits are an alternative way of satisfying the particular needs or tastes of the Filipino consumer who purchases sugar-based spirits.

13. A simple example shows just how out of reach non-sugar-based spirits are for these households: Expenditures for alcoholic beverages accounts, on average, for only 1.2% of total family expenditure[4] – that is, a maximum of 60 pesos per week. That is 1 US dollar, 40 cents per week for 90% of the consumers of sugar-based spirits. Sixty pesos will allow the consumer to purchase a bottle of Ginebra San Miguel, the most popular sugar-based gin, which is priced at 57 pesos, with tax included. The same 60 pesos is a little over one-tenth of the price of Plymouth, the lowest priced non-sugar-based gin, which is priced at 517 pesos, with tax. Clearly, it is no overstatement to say that, at this level, expensive non-sugar-based liquors are not an option, let alone a viable "alternative", for the great majority of the Philippine population.

14. The complainants' claim of substitutability assumes that the Filipino consumer is willing and able to substitute a product well within his or her budget with something more than ten times beyond that budget. The average Filipino consumer cannot afford – and therefore does not buy – spirits made from raw materials not listed in Section 141(a).

15. The existence of separate and distinct markets for non-sugar-based spirits and sugar-based spirits is highlighted by, and explains, the distinct channels of distribution for these products. The Panel in *Chile – Alcoholic Beverages* made the important observation that "if products have quite distinctive channels of distribution that could be a negative indicator with respect to substitutability." In this case, non-sugar-based distilled spirits and sugar-based spirits are sold through distribution channels that are almost ***entirely different***. Sari-sari stores consistently account for roughly 85% of off-premise sales of sugar-based spirits. By contrast, the market for non-sugar-based spirits through this distribution chain ***simply does not exist***.

16. To the extent that a there is a very small segment of the Philippine population that can afford to buy non-sugar-based spirits on occasion, even this small and unrepresentative demographic group regards the price of non-sugar-based spirits as a significant issue. Moreover, the capacity of a tiny segment of the population to purchase non-sugar-based spirits should not be used as the basis for determining that these products are directly competitive or substitutable.

17. The tests to be applied under Article III:2 are deliberately intended to recognize and give proper regard to the factual differences in each market. The Panel in *Japan – Alcoholic Beverages II* stressed this point noting that Article III:2 and its interpretative note "permits one to take into account specific characteristics in any single market; consequently, two products could be considered to be directly competitive or substitutable in market A, but the same two products would not necessarily be considered to be directly competitive or substitutable in market B."[5] The Philippines has demonstrated that the products at issue are not directly competitive or substitutable in the Philippines.

18. In the event that the Panel should find that the products are directly competitive or substitutable, the tax differential between sugar-based and non-sugar-based spirits is not more than *de minimis*. While the complainants have merely pointed to the differences in the specific tax rates, the real issue that must be examined is the effective tax burden borne by the various products at issue, in the light of the policy objectives. The Philippine excise tax system reflects the policy goals of progressive taxation as higher absolute taxes are collected on higher priced products. The difference in the tax burdens for the products at issue is not substantial: they are almost 13 per cent for sugar-

[4] FIES study.
[5] Panel Report, *Japan – Alcoholic Beverages II*, para. 6.22. (emphasis added).

based spirits and 22 per cent for non-sugar based spirits. A difference of 9 percentage points is a *de minimis* difference in the context of the segmented Philippine market.

19. Moreover, in the light of the Panel Report in *Chile – Alcoholic Beverages*, the proper test for *de minimis* is whether the tax differential has an impact on conditions of competition in the marketplace. The evidence submitted by the complainants themselves in the Euromonitor Study shows the levels of taxation have little effect on the choices of even that select group of respondents who participated in the Study. That evidence states that "***[e]ven at a 40% price decrease of imports and a 100% to 200% price increase in domestics, imported brands are typically more than twice as expensive as domestic ones.***" A tax differential of 9 percentage points does not make a difference in such conditions.

20. Finally, should the Panel find that the products in question are directly competitive and that non-sugar-based spirits are taxed above *de minimis* levels, these rates are not applied so as to afford protection to the domestic distilled spirits industry. Any distilled spirit from any country in the world made from these raw materials is entitled by Philippine law to the Section 141(a) tax rate, provided that the conditions of the Act have been met. If the legislators had intended to "protect" the domestic distilled spirits industry, this preferential rate would not have been accessible for imported products.

21. Importantly, none of the materials eligible for the lower tax rate are found exclusively in the Philippines. All of the Section 141(a) materials are found in many other countries. Indeed, the United States is consistently a top-20 producer of sugar cane and frequently outstrips the Philippines in terms of production.

22. We recall that the three-part test in Article III:2, second sentence, ***is cumulative***. The complainants have not demonstrated that the spirits at issue are directly competitive or substitutable; nor have they shown that they are dissimilarly taxed or that the measure affords protection to domestic production. Therefore, the test under Article III:2, second sentence, has not been met.

23. Article III does not guarantee market shares, and especially for products which, by nature and by price, are simply beyond the means of the consuming public in the Philippines.

ANNEX C-6

CLOSING ORAL STATEMENT OF THE PHILIPPINES AT THE FIRST SUBSTANTIVE MEETING

1. We said in our opening statement that this case would challenge you to apply familiar legal concepts to the peculiarities of the Philippine market. Our experience at the hearing confirms our expectation. The Philippine market is very different from the markets that have been examined in the previous alcohol cases. Our laws may seem puzzling to those more familiar with the systems of developed countries, who are not usually constrained in the same way as we in their policy implementation choices.

2. Despite these constraints, the Philippines has created an excise tax system that is consistent with its own domestic objectives of tax collection and progressivity, as well as its international obligations under the WTO Agreements. We hope that this hearing has helped emphasize several basic points, which I will now outline.

3. First, the excise tax regime does not discriminate on the basis of origin. Rather, it uses an internationally-recognized and accepted criterion to distinguish between distilled spirits; namely, their raw material base. The lack of discrimination against imports is shown by two compelling facts: first, that imported, properly-declared sugar-based spirits are taxed at exactly the same rate as domestically-produced sugar-based spirits, and second, that the Philippines imports significant quantities of ethyl alcohol made from sugar from overseas markets, all of which is taxed at the rate applying to sugar-based spirits.

4. Second, this system is designed to simplify tax collection and to collect progressively more taxes on higher-valued products. The distinction in raw materials is a reflection of a central reality: spirits distilled from the Section 141(a) materials are typically significantly cheaper than spirits distilled from any other raw material base. I would take this opportunity to remind you that the term "sugar-based", refers to spirits made from all Section 141(a) listed materials. The introduction of tiers in Section 141(b) adds more progressivity. A simple review of Annex A to Republic Act 8240 (PH-31, column (e)) shows the progressive nature of the taxes clearly, and provides the Panel the most straight-forward view of the design, architecture, and revealing structure of Section 141. We realize that other countries might not use the same approach, but, most probably, that is because they do not face the same problems and resource constraints that we face in the Philippines. We look forward to the opportunity to explain these challenges further so that there can be a greater understanding of the context in which Section 141 is being applied.

5. Third, when applying the concepts of "likeness" and "directly competitive or substitutable" in its Article III:2 analysis, the Panel must be clear about which products are being compared. We are confident that gin is not like whiskey, and we are just as confident that a grain-based whiskey is not like the sugar-based "whiskey". Most importantly, these products simply do not compete in the Philippines market. And why do they not compete? Is it because of the taxes under analysis? No, it is not. Rather, it is because the products are so different and – even after stripping out all taxes - are priced so differently relative to the income of most Filipinos. The tax does not create an incentive to the Filipino consumer to buy a sugar-based spirits – he or she does not need an incentive because that is the only product that is within reach. Nor does it provide a disincentive to buy non-sugar-based spirits because, regardless of tax, the net retail prices of non-sugar-based products are typically so far beyond the means of the vast majority of the population that the excise tax imposed is inconsequential to the purchasing decisions of these consumers. We have demonstrated, I trust, in our first written submission (for example, in paragraph 231) that there are significant price differentials, net of taxes.

The Government imposes higher taxes on the expensive, non-sugar-based spirits basically because it can. It can raise revenue from those who can afford it, without burdening average Filipinos with taxes on the only spirits that they can enjoy.

6. We would also like to address the issue of "latent demand," which was raised in some of the comments yesterday. The United States raised this in paragraph 32 of its oral statement, and claimed that 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." But, the Philippines has addressed this issue in its evidence, providing econometric simulations of competition without the excise tax, and also with aggressive assumptions such as a 30% increase in the average income of the Philippine population. These simulations still show an extremely low response to these dramatic price changes in the Philippine market, corroborating the findings of the complainants own evidence in the Euromonitor Survey. Contrary to the statement made by the United States (para. 21), we do not want the Panel to disregard the Euromonitor Survey: combined with other evidence, it shows just how far out of reach non-sugar-based imports are for almost all Filipinos.

7. Finally, we ask that the Panel avoid the invitation to infer competition from some of the evidence that has been presented. Pictures of two products on the same supermarket shelf, just like the bottles of spirits brought from Manila, are not evidence that the same consumer can buy either product. And, the question, it seems to us, is not (as the United States posits in para. 34) whether a consumer offered different products at a party would be indifferent – the better question might be whether the party organizer would have the wherewithal to purchase both Ginebra San Miguel and Johnnie Walker Black, and to offer it to his guests as alternative drinks. That party does not happen, to my knowledge, in the Philippines.

8. I would also like to recall that our distinguished colleague from the EU described the Philippines' argument as circular. We looked closely at the indictment of circularity. We found that the EU was in point of fact making two assumptions: it was, firstly, assuming, without proving, that sugar-based spirits were in direct competition with and substitutable for non-sugar-based spirits; it was also assuming, again without proving, that there was a relationship of causation between Section 141(a) and (b) and the great price-disparity separating sugar-based and non-sugar-based spirits. The discovery of these two assumptions of the EU brought to my mind my old professor of Philosophy 101 – Logic, Aristotelian and Symbolic – who would not countenance circularity however briefly, and who would have vehemently rejected those two assumptions as *petitio principii* - begging the very issues to be resolved.

9. In closing, we would reiterate that the provisions of the GATT in question today require consideration of the particular market in question. Assumptions based on experience in any other market do not help, and they very likely could impede the Panel from reaching the correct decision. The products treated differently under Section 141(a) and (b) do not compete in segmented Philippine market with or without the excise tax, and there is no violation, in our respectful submission, of Article III:2 of GATT 1994.

10. Mr. Chairman, members of the Panel, the Government of the Philippines thanks you – as well as the Secretariat staff - for the time and effort that you are dedicating to this case.

ANNEX D

ORAL STATEMENTS OF THE THIRD PARTIES

ANNEX D-1

ORAL STATEMENT OF AUSTRALIA AT THE FIRST SUBSTANTIVE MEETING

I. INTRODUCTION

1. Thank you for the opportunity to present Australia's views on this dispute, which raises systemic and interpretive issues concerning the application of Article III:2 of the *General Agreement on Tariffs and Trade 1994* (GATT 1994).

2. In its written submission, Australia has identified some key issues of legal interpretation and application raised by this dispute, including a particular focus on two questions. Firstly, whether spirits which meet the Philippines' excise tax raw materials requirement and those that do not can be classified as "like products" under the first sentence of Article III:2 of GATT 1994 and/or as "directly competitive or substitutable products" under the second sentence of Article III:2. Secondly, whether the Philippines' excise tax measure is "applied... so as to afford protection to domestic products", for the purposes of the second sentence of Article III:2.

A. QUESTIONS FOR THE PANEL'S CONSIDERATION

1. Case-by-case application

3. Australia's view is that the application of both the first and second sentence of Article III:2 of GATT 1994 is to be determined by the Panel on a case-by-case basis[1] through an analysis of the factual evidence provided by the parties to the dispute.

4. Australia further recognises the guidance provided to the Panel in undertaking this analysis by previous panel and Appellate Body decisions on Article III:2 of GATT 1994, and in particular the decisions in disputes concerning the treatment of imported alcoholic beverages: *Japan – Alcoholic Beverages II; Chile – Alcoholic Beverages;* and *Korea – Alcoholic Beverages*. While those cases are particularly helpful in clarifying the meaning and application of Article III:2, a case-by-case analysis allows for both the differences and similarities between this and previous disputes to be recognised and thus enables this Panel to draw its own conclusions on the particular facts of this dispute.

2. "like products" (Article III:2, first sentence) and "directly competitive or substitutable products" (Article III:2, second sentence)

5. In its written submission Australia briefly outlined the different criteria which have been applied in previous panel decisions to determine whether products are "like products" for the purposes of the first sentence of Article III:2, and whether products are "directly competitive or substitutable products" for the purposes of the second sentence of that article.

6. In undertaking this consideration, Australia submits that the Panel must determine the weight to be placed on particular factors and criteria in the interpretation of Article III:2 and should not apply such criteria in a manner that is formulaic or inflexible. In Australia's view the evaluation of these factors will differ in relation to the first and second sentence of Article III:2, noting that "like products" can be described as a narrower subset of the broader category of "directly competitive or substitutable products"[2]. However, Australia agrees with the decision of the Appellate Body in *EC –*

[1] Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 20; and *Canada – Periodicals*, p. 21.
[2] Appellate Body Report, *Korea – Alcoholic Beverages*, para. 118.

Asbestos that no one criterion should be considered determinative and the evidence as a whole must be examined to determine the characterisation of the products at issue.[3]

7. As outlined in our written submission, in applying Article III:2 to this dispute, the Panel may choose to consider the characterisation of a number of different groupings of products. The Panel may undertake a comparison between all distilled spirits; a comparison of the same types of distilled spirits (e.g. imported and domestic vodka); and/or a comparison of different types of spirits which are produced from the same raw materials.

8. A key issue in this dispute is the comparison of the physical characteristics of the distilled spirits produced from different raw materials. However, we note that previous panels have not found this distinction to be determinative on its own. For example, the panel in *Japan – Alcoholic Beverages II* found that shochu and vodka were "like products" within the meaning of the first sentence of Article III:2 although they contained similar but not identical raw materials[4]. Further, in considering whether shochu and imported spirits were "directly competitive or substitutable" under the second sentence of Article III:2 the Panel in *Japan – Alcoholic Beverages II* found that the term " 'directly competitive or substitutable' does not suggest at all that physical resemblance is required…the decisive criterion… is whether they have common end uses'".[5]

9. Australia further notes that in considering whether products are "directly competitive or substitutable" it is important to take into account product competition within the relevant market[6]. In particular, we note that the report of the panel in *Korea–Alcoholic Beverages* indicated that products with significantly different retail prices can be directly competitive, noting that even a lower income earner "can afford to purchase a bottle of a more expensive beverage at least occasionally".[7]

3. "applied... so as to afford protection to domestic products"

10. Finally, Australia submits that whether the measure is "applied... so as to afford protection to domestic products" for the purposes of the second sentence of Article III:2 is determined not only by examining the application of the measure, but also its design and architecture[8]. In paragraph 44 of its written submission Australia has identified factors which in Australia's view should form part of the consideration of this question.

11. In particular, Australia notes the discrepancy between the Philippines' stated objective of the excise tax measure, being to minimize "the regressive effects of the tax by distinguishing between lower-priced goods... and high-priced goods"[9], and the architecture and design of the measure[10] which distinguishes between the raw materials used in the production of the product, rather than net retail value of the product.

II. CONCLUSION

12. Mr Chairman, members of the Panel, Australia would be pleased to respond to any questions from the Panel on these or any other matters related to the dispute.

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[3] Appellate Body Report, *EC – Asbestos*, para. 109.
[4] Panel Report, *Japan – Alcoholic Beverages II*, para. 6.23.
[5] Panel Report, *Japan – Alcoholic Beverages II*, para. 6.22.
[6] Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 25.
[7] Panel Report, *Korea – Alcoholic Beverages*, para. 10.74.
[8] Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 29.
[9] Philippines' first written submission, para. 32.
[10] Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 29.

ANNEX D-2

ORAL STATEMENT OF INDIA AT THE FIRST SUBSTANTIVE MEETING

1. Mr. Chairman and distinguished members of the Panel, India thanks the Panel for giving this opportunity to present its views relating to this dispute in the Third Party Session.

2. In the subject dispute, the US and EU have challenged Philippines excise tax measures being inconsistent with the principle of national treatment contained in Article III.2 of GATT 1994. At issue in the dispute are a number of Philippines legal provisions, and in particular the *National Internal Revenue Code of 1997* which sets out the product categories and applicable tax rates for distilled spirits. The European Union and the United States argue that the relevant provisions ('the excise tax measure') create a tiered system of taxation by applying a lower rate of tax to spirits made from specified raw materials (sap of the nipa, coconut, cassava, camote, or buri palm, or from juice, syrup of sugar of the cane) which are commercially produced in the same country where they are processed into distilled spirits ('the raw materials requirement') Spirits which do not meet the raw materials requirement are further differentiated into three categories with differing and higher tax rates, determined by the net retail price of the spirit.

3. In its written submissions, Philippines relies on WTO jurisprudence establishing the right of WTO Members to establish and apply their own tax policies WTO Members are "free to tax distilled alcoholic beverages on the basis of their alcohol content and price", thus Philippine argues it is free to tax distilled alcoholic beverages on the basis of the raw materials used.

4. Mr. Chairman, in our view, the interpretation of 'like products' is a very important issue in this dispute. India will confine its statement on this aspect only.

5. Mr. Chairman, the over arching approach taken by the Appellate Body and WTO Dispute Settlement Panels is that the term 'like products' should be examined on a case by case basis.

A. SCOPE OF GATT ARTICLE III:2, FIRST SENTENCE

6. Philippines argues that the first sentence of Article III:2 deals with "like products", while the second sentence concerns "directly competitive or substitutable" products. Philippines has argued that imported spirits made from different raw materials are not "like" products comparable with the whisky produced in Philippines from sugar.

7. WTO jurisprudence indicates that the determination of likeness under GATT Article III:2 involves a weighing and balancing of various criteria, including the physical characteristics or "properties, nature and quality of the product" as determined by input materials used. The greater the number of differences in their essential characteristics, the less probable it is that these products can reasonably be considered "like".

8. Philippines has argued that the concept of "like products" under Article III:2 be examined on a case-by-case basis, this concept "must be construed narrowly so as not to condemn measures that its strict terms are not meant to condemn." A very important determinant for "likeness" is the physical characteristics of the product. There are significant physical differences between non-sugar-based distilled spirits and sugar-based spirits, as a result of the raw materials used.

9. As explained by Philippines, EU and US whisky use grains or cereals as the primary basis for this product. By contrast, Philippine "whisky", like all other distilled spirits produced in the

Philippines, is a sugar-based neutral spirit (ethyl alcohol) to which flavouring is added. Philippine further argues that sugar-based whisky would be prohibited by law from being marketed as "whisky" in both the EU and the United States.

10. In the case of India, we have also a somewhat similar experience as regards classification of India's 'whisky' produced from molasses which is sugar based, when exported to the EU. Whereas the whisky produced and exported by the EU and US is largely malt or cereal based. As in the case of Philippines, the EU has not recognised our molasses based whisky as 'whisky' for the purpose of imports in the EU. The underlying reasons given for non-acceptance of recognition of molasses based 'whisky' as whisky by the EU is on the ground of the raw material used for production. As argued by Philippines, the use of raw material has the effect on the product's properties. In our view, this should be an important factor to determine the 'like product' in this dispute.

B. WHETHER NON-SUGAR-BASED DISTILLED SPIRITS AND SUGAR-BASED PRODUCED SPIRITS ARE "DIRECTLY COMPETITIVE" OR "SUBSTITUTABLE" IN THE PHILIPPINES

11. Chair, for interpretation of 'like product' for the purpose of second sentence of paragraph 2 of Article III of GATT, we may have to look carefully whether the taxed products and the domestically produced products are directly competitive or substitutable. In this respect, we would refer to the Philippines submission that this issue should be examined in the specific context of the Philippine market. Sugar-based domestic liquors, which are sold at very low prices, do not offer an "alternative way of satisfying the same consumer demand in the marketplace" as that offered by high-priced non-sugar-based spirits. There is no "direct" or "proximate" competitive relationship between these products.

12. Further the imported spirits, being generally higher priced, compete in a different market segment. The Panel has therefore, to come to its own conclusions whether the non-sugar based distilled spirits (largely imported) and sugar based spirits (largely produced in Philippines) are directly competitive or substitutable.

13. Chair, we again thank the panel for this opportunity.

ANNEX D-3

ORAL STATEMENT OF CHINESE TAIPEI AT THE FIRST SUBSTANTIVE MEETING

1. The Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu would like to thank the Panel for this opportunity to present its views as a third party in this proceeding. TPKM makes this oral statement in light of our interests in the proper interpretation and application of relevant provisions in the General Agreement on Tariffs and Trade 1994("GATT 1994"), and in particular, the second sentence of Article III:2 and the Interpretive *Ad* Note to Article III:2 of the GATT 1994.

2. It is well-established in WTO jurisprudence that in order to find an internal tax measure inconsistent with the second sentence of Article III:2, three separate elements must be satisfied:

(a) the imported products and the domestic products must be "directly competitive or substitutable products," which are in competition with each other;

(b) the directly competitive or substitutable imported and domestic products are "not similarly taxed"; and

(c) the dissimilar taxation of the directly competitive or substitutable imported domestic products must be "applied . . . so as to afford protection to domestic production."[1]

3. For this oral statement, the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu would like to just focus on the first element of this test.

4. Under this first element, in order to determine whether a product is directly competitive or substitutable, the Appellate Body has confirmed for numerous times previously that -- while this category is broader than the "like" product category under the first sentence of Article III:2 – this analysis must still be done on a case-by-case, fact-intensive basis. Indeed, to make this determination, the Appellate Body has required complainants to look at a myriad of factors such as physical characteristics, common end-uses, tariff classifications, and the marketplace, including the elasticity of substitution between products, marketing strategies, and consumer preferences.[2]

5. In light of this well-established, the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu would simply note that establishing this first element requires rigorous analysis, with a need to set forth all the necessary facts for the particular products at issue in the particular market at issue.

6. The Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu would also note that this rigorous analysis must be done by the complainant as an initial matter, so as to make its *prima facie* case that there exists a potential GATT Article III:2 violation, and without which the burden of proof does not shift at all to the respondent.

7. In sum, the Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu would like to respectfully remind the panel of the fact-intensive nature of an Article III:2-second- sentence analysis which requires a high standard of burden of proof by the complainants.

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[1] Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 24. This test was subsequently applied in the *Korea – Alcoholic Beverages* and *Chile –Alcoholic Beverages*.

[2] Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 25.

8. We thank the Panel once again for the opportunity to make this statement, which we hope is of assistance to the Panel.

ANNEX E

SECOND WRITTEN SUBMISSIONS OF THE PARTIES

ANNEX E-1

EXECUTIVE SUMMARY OF THE SECOND WRITTEN SUBMISSION OF THE EUROPEAN UNION

1. At the outset, the EU observes that, in its written submissions, the Philippines itself has had to recognize that its defences have limited validity. There are always unavoidable facts that disqualify its arguments, or exceptions which show the inevitable limits of the justifications it attempts to provide for its discriminatory tax system.

2. In the first place, the EU notes that the Philippines concedes that the designated raw materials are indigenous to the Philippines but adds that they are also indigenous to other countries world-wide. In this regard, the EU fails to see why this should exclude the fact that the measures at issue may be discriminatory and thus breach Article III:2. The fact that, in principle, spirits from the designated raw materials could be produced elsewhere does not exclude that the Philippines may illegitimately favour its domestic spirits over imported like/substitutable spirits. In a globalized world there is virtually no product which can be manufactured only in one country. The Philippines is proposing an interpretation of Article III:2 so narrow as to basically read it out of the GATT itself. In fact, it can be noted that all of the three cases decided under the WTO dispute settlement mechanism and which concerned taxation on alcoholic beverages involved, like the present dispute, *de facto* discrimination.

3. Regarding the requirement that raw materials are produced commercially in the country where they are processed into distilled spirits, the EU observes this additional condition further aggravates the discrimination based on the raw material requisite. In fact, a spirit produced in countries where the climate or agronomic conditions do not permit the cultivation and production on a commercial scale of any of the designated raw materials would never be taxed at P. 13,59 ppl, even when produced from the designated raw materials and in the same manner of Filipino spirits.

A. BURDEN OF PROOF

4. Regarding the burden of proof, the EU emphasizes that it has made a very extensive and thorough examination of why distilled spirits made from designated raw materials are similar to distilled spirits made from the non-designated raw materials. Since it is well established in the case-law that the category of like products is a subset of those products which are directly competitive and substitutable, all evidence advanced with respect to each element of the similarity assessment is relevant to the consideration of the products as either like, or as directly competitive and substitutable. The issue which must be determined by the Panel is whether the weight of the evidence submitted by the Complainants demonstrates similarity and, if so, to what extent. Depending on the degree of similarities observed, the products will be considered 'like', 'directly competitive and substitutable', or neither. Considering specifically the first written submission of the EU, it clearly lays out extensive arguments and evidence with respect to similarity between distilled spirits generally. Specific references to certain distilled spirits, including whisky, gin, rum, vodka, brandy and tequila, rather than to every kind of distilled spirit, were made by way of example. The EU does not consider necessary in this case to embark in a repetitive account of each difference between imported and domestic products for every single type of distilled spirit. However, for the sake of clarity, in its second written submission, the EU lays out in detail all the similarities which it has already shown with respect to each type of distilled spirit.

B. SIMILARITY

1. Prices

5. Preliminarily, the EU wishes to recall that imported spirits, unlike domestic ones, are subject to: (i) an excise tax which is 10 to 43 higher; and (ii) customs duties raging between 10 and 15% ad valorem. Moreover, since VAT is applied on top of customs duties and excise tax, the VAT inevitably affects more heavily imported spirits rather than local ones. Thus, the EU emphasizes once again that the Philippines' arguments is basically an attempt to justify the existence of the measure at issue by pointing to the very negative and discriminatory effects that its taxation system itself produces. In addition, the EU expresses its doubts about the exact scope of the Filipino argument on pricing. The EU does not know whether the Philippines is arguing that local products are *always*, or *typically*, or *often* or *on average* less expensive. In fact, insofar as the Philippines acknowledged that there currently exist a number of imported products which are less expensive than some local products (and in spite of the fact that current end prices are affected by the discriminatory tax rates) the EU wonders whether the argument is worth consideration at all. In fact, implicitly, the Philippines is admitting that, for some imported products, there is competition also with respect to price and yet, in spite of this, they still pay a 10 to 43 times higher taxation. In fact, Article III:2 is violated even if *some* imported products are discriminated against, compared to *som*e similar domestic products. A breach of this provision does not require that *all* imported products are discriminated against, when compared to *all* domestic products.

6. Next, the EU expresses surprise and perplexity about the several and significant changes made by the Philippines to its Exhibit PH-19. In fact, the new Exhibit PH-19 amended appears to be erroneous, or at least incomplete, in several regards. Preliminarily, the EU wishes to stress that the Philippines seems to have made changes based on a sort of virtual reality. In fact, the Philippines states that it has made changes in order to reflect the "*excise tax that should have been paid*", corrected entries that "*seemed to be incorrect*", and eliminated "*suspected mistakes*". The EU doubts that any meaningful reasoning could be based on a document which the Philippines has prepared according to its own *impressions* or *suspicions*. Moreover, the EU does not understand why many products were removed from the survey because, allegedly, price data could not be verified "*as of this corrigendum*". The EU wonders why prices needed to be verified some two months after they were observed in the market. In addition, the EU expresses its surprise that many of the products which were removed because, allegedly, their price could not be verified, are precisely the imported products whose prices were most similar to the local ones. Furthermore, the EU finds rather odd the fact that only one local brandy is now listed in Exhibit PH-19 amended, finding it doubtful that the Philippines could not verify the prices of best-selling domestic brandies. On the basis of the above, the EU urges the Panel to consider carefully whether the price data contained in the new Exhibit PH-19 amended can be relied upon. Furthermore, since the price data contained in the old Exhibit PH-19 are – according to the Philippines – erroneous or not verified, the EU believes that the Panel cannot but disregard also the average prices indicated in the Philippines' First Written Submission, having been calculated on the basis of that survey.

2. Production processes

7. Regarding production processes, the EU preliminarily notes that the Philippines could not identify numerous or significant differences, in spite of the length and complexity of the process of spirits production overall. In addition, the EU examines the few differences identified by the Philippines so as to show that these alleged differences are either erroneous or entirely insignificant. Regarding fermentation, the EU stresses that the difference alleged by the Philippines is not valid for spirits produced from some raw materials others than sugar cane, some of which in fact also benefit

from the low tax rate provided for in the measures at issue. Moreover, the EU notes that fermentation from grape wine is a relatively simple and rapid process, not less than that for sugar cane.

8. With regard to distillation, the EU reiterates that whether a given hint of flavour, colour, or aroma, is produced by the congeners or by the added flavouring is quite irrelevant, and that congeners represent a minimal part of the products. Indeed, congeners usually make up far less than 1% of the final product. Further, the EU stresses that any comparison between different spirits (quite independently of whether they are Filipino or not) would show differences in congeners which may be larger or smaller, depending on the case. Taking whiskies as an example, the EU notes that one of the whiskies the Philippines has chosen for the comparison is a Tennessee whisky which has particularly high levels of congeners. However, had the Philippines chosen a different type of imported whisky, the differences in congeners as between their domestic products and the imported ones would have been far less significant and observable. In this context, the EU exhibits a comparison of the major volatile congener concentrations of different types of world whiskies made in a scientific publication of some years ago. From this comparison, it can be observed that Canadian whisky has very low levels of congeners, similar to Filipino whiskies. As a second matter, this comparison shows that other types of whiskies also have low levels of certain congeners and that differences between various imported spirits are as significant as those between some imported spirits and Filipino spirits. The fact that these differences in congeners are minor for purposes of an analysis of physical characteristics under Article III:2 is quite clear. No two whiskies sold in the world are identical with respect to the levels and combinations of various congeners. Each whisky has different levels of various congeners, just like each whisky has its own peculiarities with regard to smell, taste and colour.

9. In the second place, the EU recalls that the Philippines itself admitted that all raw materials (designated and non-designated raw materials) could be distilled so as to be completely stripped of congeners, confirming that raw material is not particularly important in this regard. Furthermore, the Philippines has also recognised that it is not true that all imported spirits retain much taste and aroma from the materials they are distilled. In fact, gin and vodka are distilled to a very high concentration of alcohol so that the basic spirit is effectively neutral. Gins are then flavoured with juniper berries and other botanicals. Conversely, some Filipino gins are not neutral as they are supposed to retain the flavour deriving from the raw materials used. Lastly, rums (imported or local) are not made from neutral alcohol. To this, it should be added that some imported spirits do not use pot stills: e.g. scotch grain whisky is distilled in a continuous process using a column still. On the contrary, some Filipino spirits are not produced by using column stills, but pot stills (e.g. 'Old Captain 12 Years Old Superior Rum').

10. With respect to ageing, the EU points out that, on the one hand not all spirits produced from the non-designated raw materials are aged (e.g. vodkas, gins), and (ii) conversely, some spirits produced from the designated raw materials in the Philippines are aged (e.g. several rums from Tanduay).

3. Physical characteristics

11. The EU notes first that the Philippines can only point to some minor dissimilarities between imported and domestic products relating to colour, smell and taste. These minor differences would be relevant if under Article III:2 products would be required to be identical in all respects. This, however, is not the case, neither under the first sentence nor the second sentence of the provision. In fact, the interpretation put forward by the Philippines would reduce Article III:2 of the GATT to apply only where goods have virtually no differences between them at all. In consequence, Article III:2 would essentially only apply to commodities. In fact, for manufactured goods, minor differences in, for example, colour, smell, price, and taste, are not only absolutely normal, but even necessary in a healthy market-place based on free and fair competition.

12. Next, the EU observes that the intoxicating effect of spirits on human beings is, without any doubt, a defining characteristic of spirits. One of the main purposes for people consuming distilled spirits is precisely to experience that pleasant intoxication that drinking spirits induces. The EU also notes that the Philippines does not contest that these effects occur regardless of the raw materials used. In this context, the EU wishes to recall that, in *EC – Asbestos*, the Appellate Body found that evidence relating to the health risks associated with a product may be pertinent in an examination of "likeness". Furthermore, it almost goes without saying that, contrary to what the Philippines contends, wine and beer do not have the same effects on humans as spirits, given their significantly different alcoholic content.

4. Consumer Tastes and Preferences

13. In answering the criticism expressed by the Philippines on the Euromonitor Survey (Exhibit EU-41), the EU notes, firstly, that, according to the most recent data, in spring 2009, around 1/3 of the Filipino population (i.e. 29,7 million persons) had access to the internet. Then, the EU observes that Euromonitor makes it very clear that the persons drawn for the on-line panel have been selected at random and were considered to be representative of the Philippines' population, with specific adjustments to age, gender and living location that allowed for closer alignment with the entire Filipino population. The EU emphasizes that the Euromonitor report shows very clearly that consumption patterns of domestic and imported spirits in the Philippines are largely similar: very little variation exists on why, how and when domestic and imported spirits are consumed. The EU further notes that the Philippines has not even attempted to rebut these findings.

14. Regarding advertising campaigns, the EU rejects the Philippines' arguments on their lack of probative value. Firstly, the EU observes that it has not only shown that both Filipino and non-Filipino sprit producers target young people and present their products as ideal for being consumed with friends. The EU has also pointed to a number of other similarities between the advertising campaigns: both Filipino and non-Filipino producers advertise their products as ideal to drink when celebrating important events, or for romantic moments or to be offered as gifts. In substance, what the EU has observed is that advertisement of spirits (irrespective of the raw materials used for distillation) manifestly target the same group of customers, who drink these products in the same type of occasions and in the same manner, which appears to be a very relevant finding for an analysis of likeness/substitutability under Article III:2. In the second place, the Philippines seems to forget that many spirits are products of large multinationals which are active internationally and market their products almost everywhere in the world. Often, advertising campaigns are conceived and run internationally and are not tailor-made for one or more specific countries. Moreover, the Appellate Body has consistently stated that "*evidence from other markets may be pertinent to the examination of the market at issue, particularly when demand on that market has been influenced by regulatory barriers to trade or to competition*". This appears to be in fact the case in the Philippines. In the third and final place, the Philippines has overlooked the relevance of comparing advertising campaigns. Their relevance has already been stressed by previous WTO adjudicators, which have found that marketing strategies that highlight fundamental product distinctions or, alternatively, underlying similarities may be useful tools for analysis.

15. Another element which shows how Filipino producers try to adapt to the changing consumers' habits and preferences, just like their foreign counterparts, can be observed with respect to the development and marketing of new products. In fact, it is evident that Filipino spirits producers, too, follow the same trends which are followed by non Filipino spirits producers in the global market. A good example can be the recent launch in the Philippines' market of two vodkas flavoured with apple after a number of similar products were introduced into the world spirits market.

5. Tariff Classification

16. The EU notes that previous WTO adjudicators considered the fact that all spirits fell under the four-digit tariff heading 2208 as a positive indication of likeness/substitutability and that evidence shows that the raw materials used are not determinative of the classification of spirits under the different subheadings of tariff heading 2208.

6. Elasticity of Substitution

17. At the outset, the EU stresses two elements which the Philippines itself has pointed out in its submissions: (i) tax discrimination between local and imported spirits in the Philippines has existed for many decades; (ii) imported spirits are not available in all shops of the Philippines. This means that in analysing the results of any study on cross-elasticity between local and imported spirits in the Philippines, one would have to take these uncontested facts into account. Local drinking traditions and habits have crystallized in decades and many Filipinos had few or no occasion(s) to try imported spirits. It is thus evident that one cannot expect that too many Filipinos, asked today of a hypothetical substitution of their traditional spirit with a new one, would do so. In fact, past WTO adjudicators were cognizant of this problem and, in previous disputes, have emphasized how a tax system that discriminates against imports has the consequence of creating and even freezing preferences for domestic goods.

18. The EU emphasizes several and important reservations it has regarding the Filipino study submitted as Exhibit PH-49. In the first place, the Philippines' analysis does not address the central question at stake in the present case, that is, the competitive interaction between local and imported spirits under a WTO-compliant, non-discriminatory excise tax regime. By applying its empirical analysis to an already distorted market, the Philippines repeats the fundamental error of justifying the measure by the effects of the measure itself. In addition, the methodology and the numerical estimates proffered by the Philippines are marred by a number of serious flaws, even when applied in the context of the prevailing discriminatory tax regime. Meanwhile, the Philippines' analysis confirms that product differentiation is a central competitive parameter in the spirits market: brands differ to some degree in terms of product characteristics and brand positioning, while addressing the same basic customer demand. The notion that products are to some degree differentiated but nonetheless compete with each other in the same product markets is well established among economists and, indeed, competition authorities around the world.

19. This study has also been the subject of a critical evaluation by KPMG (Exhibit EU-102). The 'KPMG Report' not only found in this study some key shortcomings and problems which compromise the validity of its findings on cross-price elasticities, but also concluded that both scientific literature on cross-price elasticity between alcoholic beverages and anecdotal evidence from other markets (e.g. Australia, Japan, Korea) where tax rates have recently changed, support the case that both domestic and imported products directly compete in the Philippines' market. In addition, the results of the Exhibit PH-49 appear difficult to reconcile with those stemming from the Euromonitor report (Exhibit EU-41) which found that Filipino consumers were consistently willing to purchase imports with each price reduction and this even when imported spirits remained significantly more expensive. The Euromonitor report further concludes that, overall, the closer the price between imported and domestic products, the more likely consumers are to increase their consumption of imports while decreasing their consumption of domestics. Lastly, the EU points out that there are a number of data in Exhibits PH-19, PH-49 and PH-51 which cannot be reconciled. These differences concern not only abnormal variations between the average retail prices / net retail prices of some spirits, but also different excise rates. Some data contained in one or more of these Exhibits must thus inevitably be erroneous.

7. End uses

20. The EU observes that the Philippines does not advance any arguments against the fact that all spirits, regardless of the raw material used, have the same end-uses. The EU stresses that the importance of the commonality of end-uses has been consistently emphasized in the jurisprudence. In fact, in the *Japan – Alcoholic Beverages II* case, the Appellate Body agreed with the Panel which went as far as describing common end-uses as a decisive criterion.

8. Sale and distribution channels

21. The EU emphasizes that, contrary to what the Philippines seems to suggest, imported spirits are often sold in outlets which are neither luxurious nor for high-income people.

C. DISCRIMINATION WITH REGARDS TO RUM

22. Preliminarily, the EU points out that it does not understand whether the Philippines is arguing that some imported rums were in the past taxed wrongly, but that they are now taxed at the correct P. 13,59 ppl rate, or that these rums are still now taxed wrongly, but that is because the producers/importers have not filed the proper documentation disclosing the raw materials used in the production of these products. In particular, paragraph 141 of Philippines' first written submission is ambiguous in this regard. This confusion in the Philippines' submissions is quite telling about the embarrassing situation the Philippines is struggling to explain. In substance, the Philippines would like us to believe that many large and sophisticated multinationals (like the producers of many world renowned rums) have preferred to pay millions of Pesos to the Philippines' Bureau of Internal Revenues (BIR) for several years in undue taxation, rather than sending one person to their office to declare the obvious fact that their rums are made from sugar cane. In any event, the EU observes that Filipino legislation provides that the classification of each brand of distilled spirits based on the average net retail price shall remain in force until revised by Congress. To the knowledge of the EU, the Filipino Congress has not revised the list of beverages contained in Annex A of Revenue Regulation 23/2003 (which lists the imported spirits subject to the higher excise tax rates and includes, among others, several imported rums). In fact, even recently, Malibu Rum was taxed at the P. 293.93 ppl.

23. In any event, it is clear that even if all rums (and all products from sugar cane) were taxed at P. 13,59 the substance of the case would not be any different. The discrimination which the Philippines' legislation establishes and which the EU considers in breach of Article III:2, first and second sentence, is that between spirits produced from the designated raw materials and spirits produced from other raw materials. The fact that this legislation is not applied correctly and even some imported products which should, in principle, benefit of the low tax rate are conversely taxed at higher rates, is just an aggravating factor which significantly illustrates the protectionist application of the measures.

D. THE EFFECTIVE TAXATION SYSTEM ARGUMENT

24. The EU re-iterates its strong perplexities regarding this defence. In the first place, the EU notes that the Philippines has confirmed in writing that it does not invoke any defence under Article XX of the GATT 1994. The EU believes that this element alone is sufficient to dismiss any argument on this point. In any event, on the merits of the argument, the EU restates that the Philippines has not explained why discriminating between like/substitutable products would be necessary for the efficiency of its taxation system. How its geo-economic particulars would make it necessary for the Philippines to employ discriminatory taxation for alcoholic beverages remains, to date, entirely unclear. Further, the Philippines seems to argue that it cannot impose an *ad valorem*

excise tax because that would prove inefficient. But it has not explained why. In particular, this argument appears odd if one considers that imported spirits are already evaluated when they pay customs duties calculated *ad valorem* upon entering the Philippines. In addition, the EU notes that some other countries in the Asia Pacific region (such as Vietnam, Thailand, and Korea) use an *ad valorem* excise system for alcoholic beverages. In any event, even if, for the sake of argument, one were to accept that an *ad valorem* taxation system would not be feasible, the Philippines would have to explain why all products cannot be subject to the same tax rates. This could be done, in particular, by extending the low and flat rate provided by Section 141(a) of the NIRC also to imported spirits, or by applying the 3 tax rates provided for in Section 141(b) of the NIRC, and based on the net retail price of products, also to local products.

E. THE DIFFERENT LEVEL OF TAXATION

25. The EU observes that neither in its first written submission, nor during the first substantive meeting, nor in its Responses to the Panel's Questions, did the Philippines advance any arguments to contest that spirits produced from the non designated raw materials are taxed in excess of spirits produced from the designated raw materials, pursuant to Article III:2, first sentence, GATT. With respect to the second sentence of Article III:2, the Philippines has attempted to argue that the difference in the relative tax burdens borne by the products at issue is permissible because it is *de minimis* and has no effect in the market. The EU has dealt with the issue of the level of taxation already in its previous submissions and will not reiterate its arguments. The EU will only take this opportunity to stress the following two points. In the first place, the EU can agree that what is *de minimis* can be only determined on a case-by-case basis and the point of reference is the market where competition between domestic and imported products should take place. However, the EU cannot subscribe to the Philippines' proposed approach to this issue. In fact, it should be emphasized that, according to established case-law, the purpose of Article III:2 GATT is to protect WTO Members' expectations with respect to the competitive relationship between imported and domestic products. Whether a measure is consistent or inconsistent with Article III:2 depends on whether this measure is *de facto* discriminatory not. Conversely, compliance with Article III:2 does not depend on whether the removal or modification of the measure at issue would have some immediate and significant effect on the competition between domestic and imported products. In the second place, the EU does not consider that average tax burdens can be meaningful in this analysis. As explained already, the use of averages betrays the significant price differences resulting from the Filipino tax system. In fact, jurisprudence makes it clear that averages are irrelevant.

F. SO AS TO AFFORD PROTECTION

26. The Philippines does not develop, in its submissions, many arguments on the aspect of whether the measure is applied "so as to afford protection". The few arguments which have been put forward by the Philippines have been already discussed in EU's previous submissions. The EU would just like to repeat that – whatever the value of the statements of Filipino public officials – the fact that the measures at issue are applied so as to afford protection to domestic production can be easily seen by looking at the design, architecture, and revealing structure of the measures. The EU has already developed its arguments on this point, and notes that the Philippines has failed to rebut its arguments and evidence.

G. CONCLUSION

27. In conclusion, the EU emphasizes that the defence put forward by the Philippines constitutes an attempt to re-run old arguments which have been, however, already dismissed by previous WTO adjudicators. In fact, hearing the arguments submitted by the Philippines in the present dispute is like listening to the echoes of those advanced years ago by other WTO Members, in a vain attempt to justify systems of taxation which were less discriminatory than the one currently at issue. However, wrong legal arguments, unlike good spirits, do not get any better with aging.

ANNEX E-2

EXECUTIVE SUMMARY OF THE SECOND WRITTEN SUBMISSION OF THE UNITED STATES

I. INTRODUCTION

1. This dispute concerns two specific legal claims relating to fundamental obligations under the *General Agreement on Tariffs and Trade 1994* ("GATT 1994") and a discriminatory tax system that has been in place in the Philippines for decades. Article III:2 of the GATT 1994 has been the subject of multiple DSB recommendations and rulings, and the United States has presented the Panel with a clear, straightforward demonstration of why the Philippines measures are inconsistent with Article III:2, using analysis that is consistent with the approach taken by prior panels, but suited for the particular facts of the Philippine measures and market.

2. In this submission, the United States will briefly discuss the issue of the scope of "like product" and "directly competitive or substitutable" products in the context of the Philippine measures. Following that discussion, the United States will provide further comments on several of the main points presented by the Philippines: alleged segmentation of the market; administrative capacity of the Philippines; treatment of rum; and evidentiary concerns.

II. EVIDENCE BEFORE THE PANEL SHOWS THAT THE PHILIPPINE MEASURES ARE INCONSISTENT WITH ARTICLE III:2 OF GATT 1994, FIRST AND SECOND SENTENCES

3. As the United States has explained in its previous submissions, the first and second sentences of GATT 1994 Article III:2 are separate obligations with different elements. The first sentence concerns "like" products. In order to establish that a measure is inconsistent with Article III:2, first sentence, one must demonstrate two specific elements: *first*, that the imported and domestic products are "like," and *second*, that the imported products are taxed "in excess of" the like domestic products.

4. The second sentence concerns "directly competitive or substitutable" products. Per the note *Ad* Article III:2, establishing that a measure is inconsistent with Article III:2, second sentence requires: *first*, that the imported products are directly competitive or substitutable with the domestic products; *second*, that domestic products and imported products are not similarly taxed, and *third*, that the dissimilar taxation is applied so as to protect domestic production.

5. The first element of the claim under each sentence of Article III:2 – "like product" and "directly competitive or substitutable" product, respectively – concerns the substitutability between imported and domestic products. Panels have used similar factors in examining similarities among products under both claims, applying the factors on a case-by-case basis as appropriate for the particular market. 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."

6. Contrary to the suggestions by the Philippines, the complainants have provided ample evidence to the Panel demonstrating the "likeness" and the "direct competitiveness or substitutability" of Philippine and imported brands.

7. The United States provided information on the physical characteristics of imported and Philippine vodka, brandy, whiskey, gin, rum, and tequila, through evidence such as the Philippines

own standards (vodka, whiskey, and brandy), similarity of alcohol content (with specific evidence provided for brands of brandy, whiskey, vodka, gin, rum, and tequila), and photographic comparisons (type by type, of Philippine and imported brands of tequila, brandy, whiskey, gin, and vodka). Particularly in the context of the Philippine market – where the local producers make the same "type" of product as the importers – this evidence shows strong similarities between imported and domestic goods.

8. In addition to the information on physical characteristics, the United States provided extensive evidence showing that imported and domestic products are marketed similarly and sold in the same channels of distribution. Particularly telling are store displays where imported products are sold – they appear in example after example side by side with domestic products, and with different types of spirits all displayed together. In addition, some of the labels of imported and domestic brands are so similar as to be difficult to tell apart.

9. End uses is another critical factor, particularly with regard to concluding that products are directly competitive or substitutable under the second sentence of Article III:2 of the GATT 1994. While the conclusion that the products have similar end uses is obvious from the fact that the Philippine and imported products are the same types (brandy, vodka, etc.), the United States has submitted survey analysis that provides additional support for this conclusion. The Euromonitor survey results – which cover all domestic and imported types of spirits – confirm that Filipino distilled spirits consumers use imported and domestic brands for the same end uses. Moreover, the information on elasticity of demand in the Euromonitor survey and in the Philippines' own study show that if prices of more expensive imports go down, Filipinos are more likely to choose them over local brands. This effect, though modest in both analyses, is real and supports the conclusion that the Philippine and imported products are substitutes.

10. Finally, as all parties acknowledge, distilled spirits are classified under the same four digit heading in the Harmonized Tariff System. Although not definitive, tariff classification can be an important factor concerning similarity among products recognized by other panels and the Appellate Body.

11. No single factor for "likeness" or "directly competitive or substitutable" is required or determinative. Panels have weighed them on a case-by-case basis. In this dispute, the Panel has evidence before it in all relevant areas – physical characteristics, marketing/channels of distribution, end use, price elasticity, and tariff schedule – to support findings regarding Philippine products.

12. The remaining elements of the claims under Article III:2 both concern the extent of the discriminatory treatment of like/directly competitive or substitutable products. Here also there should be no question that the Panel has ample evidence before it.

13. To find that the Philippine measures are inconsistent with the first sentence of Article III:2, the second element simply requires showing that the imported products are taxed in excess of domestic products. This conclusion is evident from the face of the measures – including the implementing annexes, which separate "local" from other brands. These documents show that nearly every imported product is taxed at one of the high rates – from ten to 40 times the rate applied to local products on a proof liter basis.

14. To find that the Philippine measures are inconsistent with the second sentence of Article III:2, the second element requires evidence showing that the difference in taxation between imported and domestic products is more than *de minimis* and that the dissimilar taxation is applied so as to protect domestic production.

15. As noted above and the United States has stated before, the rate applied to products not made from favored local-type raw materials far exceeds the rate applied to other products; and the magnitude of the discrimination far exceeds that found to be inconsistent with the GATT 1994 in prior disputes. Magnitude alone may be sufficient to conclude that a measure is applied "so as to protect domestic production" under the second sentence of Article III:2 of the GATT 1994.

16. But in addition, the structure of the measures also favors discrimination on a very broad basis: because the measures are based on raw material, Philippine producers can use favored raw materials to make different types of products (*e.g.*, vodka or gin) to compete against imports as the market changes and retain their favorable treatment. On the other side, foreign firms that use the types of raw materials apparently favored by the Philippines – such as rum producers – still only receive equal tax treatment if they successfully navigate bureaucratic obstacles. The measures are structured to continue to favor domestic production.

17. To conclude, the United States has presented more than sufficient evidence to the Panel on which to draw the conclusion that the Philippine measures are inconsistent with WTO obligations that the Philippines has undertaken. In the remainder of this submission, the United States will discuss the appropriate parameters for these findings, and respond to several specific points raised by the Philippines.

III. SCOPE OF LIKE AND DIRECTLY COMPETITIVE OR SUBSTITUTABLE DISTILLED SPIRITS

18. In this dispute, the question of what is "like" and what is "directly competitive or substitutable" depends on the particular facts and circumstances of the Philippine measures and market. In the Philippine market, the types of distilled spirits manufactured locally are the same types (*e.g.*, whiskey) as those imported from abroad for sale in the Philippines. The Philippines has acknowledged that "all sugar-based distilled spirits are labeled with the generic category name for the distilled spirit" (*e.g.*, "whiskey").

19. Philippine manufacturers also adapt to changes in the marketplace by developing new types of products – based on "neutral spirits," stripped of the attributes of the raw material so that it can be flavored with essences, extracts or other additives. For example, Ginebra San Miguel Corporation has introduced several different types of beverages in the last several years (*e.g.*, vodka, whisky), which are taxed at the favorable rate because of the raw material used. In addition, Philippine companies have introduced different versions of their products, including "premium" varieties aimed at more elite consumers.

20. In other distilled spirits disputes under Article III:2 of the GATT 1994, the complainants were concerned with the treatment of imported spirits compared to a particular type of domestic spirit. In that situation, the particular domestic distilled spirit can be examined against the products it is *most* similar to ("like products"). Then, the particular domestic distilled spirit can be examined against a wider, expanded circle of products to see whether the domestic distilled spirit is "directly competitive or substitutable" with additional products that it may not be "like." The line between products with which the domestic distilled spirit is "like" and the products with which the domestic distilled spirit is "directly competitive or substitutable" is a line between the products it is *most* similar to and other products that it is less similar to but are nonetheless directly competitive or substitutable.

21. A different type of analysis is appropriate for the Philippines, because the same types of spirits are made in the Philippines and imported from abroad. Indeed, applying the analysis from other disputes, it is unclear why there is any question at all in this dispute. Whereas in the other disputes, the complainant might pose the questions "Is vodka 'like' shochu?" or "Is pisco 'directly

competitive or substitutable' with whiskey?," an analagous question here is "Is whiskey 'like' whiskey?" The answer is "yes."

22. Given this particular situation, the United States has provided evidence comparing particular imported and Philippine distilled spirits brands of different types. These examples show that the difference between imported and domestic brands that is decisive for the discrimination under the Philippine excise taxes – raw material – is not in any way apparent to a consumer, and that the obvious answer to the question "Is whiskey 'like' whiskey?" – yes – is the correct one. This is equally true for all types of products in the Philippines – brandy, vodka, etc. In this way, for each product within HS 2208, the United States has demonstrated that a "like product" exists in the Philippines that is taxed more favorably than the imported product.

23. As to which products are "directly competitive or substitutable" and which products are "like," the United States notes that prior panels and the Appellate Body have consistently recognized "like product" as narrower than "directly competitive or substitutable." Further, the Panel's analysis may depend on the order in which it analyzes the first and second sentences of Article III:2. In particular, there is no need to analyze whether "like products" are also "directly competitive or substitutable." That conclusion follows from their "likeness."

24. The United States is specifically requesting findings covering all distilled spirits under both the first and second sentences of Article III:2 of the GATT 1994, but in different ways. With respect to the first sentence, the United States asks the Panel to review the evidence of Philippine domestic brands and their imported counterparts to confirm that Philippine "brandy" is like imported "brandy," Philippine "gin" is like imported "gin," etc. With respect to the second sentence of Article III:2, the United States requests that the Panel find that all imported distilled spirits are directly competitive or substitutable with all Philippine distilled spirits.

25. This is consistent with the conclusion reached for distilled spirits by three other panels: different types of distilled spirits (*e.g.*, brandy, vodka) are "directly competitive or substitutable" with one another. The findings in the individual disputes vary in the details, including scope of products covered, but each was clear regarding the substitutability among distilled spirits from type to type. The panel in *Chile – Alcohol* found pisco directly competitive or substitutable with products falling under HS 2208, the panel in *Korea – Alcohol* found soju, whisky, brandy, cognac, rum, gin, vodka, tequila, liqueurs and ad-mixtures directly competitive or substitutable, and the panel in *Japan – Alcohol* found soju directly competitive or substitutable with whisky, brandy, rum, gin, genever and liqueurs.

26. The Philippines suggests that the complainants' arguments should fail because of a lack of evidence, even going so far as to suggest that it is a critical flaw to focus on particular brands. But this type of evidence – and its existence in the Philippines – is the result of the Philippines' domestic production of the same types of spirits as imported spirits. As such, examples of Philippine gin juxtaposed against imported gin, or Philippine vodka juxtaposed against imported vodka are not just isolated examples – they are a demonstration of the kind of competition that exists in the Philippines, the operation of its measure, and the discrimination in the Philippines market. As such, they are particularly compelling evidence of the barriers to the market (*e.g.*, Philippine brands like "London Gin") faced by producers outside the Philippines.

27. Even so, the Panel has not only the particular examples of different brands, but also other evidence, including regulations concerning sales of distilled spirits (covering *all* distilled spirits) and store displays showing different types displayed together. The United States has also provided survey evidence on end uses, reflecting data on all types of distilled spirits. The Euromonitor Report grouped data for different types of products together, broadly showing the similarities among uses across

imported and domestic products. In fact, the same conclusions can be drawn from the data on end use collected by Euromonitor when separated by type of spirit. Generally, Filipinos consume imported and domestic products in similar ways. These data demonstrate that imported and domestic brands of distilled spirits are alternative ways to satisfy the same needs and tastes. Finally, the grouping of distilled spirits in the Harmonized System is itself a factor indicative of their similarity.

28. For both the first and second sentences of Article III:2, the conclusion should be guided by the ample evidence and the Philippine measures themselves, which cover all distilled spirits. Under the measure, the Philippine domestic manufacturers can – and do – manufacture any type of distilled spirit and may enjoy the benefits of favorable tax treatment. Accordingly, the Panel's findings should cover the same scope of products.

IV. ACCEPTING THE PHILIPPINES' MARKET SEGMENTATION ARGUMENTS WOULD PRESERVE THE STATUS QUO OF WTO-INCONSISTENT DISCRIMINATORY TREATMENT OF IMPORTS

A. THE PHILIPPINES' APPROACH WOULD PERMIT MEMBERS TO JUSTIFY DISCRIMINATION BASED ON PRICE BY CITING THE PURCHASING PATTERNS CREATED BY THE DISCRIMINATION

29. One theme of the Philippines is that, notwithstanding that both producers in the Philippines and producers in Members exporting to the Philippines manufacture whiskey and the like, the Philippine market should be divided into different segments based on price, and that as a result Philippine domestic products compete in an entirely different market segment.

30. In one segment, the Philippines would place less expensive brands of distilled spirits, and in the other more expensive spirits. Acceptance of this approach requires treating "sugar based" – to use the Philippines' term – as a proxy for "less expensive."

31. First, such a proxy does not work. Both imported brands and domestic brands are sold at a range of prices, and there are some brands of imported products that cost less than domestic counterparts, such as SKYY vodka and Gilbey's 1857 vodka. Second, there is no need to have a proxy for "less expensive." If the Philippine measures were really about price, it would not need to refer to the raw material used for production. It is only because the Philippine measures sort products by raw material (and discriminates on that basis) that the Philippines takes its approach.

32. This brings to light the fundamental problem with the Philippine market segmentation proposal: it uses the mechanism of discrimination (price) to argue that imported and domestic products do not compete. But the discriminatory impact on price from the discriminatory tax measures *is the problem* that the United States is seeking to address in this dispute.

33. The United States is not suggesting that, but for the excise taxes, imported and domestic products in the Philippines would all be the same price in the Philippines. But by the Philippines' own proposal for segmentation, price affects consumers' purchasing decisions, and the excise taxes are one component of the price of distilled spirits in the Philippines. If the Philippine arguments were accepted, it would mean that a Member could use taxes to make local products relatively cheaper than imported products, and then use the fact that consumers choose local products because of lower cost as the basis to avoid a finding that the taxes discriminate against imported products.

B. COMPETITION BETWEEN PRODUCTS IS NOT ABOUT INCOME DISTRIBUTION

34. The Philippines proposes that the income distribution in a Member may affect whether products are "like" or "directly competitive or substitutable." However, this is at odds with the analytic approach taken by panels and the Appellate Body in the past.

35. In particular, each of the factors relied upon by panels and the Appellate Body concern the *goods themselves* – whether physical characteristics, distribution, uses, substitutes, tariff classification and the like. In so far as purchasers are a factor, the emphasis is on the uses to which those goods will be put (that is, whether they are substitutes) and not whether or not consumers can afford a good.

36. Indeed, panels and the Appellate Body have stated clearly that the absence of actual purchases (or even purchases in the near future) does not mean products cannot be substitutes. For example, the Appellate Body in *Korea – Alcohol*, noted the importance of considering latent demand, and whether products *may* be substituted, even if they are not purchased under current conditions. It stated that "the word 'substitutable' indicates that the requisite relationship *may* exist between products that are not, at a given moment, considered by consumers to be substitutes but which are, nonetheless, capable of being substituted for one another."

37. If income distribution could affect whether goods are "substitutable" for the purposes of GATT Article III:2, it would draw emphasis away from the goods themselves and whether they may be substituted, where it belongs, and allow purchasing power or affordability to affect whether such goods are substitutes.

V. ADMINISTRATIVE CHALLENGES DO NOT RELIEVE THE PHILIPPINES OF ITS WTO COMMITMENTS

A. EACH WTO MEMBER TAKES ON THE SAME COMMITMENTS

38. The next theme of the Philippines relates to its capacity as a developing country Member. It cites the administrative difficulties it has faced in collecting taxes as support for two propositions: the Philippines has to rely on indirect taxes such as excise taxes on distilled spirits, and it could not administer another system such as *ad valorem*.

39. As an initial matter, it is unclear what these arguments are intended to demonstrate. The Philippines clarified that it is not raising an Article XX defense. Therefore, the arguments concerning capacity are apparently to assert, in some way, that the Philippine measures are not inconsistent with the GATT 1994 because the Philippines does not have the capacity to manage a different system that would result in progressive taxation.

40. In addition, it is difficult to understand how the Philippines system is "progressive," given that high excise taxes are applied to some products just because of the raw material concerned. As the United States has pointed out, some imported products are relatively less expensive before excise taxes, but when the taxes are added the cost to consumers exceeds that of a local product.

41. Both the United States and the Philippines have cited *Japan – Alcohol* on the issue of a Member's ability to determine its own policy, where the Appellate Body states, "Members of the WTO are free to pursue their own domestic goals through internal taxation or regulation so long as they do not do so in a way that violates Article III or [other WTO Agreement commitments]."

42. The Philippines proposes that *Japan – Alcohol* supports the idea that its excise tax regime is within permissible bounds under the WTO, and it is simply its policy choice to meet its fiscal

objectives. This interpretation is incorrect. While a Member retains the ability to determine its own tax policy, that discretion is subject to the obligations that the Member has agreed to assume under Article III:2 of the GATT 1994. The Philippine excise tax regime is inconsistent with Article III:2 of GATT 1994. The Philippines is free to pursue indirect, progressive taxation, but it must do so in a way that does not discriminate against imported goods.

B. THE PHILIPPINES' CURRENT SYSTEM, BASED ON RAW MATERIALS, REQUIRES PARTICULAR ADMINISTRATIVE BURDENS

43. Moreover, it is difficult to reconcile some of the Philippines' concerns about capacity for implementation of its tax policy with the description of the way in which its current measures are implemented.

44. In its response to Question 47 from the Panel, the Philippines describes the process by which its tax authorities identify and verify the raw materials used to produce a brand of distilled spirit, as well as determining the net retail price. To verify the raw materials used for a distilled spirit, the Philippines Bureau of Internal Revenue may examine "product literature, brochures and other documentary proof and, if possible, [conduct] laboratory tests of the sample." The Philippine authorities must also verify that the product is produced in a country where the particular raw material is "commercially produced," in order to determine whether the product qualifies for lower tax treatment under Section 141(a). Each of these examinations is necessary only because the Philippines' excise tax system applies different taxes to distilled spirits depending on the raw material. They are extra steps for Philippine administrators that policymakers have elected to maintain.

45. The United States is not taking a position on what measures the Philippines should adopt, so long as those measures are not WTO-inconsistent. At the same time, if the Philippines is arguing that it does not have capacity to operate a different system, it is curious that it would maintain a system which requires such additional steps. And it is also curious that the Philippines purports to operate a "progressive" tax system that differentiates by value, but nonetheless administers it through requirements on raw materials and on commercial production.

VI. THE POSSIBILITY FOR DIFFERENT TREATMENT OF RUM DOES NOT MITIGATE THE WTO-INCONSISTENCY OF THE PHILIPPINE TAX SYSTEM

46. The Philippines has explained that it does not discriminate against rum, and describes how importers may verify that their products are made from local raw materials. It also explains the interpretation of the "commercial production" requirement under which, according to the explanation, the production of the raw materials and the production of the distilled spirit do not need to occur in the same country. If the country where the spirit is distilled also produces the raw material as a general matter, the distilled spirit may qualify for favorable tax treatment.

47. In fact, notwithstanding this possibility, the Philippine measures place additional burdens on, and discriminate against, imports even when made from favored raw materials. For example, the "commercial production" requirement means that a number of countries who produce distilled spirits cannot qualify for favorable tax treatment. Thus, the Philippine measures restrict the scope of imported products that may share the low tax treatment accorded to all Philippine products. The only apparent reason behind such a restriction, which only affects imported products is to help protect domestic production. As the United States explained in its First Written Submission, the Philippine measures are applied "so as to afford protection" to domestic production for the purposes of Article III:2 of GATT 1994 not only because of the sheer magnitude of the difference in taxation between imported and domestic products, but also because of the structure of the measure. As the case of rum bears out, the structure of the measure includes *both* the requirement to use typical local

raw materials, and that such materials must be commercially produced in the country where they are processed into distilled spirits.

48. A further evidence of the protectionist nature of the requirement is the fact that there are imported rums that continue to be assigned the higher excise tax rates even though they are made from sugar, such as Malibu rum.

49. In addition, even if some rum products benefit from low tax treatment, that does not mean that the Philippine measures are consistent with its WTO obligations. Imported rums are a tiny segment of the market – overall, rum accounts for approximately 29% of spirits sales in the Philippines, but rum *imports* are only 0.6% of distilled spirits imports. As such, even if some brands of imported rum receive the low tax rate, this would not change the fact that the Philippines' measures subject imported distilled spirits to discriminatory treatment.

VII. THE PHILIPPINES' ADDITIONAL EVIDENTIARY COMPLICATIONS DO NOT CHANGE THE RESULT

50. The Philippines has taken issue with the evidence presented by the United States and the European Union, but its views about what would be the "right" type of evidence do not change the fact that there is ample evidence before the Panel. For example, as noted in Section III above, the Philippines has taken issue with the use of specific examples of brands of gin, vodka, etc., but such examples are particularly relevant by nature of the Philippines measure, in showing that Philippine gins, vodkas, etc. do not look different from imported products.

51. Similarly, the Panel has different sources of information before it on consumer preferences, particularly elasticity of demand in response to changes in price (*e.g.*, Exhibits US-41, PH-49, PH-51). The Philippines' studies are flawed in ways that suggest its results underestimate the substitutability of products (*see, e.g.* Exhibit US-48*)*. Nonetheless, the weak results in the Philippines' study reflect substitutability among imported and domestic products; as such this additional source of information merely adds to the record – it does not change the appropriate finding in this dispute.

52. Similarly, the parties have presented different forms of evidence to the Panel in respect of the taxes applied to imported and domestic spirits. Indeed, it is difficult to identify the best way to explain the tax differential between imported and domestic spirits. Because the taxes for products made from non-local products vary by value, and all products are assessed on a proof liter basis, it is necessary to examine individual brands. But, no single brand can stand in for "all imports" or "all domestics." The Philippines' emphasis on averages only serves its argument on market segmentation, and hides the variety – and extremes – of the taxes they impose.

53. None of these differences among parties' presentations affect the appropriate findings in this dispute, however, because the evidence all points in the same direction: higher taxes are imposed on imported products compared to local products. The Panel may review the Philippines' Exhibit PH-19, data on prices and taxation from Exhibit PH-49 or review evidence on how taxes are reflected by prices in stores. In addition, and perhaps most tellingly, the Panel may look directly at the Philippines' own implementing regulations for its measures. The Philippines has compiled detailed annexes to its regulations with information on individual brands sold in the Philippines and the tax applied, which show that the taxes on imported products are higher than the taxes on local products. As the United States observed in that submission, even the lowest per-bottle taxes among the higher-taxed products exceed the taxes on products listed under the "local" annexes in these laws and regulations.

54. In short, the complaints of the Philippines about the kind of evidence provided by the complainants do not change the fact that the evidence plainly shows that the Philippines' excise taxes on distilled spirits are inconsistent with Article III:2 of the GATT 1994.

VIII. CONCLUSION

55. This dispute does not present novel legal issues, nor does it involve a particularly complicated set of facts. The Philippines applies tax rates to spirits not produced from local-type materials far in excess of those applied to "like" local distilled spirits – from ten to 40 times higher. These Philippines and imported spirits are also "directly competitive and substitutable," and the Philippines imposes the differential tax in order to protect domestic production. Accordingly, the United States respectfully requests that the Panel find that the Philippines measures are inconsistent with the first and second sentences of Article III:2 of the GATT 1994.

ANNEX E-3

EXECUTIVE SUMMARY OF THE SECOND WRITTEN SUBMISSION OF THE PHILIPPINES

I. INTRODUCTION

1. The Philippine measure being challenged does not differentiate between imports and domestic products. It distinguishes among distilled spirits on the basis of a well-recognized, contextually-relevant, and neutral criterion (the raw material base). The evidence shows that, even without the taxes in question, the products for which the complainants assert discrimination are treated as different products in the Philippine market, beyond the means of the vast majority of the consuming public.

2. The evidence that the Philippines has provided shows three incontrovertible facts that are at the heart of this matter: first, the Philippine market is dominated by consumers with very limited income; second, the prices of non-sugar-based spirits are simply beyond the reach of those consumers, such that sugar-based and non-sugar based spirits do not compete in the Philippines market in any meaningful way; and third, despite the obvious efforts of producers to have the sugar-based products appear to be as similar as possible to the non-sugar-based spirits, the products are not sufficiently "like" each other such that they can compete meaningfully in the segmented Philippines market. In short, sugar-based and non-sugar-based spirits are different products serving different consumers in the Philippine market. Article III:2 does not require uniform tax treatment in such circumstances.

II. THE COMPLAINANTS HAVE NOT DISCHARGED THEIR BURDEN OF PROOF

A. THE COMPLAINANTS HAVE FAILED TO SHOW THAT SUGAR-BASED SPIRITS AND NON-SUGAR-BASED SPIRITS ARE "LIKE" OR "DIRECTLY COMPETITIVE OR SUBSTITUTABLE" IN THE PHILIPPINE MARKET

3. By this stage in the proceedings, it should be clear to the parties and to the Panel precisely what products form the basis of the discrimination claim. The complainants have failed to make this clear. The Philippines highlighted some of the short-comings of the complainants' evidence in its first written submission ("FWS"),[1] calling to the Panel's attention the fact that the complainants have not undertaken a complete analysis of any single distilled spirits category. In other words, contrary to the complainants' claims, the evidence they produced was in relation to distilled spirits as a genus. Neither the EU nor the United States has provided the Panel with the necessary evidence to find that any single category of non-sugar-based spirit is "like" or directly competitive or substitutable with a flavoured distilled spirit made from sugar in the context of the Philippines market.

4. In its answers to the Panel's Questions, the United States also seems to invite the Panel to approach the analysis for both "like" products and "directly competitive or substitutable" products on a category-by- category basis,[2] without offering the Panel evidence that would enable it to follow this option. Also, the US position in its answer differs from the US's argumentation in its FWS, where it

[1] Philippines' first written submission, paras. 59-72.

[2] See US Replies to Question from the Panel (US Replies to Questions), Question 18; see also, Question 51, para. 47.

stated that the product categories are "all Philippine distilled spirits" compared with "all imported distilled spirits."[3]

5. Further, while the complainants have asked the Panel to find *all* distilled spirits are "directly competitive or substitutable,"[4] they do not submit evidence on all spirits in the Philippines market. Indeed, the complainants submit only very limited evidence or argumentation regarding a very small number of brands. This insufficient to support a finding of direct competition or substitutability in relation to all brand. Also, the complainants have not shown that the few brands for which evidence or argumentation was presented are representative of the universe of the distilled spirits in the Philippine market.

B. THE "GROUPING" OF THE PRODUCTS DOES NOT RELIEVE THE COMPLAINANTS OF THE BURDEN OF PRODUCING EVIDENCE WITH RESPECT TO ALL DISTILLED SPIRITS FOR WHICH THEY WISH THE PANEL TO MAKE FINDINGS, NOR SHOULD "GROUPING" MASK THE INDIVIDUAL CHARACTERISTICS OF THE PRODUCTS WITHIN THESE CATEGORIES

6. The Panel and the Appellate Body in *Korea – Alcoholic Beverages* approved "grouping" as a methodological tool for the requisite comparison under Article III:2, second sentence. However, it was emphasized that findings could only be made with respect to products for which evidence was presented.

7. Further, the Appellate Body made clear that a panel should be careful to ensure that any such grouping does not result in overlooking or ignoring individual characteristics of products forming part of that group. If the Panel pursues a "grouping" approach in this case, it must exercise great care to ensure that the categories of products they are grouping together are "sufficiently similar" in terms of "composition, quality, function and price". Moreover, the Panel must ensure that when the comparison between product groups is made, the individual product characteristics are given proper consideration, including their quality, price and composition.

C. THE FACT THAT THE APPELLATE BODY HAS FOUND DISTILLED SPIRITS TO BE DIRECTLY COMPETITIVE OR SUBSTITUTABLE IN OTHER MARKETS IS IRRELEVANT TO DETERMINING WHETHER THE PRODUCTS ARE DIRECTLY COMPETITIVE OR SUBSTITUTABLE IN THE PHILIPPINE MARKET

8. The Philippines has emphasised that determinations by previous panels and the Appellate Body in other cases involving other, non-Philippine, markets are irrelevant to determining whether the products are "like' or "directly competitive or substitutable" in the Philippine market.[5]

9. The consideration of whether products are "like" or directly competitive must be done in the context of the relevant market. This is not an abstract philosophical issue. The market – and not the products *per se* – determines the competitive relationship between those products, as confirmed by the existing WTO jurisprudence. The complainants have been unable to produce sufficient evidence to show that the products at issue here are directly competitive or substitutable in the *Philippine* market. In contrast, the Philippines provided evidence to show that they are not.

[3] US first written submission, paras. 66 and 100.
[4] US first written submission, paras. 66 and 100; EU FWS, para. 49 .
[5] Philippines' first written submission, paras. 59-60, paras. 217-222. Philippines' oral statement, paras. 10 and 32.

III. SUGAR-BASED AND NON-SUGAR-BASED SPIRITS ARE NOT "LIKE" OR "DIRECTLY COMPETITIVE OR SUBSTITUTABLE" IN THE PHILIPPINES

A. THE DIFFERENCES IN THE PHYSICAL CHARACTERISTICS OF SUGAR-BASED AND NON-SUGAR-BASED PRODUCTS RENDER THEM "UNLIKE"

1. The physical differences between non-sugar-based and sugar-based spirits are substantial and lead to material differences throughout the production, distribution and marketing processes.

10. The Philippines has demonstrated that the physical differences between sugar-based whiskies, brandies, vodkas, gins and tequilas are substantial.[6] The only similarity among these products is that they are all distilled spirits in the generic sense of the word. The EU and the US have not been able to produce evidence showing a degree of similarity that would permit the products to be considered "like" within the narrow meaning of the term under Article III:2, first sentence.

11. "Likeness" by itself, has no intrinsic meaning and has to be determined in relation to the market. The characterization of whether two or more products are "like" each other cannot be made in the abstract and must relate to economic decision making that concerns trade, including the decision by the consumers in the relevant market to purchase or not to purchase these particular products.

12. In this case, it may be said that different physical characteristics (arising from the use of different raw materials – 141 (a) raw materials on one hand and 141 (b) raw materials on the other) lead to different production processes[7] of different time durations[8]. These, in turn, result in different production costs[9] which, together with the manufacturer's customary margins, will require different distribution systems and costs as well as different marketing techniques. At the end, different net retail prices will result. This, in turn, will ultimately affect the consumer's decision whether to purchase a particular product. That decision will reflect the consumer's perception of whether or not two or more products are "like" or "directly competitive or substitutable."

13. In the Philippines' view, the fact that flavourings and additives are necessarily added to sugar-based spirits illustrates how different the products actually are. Physical differences must exist if additives and flavourings must be added to sugar-based spirits to make them approximate the taste of non-sugar-based spirits. This is also consistent with the US and EU's own domestic regulations, which view brandies made from raw materials other than grapes to be different from brandies made from other raw materials and whiskeys made from grains to be different from those made from sugar. The Philippines' view is consistent with the narrow interpretation of "likeness" adopted by previous panels.

14. The Philippines agrees that all the factors for which evidence has been provided should be taken into consideration by the Panel when determining whether sugar-based spirits and non-sugar-based spirits are "like", however, the differences in physical characteristics of the products resulting from the different raw materials used should be afforded greater significance given the well-recognized, inextricable link between a distilled spirit's product identity and the raw materials and ingredients from which they are made.[10]

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[6] Philippines' first written submission, paras. 95- 170.
[7] Philippines' first written submission, paras. 97 to 99, 108 and 109.
[8] Philippines' first written submission, paras. 115 and 116.
[9] Philippines' first written submission, paras. 110 and 111.
[10] Philippines first written submission, para. 96.

2. Differences in raw materials alter consumer perception of non-sugar-based and sugar-based distilled spirits and these differences are apparent to 'normal' consumers

15. As the Philippines noted in its answers to Questions 29 and 31, the use of sugar cane molasses instead of the other raw materials alters consumer perception of those products, including their taste, aroma, and status in the market. Furthermore, these differences are perceived by consumers.

16. The complainants' own evidence confirms that these differences are apparent to consumers. The Euromonitor survey, referring to the segment of the population that has tasted both non-sugar-based and sugar-based spirits, notes that "they agree 2 to 1 that they did not like the taste of local spirits. They also overwhelmingly concur that local liquors are of inferior quality, socially unacceptable and poor mixers."[11] The survey shows that, in the minds of consumers, there is a clear difference, in both taste and quality, between sugar-based and non-sugar-based spirits, supporting the findings produced by the Philippines' expert.[12] The differences are also apparent from the dramatically different pricing of the products, which reflects the different physical characteristics and corresponds to the expectations of consumers when purchasing these products.

3. Price differentials materially affect the decision of the consumer in buying or rejecting one product as a substitute for another product, as like or unlike the former product

17. The price of non-sugar-based spirits and sugar-based spirits is also a relevant criterion for determining likeness, as supported by the jurisprudence. Price may not be a significant factor in the like product analysis in every case, but it is important in this case. As the Philippines has explained, the like product analysis for the purposes of Article III:2 is flexible enough to take into account market-specific factors that affect the key question, which is whether the products under analysis compete in the relevant marketplace. The Appellate Body has expressly recognized that a Panel must also consider "other criteria that may also be relevant in certain cases" to arrive at a conclusion regarding the "likeness" of products.[13]

18. The Philippines points to the Panel in *Dominican Republic – Cigarettes* case as an instance in which the Panel responded to the particular facts of the case to take into account "other criteria that may also be relevant", consistent with the Appellate Body's statements. These arguments are also supported by the reasoning of the Panel in the recent case of *Thailand – Cigarettes (Philippines)*, which adopted a similar approach to evaluating for "likeness". Furthermore, when considering consumer habits and preferences, the Panel considered "switching evidence and price elasticity, and two economic studies on the elasticity of substitution and the cross-price elasticity of demand."[14]

19. The evidence in this case shows that Philippine consumers do not treat sugar-based spirits and non-sugar-based spirits as "like" each other. In fact, these products operate in different market segments, defined by the price of the distilled spirits relative to the incomes of the consumers. The differences are of such significance in the market as to render the products unlike for the purposes of Article III:2, first sentence, of GATT 1994.

[11] EU-41; US-41: Euromonitor Consumer Preference Survey, August 2010, p. 19.
[12] See PH–30: Philippines' first written submission, paras. 139, 150-151, 159, 162.
[13] Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 19.
[14] Panel Report, *Thailand – Cigarettes (Philippines)*, para. 7.442.

4. The Tariff Classifications applied by the United States and Australia also recognize differences between distilled spirits based on the raw materials used

20. The Philippines draws the Panel's attention to the fact that the answers provided by the United States and Australia show that their tariff classifications recognize that distilled spirits made from sugar cane molasses are different from distilled spirits made from other raw materials, regardless of whether they are called "whiskey," "brandy," "gin," etc. The Philippines respectfully submits that, at this point in the proceeding, there can be no doubt that the tariff schedules recognize the importance of raw materials in classifying distilled spirits. Simply stated, it is one of the primary bases for distinguishing between types of spirits. This is highly consistent with the Philippines' arguments in this case, and the basis for the distinction in the Philippine tax provision under analysis in this case.

B. NON-SUGAR-BASED SPIRITS ARE NOT DIRECTLY COMPETITIVE WITH OR SUBSTITUTABLE FOR SUGAR-BASED SPIRITS

1. Article III:2, second sentence requires the competition to be "direct" meaning that the competitive relationship between non-sugar-based and sugar-based products must be highly proximate

21. The Philippines has emphasised, and the complainants agree, that the nature of the competition between products being analyzed under Article III:2, second sentence, must be "direct".[15] The jurisprudence has confirmed that this refers to the "degree of proximity" in the competitive relationship between the products.[16] The Philippines has argued that, in order to give proper meaning and effect to the term "directly", recourse can be had to the ordinary meaning of the term: "completely, absolutely, exactly". While the United States objects to this characterisation, noting that the products described in the second sentence of Article III:2 "is a broader set of products than those that are 'like'"[17], the physical similarities between the products speak to a question that is different than the proximity of the competitive relationship between the products. One does not necessarily follow the other. Nor is requiring complete, absolute or exact competition between products inconsistent with the fact that direct competition can involve "potential" competition.[18] The Philippines agrees that the scope of Article III:2, second sentence, may include latent demand.[19] However, in keeping with the meaning of the term "directly competitive", previous panels and the Appellate Body have emphasised that there is a temporal limit to this exercise (the near future), in recognition of the fact that the objective sought by undertaking the inquiry into potential competition is to determine whether the products are *capable* of having a relationship that is as highly proximate as Article III:2, second sentence demands.[20] To do away with this temporal limitation and to treat vague potentiality in the indefinite, ever-unfolding, future as sufficient would reduce to nonsense the requirement of direct competition or substitutability.

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[15] US Replies to Questions, paras. 36-41; EU Replies to Questions,, para. 70.

[16] Appellate Body Report, *US – Cotton Yarn*, paras. 97- 98; Appellate Body Report, *Korea – Alcoholic Beverages*, para. 116.

[17] US Replies to Questions, para. 40.

[18] EU Replies to Questions, para. 75.

[19] Philippines' Replies to Questions, Answer to Question 52.

[20] Appellate Body Report, *Korea – Alcoholic Beverages*, para. 114; Panel Report, *Korea-Alcoholic Beverages*, para. 10.48.

2. The extremely low purchasing power of the great majority of Filipinos relative to the price of non-sugar-based spirits segments the Philippine market

22. The Philippines has explained and demonstrated that the Philippine consumer market for distilled spirits is segmented by the purchasing power of the population relative to the *pre-tax prices of distilled spirits*.[21] Thus, the Philippines has shown that the cause of the lack of competition between non-sugar-based spirits and sugar-based spirits is a product of market forces *unrelated to the existence or content of* the measure at issue.

23. The Ocelot Report, the quarterly survey undertaken by Ginebra San Miguel, shows that approximately 90% of consumers of sugar-based spirits earn up to a maximum of 20,000 pesos per month. Approximately 85% of the Philippine population earns up to a maximum of approximately 20,000 pesos per month, per family. Of this 85%, the majority earns less than 10,000 pesos per month per family. The FIES shows that those in the 10th decile earn between two and three times as much as 85% of the population *per month* and over 5 times as much as 60% of the population *per month.* These figures are not per individual, but per family, and the average family in the Philippines is made up of 4.8 persons. Putting these income figures in the context of the pre-tax pricing of distilled spirits, the market segmentation is strong and clear. The market is segmented into what may be referred to as "majority" market (including the great majority of Filipino consumers) and a "minority" market. The price differential between non-sugar-based spirits and sugar-based spirits compared to the income of the great majority of Filipinos prevents consumers from the majority market from considering non-sugar-based spirits as an "alternative way[] of satisfying a particular need or taste",[22] or, as the Appellate Body put it, considering that the products "offer alternative ways of satisfying the same consumer demand in the marketplace."[23]

24. The pre-tax prices of non-sugar-based spirits are out of reach for the great majority of consumers. The maximum weekly expenditure for alcoholic beverages is only 60 pesos for 85% of consumers. The amount of 60 pesos is only 1 percent of the pre-tax price of a bottle of Remy Martin XO cognac (average NRP PhP 5,919.39) or Johnnie Walker Blue Label whiskey (average NRP PhP 5,690.10), and less than 13 percent of the pre-tax price of a bottle of Stolichnaya vodka (NRP PhP 559.14**)** or Jose Cuervo Gold tequila (NRP PhP 479.14).[24]

25. In response to the Panel's question 33, the United States discusses one non-sugar-based spirit that is priced lower than one sugar-based spirit at the NRP level.[25] Even if this price comparison had

[21] Philippines, Replies to Questions 35 and 36; PH-49 and PH -51; Philippine FWS, paras. 226-236.
[22] Appellate Body Report, *Korea – Alcoholic Beverages*, para. 115.
[23] Appellate Body Report, *US – Cotton Yarn*, para. 91.
[24] The Philippines acknowledges, with regret, that there were errors in the original price survey appearing in PH–19, which were corrected during the First Substantive Meeting of the Parties through the Submission of PH–19 (Amended). In its answers to the Panel's questions, the United States noted that there appeared to be a further mistake with PH–19 (Amended), as many of the local brandy prices had been removed without explanation. This comment led the Philippines to conduct a thorough review of the pricing information, which revealed additional mistakes. The Philippines is including as an attachment to the second written submission a corrected version of the price survey in PH-19, which and this corrected version is referred to as PH–77.
[25] US Replies to Questions, para. 21. The US price comparison of Gilbey's 1857 Vodka to SKYY Vodka revealed another error in the database, which has now been corrected in PH-77. While regrettable, the error was obvious from the context. PH-19 Amended showed two entries for Gilbey's 1857 Vodka: 1) a one liter bottle selling in the Supermarket A channel for 177.0 PhP, and in Supermarket B for 182 PhP; and 2) a 700 ml (smaller) bottle with a price of 298 PhP in the Supermarket A category. The US price comparison used the 298 price, even though it would not make sense for a product with 30% less volume to sell for a 66% higher price. On a volume equivalent basis, the price chosen by the United States for its comparison is more than

been correct, it would show, at best, only a marginal price overlap at a price range that is well beyond what the great majority of Filipinos can afford and would be willing to spend. Showing an occasional price overlap in the abstract does not show that the products compete and that the consumers would substitute one product for the other.

26. The Philippines believes strongly that the Panel should base its decision in the case on the normal pricing in the market, being careful to avoid reliance on outliers or aberrations. This is one of the reasons that the Philippines has used average prices, as averages tend either to expose aberrations or soften their effect. Still, an over-reliance on spot transactions creates the risk that the Panel's decision will be based on pricing that is aberrational, and outside the mainstream of commerce. There is evidence in this case that can help the Panel avoid reliance on outliers. The complainants' own evidence states that, "even at a 40% price decrease of imports and a 100% to 200% price increase in domestics, imported brands are typically more than twice as expensive as domestic ones."[26] Also, the price survey and the related studies provided by the Philippines demonstrate the significant differences in the average net retail prices for each type of spirit. The differences between the imported and local prices are significant, as described in the Philippines' FWS.[27] The corrections to the underlying data do not change the average net price analysis.

27. Further, as the Philippines explained in response to Question 52, the results of the studies conducted by the University of the Philippines School of Economics show that there is no meaningful potential for future competition.

3. Non-sugar-based and sugar-based spirits do not compete in the market segment that is representative of the Philippine market

28. As explained in the Philippines' response to the Panel's Question 36, the assessment of whether sugar-based and non-sugar-based products are competitive in the Philippines must be done in relation to the market that is most representative of the market as a whole. In other words, it must be done in relation to the market where most Filipino consumers participate. In the Philippines, this is clearly not the market of the top 10% income decile, earning an annual income of over *six* times that of 50% of the population.

29. Not only is an analysis based on the representative group of the Philippine market the most consistent with achieving the objectives of Article III:2, as explained in the Philippines' Replies to Questions,[28] it is also the most consistent with the jurisprudence. The Philippines notes that the Panel in *Chile-Alcoholic Beverages* noted that while it is unnecessary to show that the products are substitutable for all purposes at all times to be considered substitutable, "it is sufficient that there is a pattern that they may be substituted for some purposes at some times by some consumers."[29] However, a careful reading of the application of this reasoning by the Panel shows that the Panel was referring to a representative sample of the entire market when it used the term "some consumers." This reasoning supports the logical and rational position that the evidence of substitutability for the purposes of Article III:2 second sentence must emanate from a segment of the population that is genuinely and realistically representative of the market in which the products are consumed. It is insufficient to present evidence, as the complainants have done, that substitutability may occur at low levels in a very small segment of the overall market in question, a segment in which the economic

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double the other observed prices. When the researchers were asked to re-check this price, they found the correct price for the 700 ml bottle to be 128 PhP, which is the price reported in PH-77.

[26] Exhibit EU-41; Exhibit US-41, p. 30.

[27] Philippines' first written submission, para. 231.

[28] Philippines' Replies to Question 36.

[29] Panel Report, *Chile – Alcoholic Beverages*, para. 7.43.

means are vastly different than the majority segment. The complainants have not offered any evidence showing that any competition, direct or otherwise, exists in the majority market.

30. The complainants also attempt to show occasional substitutability on special occasions. However, again, the complainants make assertions that this substitutability is possible in the majority market, but fail to provide any such evidence. Further, the fact that the hypothetical consumer is not buying his usual product on that occasion, and, instead, is making an "exceptional" decision, is telling. The products do not satisfy the same need or consumer demand. From the EU's own hypothetical, it is clear that the demand is not the same in nature or in frequency and does not involve the same purchasing considerations or motivations. If there are isolated instances of a family in an income bracket saving up to purchase a non-sugar-based spirit for a very special occasion, this is evidence of exceptionality, not of direct competition or substitutability between non-sugar-based spirits and sugar-based spirits. The decision to purchase in such a case is based on a different set of factors and fulfils a different need, demand or objective.

4. The different distribution channels for sugar-based and non-sugar-based products reflect and reinforce the market segmentation and lack of direct competition or substitution

31. As the Philippines has shown in it FWS, the distribution channels for sugar-based and non-sugar-based spirits are distinct, reflecting the different consumer markets they serve.[30] Local sari-sari stores, which are frequented by all except the most affluent of consumers, account for approximately 85% of off-premise sale of sugar-based spirits.[31] One of the surveys conducted showed that not a single sari-sari store carried non-sugar-based spirits.[32] Further, the 2010 International Wine and Spirits Record (IWSR) report submitted by the complainants[33] show that non-sugar-based spirits are overwhelmingly (as much as 90%) sold through on-premise channels as opposed to off-premise channels (as little as 5%). The reverse is true for sugar-based spirits, which are predominantly (as much as 90% for some spirit types) sold through off-premise channels.

32. The United States and the EU have not been able to show that the minimal overlap in distribution channels are the same distribution channels frequented by the majority of the population. As noted above[34], the on-premise sites where some sugar-based spirits and non-sugar-based spirits are offered to consumers are limited to on-premise retailers whose price-ranges suggest that they are not frequented by Filipinos belonging to the majority market. The Panel in *Chile – Alcoholic Beverages* made the important observation that "if products have quite distinctive channels of distribution that could be a negative indicator with respect to substitutability. For example, if the products were ***regularly presented separately***, it would be *one* piece of evidence that perhaps consumers did not group them together in their perceptions."[35] In light of the uncontroverted evidence regarding sari-sari stores, non-sugar-based spirits and sugar-based spirits are almost always presented separately, especially in the most representative market comprising the great majority of Filipino consumers.

[30] Philippines' first written submission, paras. 252-271.
[31] Philippines' first written submission, paras. 255-259.
[32] Philippines' first written submission, para. 258.
[33] Exhibit EU-15; Exhibit US-15: Excerpts from the 2010 Report on the Philippines published by the International Wine and Spirit Record (ISWR).
[34] Section III.B. 3.
[35] Panel Report, *Chile – Alcoholic Beverages*, para. 7.59. (emphasis added).

C. THE CONCEPT OF *DE MINIMIS* MUST BE ANALYSED IN RELATION TO WHETHER THE MEASURE AFFECTS THE COMPETITION OF PRODUCTS IN THE RELEVANT MARKET

33. The Philippines believes that the concept of *de minimis* is a market-based concept. To be meaningful within the context of Article III:2, it should be defined by the extent to which the tax burden affects the competition of products in the market in question. This is not a "trade effects" test as the United States asserts.[36] Rather, following from the fact that there is no "set level of tax differential which can be considered *de minimis* in all cases", the Panel in *Chile-Alcoholic Beverages* noted that "it is not necessarily true that small differences in tax levels will have an effect in the market."[37]

34. Whether the difference should raise concerns under the WTO Agreements must be assessed in relation to the market in question, and specifically, whether consumer choices are affected by the tax. Such a reading is consistent with the purposes of Article III:2 and the WTO Agreements as whole. Contrary to the EU's argument, whether the producer of the goods is concerned about the level of the tax is not relevant for the purposes of Article III:2, second sentence.[38] If this were a relevant factor, it would be difficult to foresee an excise tax differential that would not fall afoul of Article III:2, second sentence, as a producer could be expected to be concerned with any tax differential.

35. The Philippines has shown that the factors that affect the choice between sugar-based and non-sugar-based spirits are unrelated to the excise tax rates.[39] Consequently, a tax differential that may appear significant in other cases or other markets may be *de minimis* in this case, where the Philippines has shown that the majority of consumers earn incomes that do not anyway permit them to select non-sugar-based spirits, even if sold at prices net of tax.

D. THE EXCISE TAX HAS NOT BEEN APPLIED "SO AS TO AFFORD PROTECTION" AND SO ANY DIFFERENCES IN TAXATION ARE NOT IN VIOLATION OF ARTICLE III:2, SECOND SENTENCE

36. The Philippines has demonstrated that the differences in the actual excise taxes due in the four tiers of Section 141 have not been applied "so as to afford protection" to the any domestic industry. This is exemplified in two ways. First, the Philippines has shown that distilled spirits made from the designated raw materials under Section 141(a) are afforded the lowest tax rates, regardless of their origin. The BIR rulings also show that the requirements of Section 141(a) are read and applied in an extremely permissive manner. Second, the Philippines has shown that local distillers source significant amounts of their ethyl alcohol from imports from all over the world, and, regardless of the origin of those raw materials, the spirits produced therefrom, if sugar-based, are taxed at the Section 141(a) rates.[40] The global sourcing of Section 141(a) raw materials for production into distilled spirits in the Philippines also shows that the Section 141(a) raw materials are not exclusive to the Philippines. Indeed, exhibits PH – 71 and PH – 69 show that exports from both the EU and the United States have been afforded Section 141(a) excise tax rates.

37. This is not a case involving a certain national drink that the excise tax is seeking to protect or even a case of *de facto* discrimination involving a preference for materials that are found exclusively in the Philippines.[41] All spirits, regardless of origin, are eligible for and receive the Section 141(a)

[36] US Replies to Questions, para. 59
[37] Panel Report, *Chile – Alcoholic Beverages*, para. 7.90.
[38] EU Replies to Questions, para. 93.
[39] PH-49.
[40] Philippines' first written submission, para. 25; Philippines' Answers to Question 59; PH-69.
[41] Philippines' first written submission, paras. 292- 314.

rates if the requirements of Section 141(a) are met. There is no protective application of the excise tax measure in this case.

IV. CONCLUSION

38. Article III:2 protects competitive opportunities. Where products do not directly compete, and have little or no prospect of competing in the near term, Article III:2 does not require that the domestic tax system treat the products similarly. Without evidence of direct competition, and in light of the evidence that the products are not "like" each other in the Philippines market, the Panel should find that the complainants have not shown that the challenged measure violates the obligations of the Republic of the Philippines under Article III:2 of the GATT 1994.

ANNEX F

ORAL STATEMENTS OF THE PARTIES AT THE SECOND SUBSTANTIVE MEETING

ANNEX F-1

EXECUTIVE SUMMARY OF THE OPENING ORAL STATEMENT OF THE PHILIPPINES AT THE SECOND SUBSTANTIVE MEETING

1. Taxation is a challenging issue in the Philippines. We need a tax system to generate the revenue necessary to fund government services, but we have to be fair and equitable, and we have to be especially sensitive to the potential regressive effects of taxes on a poor population. We also need a system that minimizes the chances for tax evasion or underpayment of taxes. The excise tax system on distilled spirits is designed to strike a delicate balance by imposing lower taxes on low-priced spirits made from the Section 141(a) materials and higher taxes on spirits made from other materials. In light of the income distribution in the Philippines, the higher taxes of subsection (b) only apply to the products consumed by the small and wealthy minority of the Philippine population

2. Using raw materials as the basis of distinguishing between these products is not arbitrary or discriminatory within the meaning of Article III:2. Spirits made from Section 141(a) materials are of a relatively lower complexity, pedigree, cost, and price. By contrast, spirits made from products such as grains and grapes are more expensive to produce and have a higher value in the market.

3. In the Philippine market, sugar-based and non-sugar-based products are not treated as "like" or "directly competitive or substitutable" because they are different and because the non-sugar-based spirits are simply beyond the means of the vast majority of the Philippine consumers. Where there is no meaningful competition or substitutability, there can be no discrimination within the meaning of Article III:2.

4. No previous Panel has examined these issues in the context of the Philippine market, or in other markets having the characteristics of the Philippines. The key issues in this case are novel and are being considered for the first time.

5. It is incumbent on the complainants to present evidence that products compete in the Philippines market. This involves the development and presentation of evidence for each product category and for each of the criteria of likeness, including that they are within economic reach of the Philippine consumers. The EU and US, we submit, have not discharged their burden. The EU claims in its Second Written Submission that it "does not consider [it] necessary in this case to embark in a repetitive account of each difference between imported and domestic products for every single type of distilled spirit".[1] But, this is the burden that follows from claiming discrimination in the context of the Philippine market. The problem remains even at this late stage of the proceeding.

6. In contrast, the Philippines presented evidence to rebut the complainants' assertions. This included a survey of the actual prices in the Philippine market, which was amended twice. While the Philippines regrets the mistakes, the Philippines rejects categorically the extraordinary suggestion made by the European Union that these changes were made in order to manipulate the data or to achieve a desired result. The Philippines as acted in good faith throughout the proceeding. The Panel is charged with finding the truth, and it is for this reason that the Philippines undertook the initiative to provide a survey of prices in the Philippine market. It is for this same reason that we have asked the Panel to allow us to remove mistakes from the data.

[1] EU SWS, para. 26.

"Like" products

7. The Philippines has shown that the raw materials used to make a distilled spirit affect the entire production chain of distilled spirits, leading to different products of differing character, taste and consequently, price. The EU has highlighted only minor similarities that necessarily follow from the fact that the products are all distilled spirits. Though the European Union attempts to downplay the role of the congeners in the products made from different materials, congeners are to distilled spirits what DNA or genetic code is to the human being. The fact is that brandy is different from whiskey, both are different from vodka, and gin would not be confused with tequila, all of which relates directly to the congeners that remain or are removed in the distillation process.

8. Previous panels have found that physical differences disqualify a product from being seen as "like" another.[2] Moreover, these products are treated as unlike by Filipino consumers, who are the ultimate litmus test for "likeness".

9. The EU and the US are very familiar with the importance of raw materials to the resulting finished distilled spirit. As the Philippines has shown, both have recognized these differences in their domestic regulatory regimes for distilled spirits.

10. Price, among other things, is a reflection of how a product is perceived in a relevant market. The pricing data provided by the Philippines leads to a picture that is not different from that emerging in EU – 41 and US – 41, the Euromonitor Report. The Euromonitor Report states unequivocally that "even at a 40% price decrease of imports and a 100% to 200% price increase in domestics, imported brands are typically more than twice as expensive as domestic ones."[3] Price is an important factor, particularly in this case, because it very materially affects the ability of the products to compete with each other in the Philippine market. One product cannot be said to be like another if its physical characteristics are so different that it is priced out of reach of the ordinary consumer.

"Direct Competition/Substitutability"

11. The Philippines notes that neither the EU nor the US has been able to present sufficient evidence to show that Filipinos perceive these products to be directly competitive or substitutable. The Appellate Body has clarified the standard: namely, whether the situation in the relevant market is such that consumers perceive non-sugar-based spirits as an "alternative way[] of satisfying the same consumer demand"[4]. The Philippines has provided unrebutted evidence as to the income of the population relative to the prices of certain non-sugar-based spirits. The evidence shows that there is a significant divide in the distilled spirits market created by the purchasing power of the great majority of Filipinos relative to the *pre-tax* prices of sugar-based and non-sugar-based spirits. We have shown that the very limited pricing overlap occurs at a price level that significantly exceeds the disposable incomes of the great majority of consumers.

12. In response to this, the US has stated that "competition between products is not about income distribution". The Philippines submits that whether a consumer can or will purchase one good or the other is precisely what competition is all about. A key determinant in that decision-making process is whether that consumer has the means to buy that product. This was recognized by the Panel in *Japan – Alcoholic Beverages II*, which noted that "[i]n the case of product demand and product

[2] Philippines FWS, paras. 78-93; Philippines' responses to first set of Panel questions, response to question 22, pp 7-8.; Philippines' SWS. paras. 29-33.
[3] Exhibit EU–41; Exhibit US–41, p. 30.
[4] Appellate Body Report, *US – Cotton Yarn*, para. 96.

substitutbility …the relevant information includes prices, quantities, and incomes."[5] Disposable income relative to price is absolutely critical. There cannot be competition without the means to purchase.

13. The emphasis in this case is not on income alone, but on income relative to price, the latter being an integral part of the good and a reflection of the good's value in the relevant market. The consumer's decision making at the moment of purchasing is the key to any analysis of actual competition.

14. The EU and US contend that the products are directly competitive, and they present pictures showing the imported and local spirits offered for sale in certain supermarkets. But these pictures do not show us which consumers buy the products, with what frequency, or whether the typical consumer has the ability to purchase both products. Physical proximity on a shelf is not evidence of competition.

15. The Philippines recalls the evidence it has produced showing that over 85% of sugar-based spirits are sold in sari-sari stores as opposed to other outlets.[6] We also note the evidence of the complainants in the International Wine and Spirits Report[7] which, consistent with the Philippines' evidence, shows that non-sugar-based spirits are overwhelmingly sold through different distribution channels. In this case, non-sugar-based distilled spirits and sugar-based spirits are sold through distribution channels that are ***entirely different***. A few pictures do not change this fact or prove direct competition.

16. ***Direct*** competition or substitutability is the standard that must be applied to this case. This means that the complainants must show that the proximity of the competitive relationship between the products is very high. No such proximity has been shown in this case. The Philippines has presented evidence showing that this is due to the high *pre-tax* price of non-sugar-based spirits relative to the income of the majority of consumers. The Philippines has also proven that, in the near future, these products will not compete in the same market for the same reason.[8] In light of the evidence on record, the facts of this case are outside the parameters of Article III:2 second sentence.

Evidence of substitutability

17. The concerns raised by the EU and the US regarding the reliability of PH - 49 and PH -51 is surprising as each alleged methodological short-coming is either one that has been found to have been perfectly acceptable, if not preferable, by previous WTO panels, or is one that is also employed in the methodology used by the complainants in the Euromonitor Report[9]. The complainants have failed to provide any compelling reason why the Panel in this case should not take the findings of these studies into account. They have also provided evidence of substitutability using the same methodology they allege to be flawed.

18. The evidence provided by the complainants and the Philippines demonstrate that there is insufficient degree of substitutability in the Philippine market for the purposes of Article III:2 second sentence. The Philippines has acknowledged that there is a very small segment of the Philippine population that can afford to buy non-sugar-based spirits on occasion. However, the capacity of this unrepresentative segment of the population to purchase non-sugar-based spirits should not be used as

[5] Panel Report, *Japan – Alcoholic Beverages II*, para. 6.31.
[6] Philippines' FWS, paras. 257-260.
[7] EU-15; US–15.
[8] PH-49 and PH-51; responses to Panel question No. 52, pp. 26-27.
[9] EU-41, US-41

the basis for determining whether these products are directly competitive or substitutable in the Philippines market as a whole.

19. The complainants are asking the Panel to infer direct competition. The EU claims in paragraph 4 of its second written submission that the Philippines must concede that 13.7 million citizens have the means to treat non-sugar-based spirits as a substitute for sugar-based spirits. The Philippines makes no such concession, and it is precisely this type of inference that the complainants in this case try to pass off as evidence of direct competition. Direct competition should be demonstrated, not inferred, and especially not with this type of calculation.

20. In estimating the percentage of Filipinos who might be able to consider purchasing non-sugar-based products, a panel would have to consider that the net retail price of the cheapest of these products is approximately 150 pesos. We previously explained that the household representing the 85th percentile of the population only has 60 pesos per week to spend on any type of alcoholic beverage.[10] Using the same calculation methodology and the data from the FIES study, we can calculate that the households with a budget of at least 150 pesos per week for alcoholic beverages represent the top 1.4% of Philippine households. And, given the extremely low elasticity of substitution shown by the econometric studies, the evidence supports the notion that people in the top segment of society are motivated by factors other than price, including the prestige of drinking internationally-known brands of distilled spirits. Price proximity in this portion of the market is not evidence of direct competition or substitutability.

So as to afford protection and the operation of Section 141

21. Section 141 of the Philippines' National Internal Revenue Code as amended is not applied so as to afford protection to the domestic industry. The Philippines has demonstrated that the law operates to permit any spirit made from any of the Section 141(a) materials to be taxed at the Section 141(a) rates, regardless of origin. The example of rum illustrates the non-discriminatory application of this provision.

22. The Philippines has provided evidence that certain imported rums are taxed at the section 141(a) rate when the proper declarations are filed upon importation. This evidence has remained unrebutted. The Philippines can only conclude that if the importer follows the appropriate procedures under Philippine law to claim that the wrong tax was applied, and that it satisfies the conditions of section 141(a), any error will be corrected. The WTO is not the proper forum for the importer to pursue its remedies under Philippine tax law.

23. The administrative challenges the Philippines faces in implementing a suitable tax structure are not presented as a defense to a supposed breach of its WTO commitments. Rather, they have been brought to the Panel's attention to illustrate the issues faced by a specific developing country dealing with specific problems as best it can. Just as our level of economic development does not give us license to act inconsistently with our obligations, the measures that we take to address our development needs should not be presumed to be illegal because they look different from measures applied in economically more advanced countries.

[10] Answers to Panel question No. 35, pp. 14–16.

24. Section 141 is a product of the Philippine reality. Section 141 distinguishes between products based on raw materials, but it does not discriminate against "like" or "substitutable" products from other WTO Members within the meaning of Article III:2. Some products do not sell well in the Philippine market at large. But, the relationship of price to income is the cause of this limitation, not excise taxes. In such a situation, a finding of discrimination will assume competition in a market where none exists. The Philippines respectfully submits that this is not what Article III:2 was intended to achieve.

ANNEX F-2

CLOSING ORAL STATEMENT OF THE PHILIPPINES AT THE SECOND SUBSTANTIVE MEETING

1. There has been a lot of disagreement during the proceedings, and, as always, there is a lot of information to process. But, we also believe that there has been some helpful convergence of views as a result of the back and forth with between the parties and with the Panel.

2. As the Philippines sees it, certain things are agreed, and the disagreement is clearly presented to the Panel for decision.

3. An example of the latter is the issue of like products for the purposes of the particular Article III:2 claims in this case. We can all agree that the concept of "like product" is narrower than the group of all products that compete with one another in a particular market. And, everyone agrees on the need to present evidence and establish that the products in question are "like products" for the purposes of Article III:2. We even agree that "like product" is not solely about the product itself, but about the market in which it is being analyzed and the purpose for which it is being analyzed.

4. There is a clear disagreement as to the proper results of the analysis. The US has paraphrased its position by saying that the task is to determine whether a whiskey is like a whiskey. The EU has emphasized that the only differences are minor, such as differences in the level of congeners. The Philippines believes that the issue is a little more complicated than that. To take the example of whiskey, the question is whether the whiskey made from Article 141(a) materials is like other whiskey taxed at a higher rate. And yes, the level of congeners is an important difference, even if they account for less than 1% by volume of the product. Simply stated, they are what gives a malt-based whiskey its essential character, which is decidedly different when that essence is provided by an artificial flavoring. And, there seems to be no doubt that the main distribution channel for sugar-based products – the sari sari stores – do not sell non-sugar-based products. The panel should reflect on this very basic fact that sometimes gets lost in all the details. Would products which are "like" in the eyes of the consumers be treated so differently in the market? We think that this is very revealing. In any event, the facts are before you, and you need to weigh the facts and make a decision.

5. There has also been a clarification of the positions with respect to the broader group of products that compete – that is, those which are directly competitive or substitutable. The US clarifies that it wants the Panel to find that "all imported distilled spirits are directly competitive or substitutable with all Philippine distilled spirits." Here, the Panel has a more difficult task. Where is the evidence that a spirit made from nipa competes directly with Scotch whiskey, or other non-sugar-based products for that matter? And, do we really believe that a Philippine consumer of a Remy Martin brandy would be willing to substitute an 80 peso bottle of Ginebra San Miguel? Does that sound right to us? Is this the type of direct competition and substitutability that the Appellate Body described as being alternative ways to satisfy the same demand? We do not think so, and we do not think that there is enough evidence for the Panel to simply conclude that all imported distilled spirits are directly competitive or substitutable with all Philippine distilled spirits.

6. And, the Philippines has provided substantial evidence that the competition is very low or non-existent, and does not rise to the level of "direct" competition for the purposes of Article III:2. The major points are these:

(a) The price data, combined with data regarding income levels throughout Philippine society, shows that the cheapest of the non-sugar-based products are priced – on a net

price basis -- at a level beyond the means of the vast majority of Philippine consumers. In other words, any price proximity occurs at an income level above what the vast majority of the population can afford. If consumers cannot afford the products, there is no meaningful competition or substitutability, and especially not the type of direct competition that the Appellate Body has characterized as competing products offering consumers alternative ways to satisfy the same demand.

(b) The price elasticity analysis shows very low levels of substitution, even among the small part of the population who have the ability to choose. Non-price factors appear to be strong in that small segment of the population that prefers internationally-branded non-sugar-based spirits. This is not surprising; instead, it is common sense validated by an econometrics analysis.

(c) In these circumstances, any differences in tax rates is not meaningful. It has no market affect. What is the meaning of a 5, 10, or 20 per cent difference in tax treat on products that do not compete? Nothing. Which is why Article III:2 requires direct competition before any difference in tax treatment is considered to be a violation.

(d) Finally, the tax measure at issue is not designed to afford protection. Let us not forget that the current system replaced a system that distinguished between imports and domestic products, or that imports of sugar-based ethanol are significant and are taxed at the Section 141(a) rates. The record also shows that rum imports are taxed at the Section 141(a) rates. If one were to design a tax to afford protection, it would not look like this.

7. So, what is the purpose of this tax measure, with all of its idiosyncrasies and quirks? Simply stated: to raise revenue, to avoid tax evasion or underpayment, and to establish a progressive tax system on liquor. The other parties have indicated that they have no problem with a specific tax system, or the notion of specific taxes being applied in a progressive manner to different price tiers. This is what the current system does, without discriminating in the terms of Article III:2.

We take this final opportunity to thank the Panel and the Secretariat for its consideration of this issue, and we thank the representatives of the other parties for their work.

ANNEX F-3

EXECUTIVE SUMMARY OF THE OPENING ORAL STATEMENT OF THE EUROPEAN UNION AT THE SECOND SUBSTANTIVE MEETING

The EU initially emphasized that, as times goes by, the discrimination against imported spirits in the Philippines becomes even worse. In fact, as of 1st January 2011, pursuant to Republic Act No. 9334, the excise rates for spirits have all been increased by 8%. This means that also the price gap between domestic and imported spirits has widened. The noted that Article III:2 is a key provision of the GATT and its importance was in fact recognised in the recent Panel Report in *Thailand – Cigarettes*, in which the Panel stated stressed that "the national treatment obligation must be interpreted strictly".

Fundamentally, the EU finds that there is one issue which stands out from the different legal and factual aspects the Panel will need to examine and adjudicate upon. In very simple terms, it could be put as follows: is a brandy like another brandy? Does vodka compete with gin? The European Union believes that there is ample and un-rebutted evidence in the file which points unquestionably to one clear answer to the above questions. It is the answer which, most probably, the overwhelming majority of ordinary men and women in the street would have given, without even looking at any evidence. However, since common wisdom is not enough in a DSU procedure and the burden of proof rests upon the applicants, the EU and US produced a very rich, meticulous and exhaustive evidentiary framework.

It appears to the EU that the Philippines' SWS does not contain any new issues of law or fact. Essentially, it reiterates the arguments illustrated in previous submissions. Interestingly, in paragraph 25 of the SWS, the Philippines summarizes the alleged differences between spirits distilled from the designated materials and spirits distilled from the non-designated materials with one chart. The EU showed that, already in the record, there was sufficient evidence that each of the "steps" identified in the chart is not correct. In other words, the Philippines took some differences which may exist between certain local products and certain imported products and pretended that they apply to all domestic products with respect to all imported products. The EU also showed that analogous differences exist between different imported products and this is necessarily so because the products subject to these proceedings are differentiated products, not commodities. Minor differences between the products must exist in such a market. However, these minor differences are essentially not due (or not only due) to the raw material used for the distillation, but to a variety of reasons.

So, to put it in very simple terms, it is the opinion of the EU that one cannot put on one side all spirits from the designated raw materials and on the other side all spirits from other raw materials. This grouping does not work. From whatever perspective one would look at these two groups (e.g. production process, cost of the product, physical characteristics of the product etc.) there will always be some spirits produced from e.g. sugar cane that have more in common with some spirits produced from e.g. grape wine and vice versa. Not a single criterion of analysis would allow you to divide spirits on the basis of the designated raw material.

In this context, the EU recalls that, as the Panel in *Thailand – Cigarettes* emphasized, the language of Article III:2, first sentence, does not indicate that "all" imported products should be found like "all" domestic products. The Panel did not consider that a comparison between "all" imported cigarettes and "all" domestic cigarettes was required for the analysis of likeness under Article III:2, first sentence. It thus examined whether the Philippines had established with supporting evidence that the imported cigarettes at issue were like at least some domestic cigarettes. Therefore, in essence, in the present case, the co-complainants would have met their burden of proof and substantiated their

claims under Article III:2 insofar as they have shown that some Filipino spirits are similar to some imported spirits and that Excise Tax Regime treats them dissimilarly.

Examining in detail the chart, the EU in the first place observed that it is untrue that different raw materials result in different physical characteristics. In fact, the Philippines acknowledged that even if this step were true for other types of spirit (quod non), at least with regard to vodkas this would be incorrect: vodkas all have identical or very similar physical characteristics. This was only an example taken from the SWS of the Philippines. In fact, in its SWS, the EU mentions are several other statements made by the Philippines in which it has conceded that in many cases different raw materials do not result in different physical characteristics. In addition, the EU also showed that two products made from two different raw materials (Filipino sugar cane whisky and Canadian rye whisky) have very similar levels of congeners. So, apart from being virtually identical in 99% of their composition (water and ethanol), these two products are similar also with regard to the residual 1%. On the contrary, when the EU compared Canadian whisky with a malt Scotch whisky, it showed differences in congeners which were much more significant than those between Canadian whisky and Filipino whisky. Lastly, the EU finded it curious that, only a few months ago, in the *Thailand – Cigarettes* panel proceedings, the Philippines argued (and the Panel accepted) that local and domestic cigarettes had similar physical characteristics in spite of being made from different varieties of tobacco and in spite of the fact that they contain different flavouring additives.

In the second place the EU observed that different raw materials do not involve different production processes. In fact, the Philippines admits that any vodka is "always distilled to the point of making a neutral spirit to which no additional ingredients need be added". Also, any vodka is produced through charcoal filtration. Similarly, the Philippines confirmed that imported gins too are distilled to the point of making a neutral spirit and that imported gins, just like domestic gins, are always flavoured with juniper berries. With regard again to distillation, the EU wondered whether the Philippines is arguing that distilling alcohol from camote/sweet potato involves a substantially different process from distilling alcohol from normal potato. Indeed, spirits distilled from these two very similar root vegetables are subject to very dissimilar tax rates. In this context, the EU recalled that Filipino spirit producers do not use only sugar cane for their alcohol production, but also other raw materials (including in fact camote/sweet potato) as confirmed in Ginebra San Miguel's 2009 Annual Report (Exhibit EU-105). Moreover, the EU noted that the Philippines' "Old Captain 12 Years Old Superior Rum" is produced by pot distillation, just like French cognac. On the other hand, Philippines' "Ginebra San Miguel" is produced through continuous distillation, similarly to Scotch grain whisky. Lastly, with respect to ageing, the EU indicates that both domestic "White Castle 5 Years Old Whisky" and "Napoleon VSOP Brandy", and imported "Johnny Walker Whisky" and "Fundador Brandy" are aged in oak barrels.

In the third place, the EU contends that different raw materials do not involve different time durations. In fact, it pointed out that fermentation of grape wine or wine (which is the basis of many imported spirits) is a process that is simpler and faster than fermentation of sugar cane (which is at the basis of most Filipino spirits). At the same time, generally imported vodkas and gins reach the market shortly after distillation. No additional substantial process is needed in the production of these spirits. On the contrary, a Filipino customer needs to wait several years for some local products which are aged.

In the fourth place, the EU stressed that it is incorrect to argue that different raw materials results in different production costs. In fact, production processes vary and those required to produce some spirits from the designated raw materials are not necessarily less costly and/or simpler and/or shorter. Producing, for example, a brandy or a rum which is aged for several years in an oak barrel is more expensive than producing a brandy or rum which is not aged. Several Filipino brandies and rums are in fact aged and numerous imported grape wine or fruit brandies or rums are not aged.

In the fifth place, the EU observed that different raw materials do not result in different distribution systems. Firstly, the EU referred the Panel to its FWS in which it has highlighted the similarity of the distribution network (i.e. the system of wholesalers and distributors) between domestic and imported spirits. With regard to the points of sale, then, the EU addresses firstly the Philippines' statement according to which one of the surveys they conducted showed that not a single sari sari store carried non sugar-based spirits". The EU emphasized that the other survey conducted by the Philippines (Exhibit PH-55) showed that some sari sari stores do indeed sell some imported brands. In fact, among the imported spirits mentioned under the categories "usually carry", "usually kept in stock" and even under "most popular brands" appear (and often for more than one shop): "Fundador Brandy", "Alfonso I Brandy", "Absolut Vodka", "Johnny Walker Whisky", "Hennessy Cognac". However, the EU found it obvious that sari sari stores sell mainly local products, since these shops have limited shelving space and predominantly serve low-income customers. Therefore, it is normal that sari sari shop-owner prefer to store and offer to their low-income customers low-taxed products rather than high-taxed products. In this regard, the EU observed that the Philippines was once again making the mistake they had repeatedly made throughout these proceedings: attempting to justify the discriminatory measure by pointing to the very negative effects produced by the measure. In any event, leaving aside the aspect of sari sari stores, the EU pointed out that to the extent that supermarkets sell all spirits side-by-side, as do many restaurants, bars, pubs and catering companies, the Philippines' argument is clearly unfounded. In this regard, the EU noted that in its Opening Statement, the Philippines acknowledge that there is a partial overlap of the sales channels.

In the sixth place, the EU believed that different raw materials do not result in different marketing techniques. The EU firstly noted that in previous submissions, the Philippines has only included vague assertions on this aspect without no supporting evidence. On the contrary, the EU stressed that it has shown that both foreign and Filipino spirits producers have largely similar television and press advertisements and that they develop and market new products following the same global trends.

The EU also referred to additional examples of similar marketing strategies: sponsoring sports events (Exhibit EU-106); having famous actresses and singers sponsoring their products (Exhibit EU-107); producing sponsored calendars with top models (Exhibit EU-108); organising itinerant tasting and promotion events (Exhibit EU-110) or seminars and competitions in cocktail mixing (Exhibit EU-111). The EU also emphasized how press advertisings are sometimes extraordinary similar (see Exhibit EU-109).

In the seventh place, according to the EU, different raw materials do not result in different net retail prices. At the outset, the EU recalled that imported spirits pay customs duties ranging between 10 and 15% ad valorem and noted that these significant duties are not taken into account when the Philippines speaks of "net retail prices" of spirits. Moreover, the EU added that since importers can only sell minimal quantities of their products, they incur disproportionate marketing, distribution and logistics costs, unlike local producers. It stressed that the importance of economies of scale, apart from being recognised by established economic literature, is also openly voiced by Ginebra San Miguel. In spite of being the absolute market leader in the Philippines (accounting for around half of the overall market for spirits) its CEO affirms that they need to sell more products year after year to achieve economies of scales – volumes to obtain more resources to pursue further growth (Exhibit EU-112). In this context, the EU also observed that a recent study reveals that, on a global basis, beverages companies (including spirits producers) have been acquiring or partnering with other beverages companies outside their core product segments (e.g. in the soft drinks or fruit market segments) in order to realise economies of scale (Exhibit EU-113). As its 2009 Annual Report reveals, also Philippines' Ginebra San Miguel has recently done so, by integrating the non-alcoholic beverage business (NAB) into the alcoholic-beverage business (Exhibit PH-105). In the opinion of the EU, this shows that Filipino spirits producers follow world trends not only when it comes to, for example,

marketing their products or developing new ones, but also with regard to corporate strategies. In addition, the EU emphasized that large evidence demonstrates that, already now, several imported spirits show a price which is comparable to that of their domestic counterparts. And this is the case both in on-premises outlets and in off-premises outlets.

The EU then reiterated its doubts on the completeness, correctness and accuracy of Exhibit PH-77. Among other things, the EU noted that this third version of the price survey still lacked some important data. In fact, the net retail price of some imported spirits was missing from the document. This is considered a particularly serious flaw insofar as some of these spirits are precisely the least expensive spirits imported into the Philippines' market. And this omission seemed also inexplicable given that the document does indicate the average retail price (i.e. price including taxes), and the Philippines cannot ignore the tax applied on those products, since tax rates are provided for in its legislation. The EU then went on to give a few examples of imports where no net retail price is indicated and which concerned brands among the lowest-priced imported spirits in the Philippines. Furthermore, the EU noted that also some local spirits are missing from the list. In particular, the absence of "Tanduay Centennial Rum" is quite remarkable since this domestic product is one of the most expensive spirits sold in the Philippines. In any event, according to the EU, if one looks at those products which are mentioned in Exhibit PH-77 and whose net retail price is in fact indicated, one would see that numerous imported products have prices comparable to their domestic counterparts. The EU then gave several examples of those spirits with comparable prices.

In this context, the EU adds two small points. In the first place, the EU notes that in paragraph 18 of its Opening Statement, the Philippines agreed that there is already now some pricing overlaps of imported and domestic spirits. In the second place, the EU observes that in paragraph 35 of its Opening Statement the Philippines stated that the cheapest imported spirit brand has a Net Retail Price ("NRP") of around P. 150. However, the EU noted that in Exhibit PH-77 there were imported spirits with a NRP below P. 150.

In conclusion, the EU found the illustrative chart presented by the Philippines manifestly wrong. An overwhelming amount of evidence disproves every single assertion made in that chart. In this context, the EU recalled that it has also shown that Filipino domestic regulations e.g. on distribution and drunk driving do not distinguish between different types of spirits, even if the Philippines contested the relevance of this aspect. The EU noted that the Panel in *Thailand – Cigarettes* appears to agree on this point since it concluded that imported and domestic cigarettes were "like" also on the basis of the fact that all cigarettes were subject to "the same domestic regulations on advertising, marketing, distribution, as well as labelling".

The EU concluded on likeness by noting that all the evidence shows that that what previous Panels have found in past cases appeared wholly correct also with regard to the Philippines. The EU did not find it surprising since a bottle of vodka remains a bottle of vodka wherever it is purchased. In fact, the purchaser will drink it in the same manner, on the same occasions, and for the same reasons vodka is drunk everywhere in the world. Whether this vodka was distilled from potato, sugar cane, grain, grape wine or camote is something that the average customer will not even be aware of, and certainly will not affect his/her choices.

Having dealt with the main issues arising from the case, the EU pointed again to the inexplicable requirement that, in order to benefit from the low and flat tax rate, the raw materials must be produced commercially in the country where they are processed into distilled spirits. This additional condition further aggravates the discriminatory nature of the measures at issue. Indeed, whether a spirits distilled from one of the designated raw materials can or cannot benefit of the low tax rate depends only on whether or not the climate or agronomic conditions of the country where it is

produced allow for a commercial production of that raw material. This means that two products which may be identical might be treated differently only by reasons of their place of origin.

The EU gave a concrete example to show its argument and stressed that it fails to see the logic of this requirement and how the Philippines can argue that the Excise Tax Regime is origin-neutral and non-discriminatory. Lastly, the EU pointed out that, in response to Question 20 from the Panel, the Philippines had stated that with the exception of sugar cane and cassava, the distilled spirits made from the remaining Section 141(a) materials were not produced in commercial quantities in the Philippines; their production being limited to artisanal producers. The EU therefore wondered whether spirits distilled from, for example, coconut (like 'Lambanog') are wrongly taxed at P.13,59 and whether Ginebra San Miguel's products should be pro rata taxed at higher rates when produced from camote. Concluding on this point, the EU emphasized that the major problem under WTO rules was the distinction between spirits produced from the designated raw materials and spirits produced from the non-designated raw materials. This is what results in a discrimination prohibited by Article III:2. Yet, this additional requirement on the production of the raw materials (like, for instance, the fact that many rums, in spite of being produced from sugar cane are still subject to the higher tax rates) was just an additional proof that behind the system there is pure and simple protectionism.

The EU further observed that in its SWS the Philippines did not elaborate at all on the tentative justification it had raised during the first hearing and which concerned the alleged effectiveness of the fiscal treatment. The EU pointed out that in the *Thailand – Cigarettes* case, the Panel correctly rejected a similar argument advanced by the defendant, noting that, in case, it could have only examined it under Article XX, but that the defendant had not raised an Article XX defence. The case is similar to the current dispute since the Philippines has confirmed more than once that no Article XX defence has been raised.

In conclusion, the EU observed that, beyond the several and key commonalities between these previous three alcohol cases and the present one, there were two dissimilar features in the latter. In the first place, in past cases, the tax differential between domestic products and imported products was of a lower magnitude. Never has a panel examined an excise tax on alcoholic products which could be more than 43 times higher than that levied on similar domestic products.

In the second place, and importantly, in past cases there was usually one typical or traditional domestic spirit (shochu, soju, or pisco) which was fiscally favoured over all other spirits. For all other types of spirits, and with the exception of the *Japan – Alcohol* dispute, normal competition could exist, irrespective of the origin of the products. This is not the case in the present dispute. In the Philippines, all domestic spirits (whatever the type, alcohol content, price, etc.) are favoured over virtually all imported products. It is hard to imagine a tax system which is more discriminatory than this one. And, in fact, the EU did not find it surprising that this tax system had virtually annihilated foreign competition, squeezing all imported brands into an insignificant 2-3% of the overall spirits market.

ANNEX F-4

EXECUTIVE SUMMARY OF THE CLOSING ORAL STATEMENT OF THE EUROPEAN UNION AT THE SECOND SUBSTANTIVE MEETING

In the first place, the EU noted that there was some agreement between the Parties on the facts of the case. In this regard, the EU stressed that it was important to distinguish between facts and legal characterisation of facts. The complainants must adduce sufficient evidence to support the statements of facts which they make. Legal characterisation is, on the other hand, a step beyond that, and it is a question of judgment which the Panel is here to adjudicate upon.

In the second place, the EU noted that Mr. Allen of the Filipino Delegation confirmed several times that the raw materials that benefit of the low tax rate are those that "*grow well in the Philippines*", "*are cheap in the Philippines*", "*are easily available in the Philippines*". On the contrary, raw materials which are "*expensive in the Philippines*" such as grape wine are not among the designated raw materials. This confirms what the EU has been arguing since the beginning: the measures at issue are designed and applied "*so as to afford protection to domestic production*". In this context, the EU added that the fact that the measures at issue replaced a measure which was openly discriminatory did not constitute a defence. On the contrary, the EU recalled that in past disputes the fact that a WTO Member replaced a measure which was overtly discriminatory with one which was only *de facto* discriminatory was considered as a factor showing the willingness of that Member to prolong the effect of the overtly discriminatory measure (e.g. Panel Report in *Australia – Automotive Leather (21.5)*).

Finally, the EU emphasized that the test proposed by the Philippines in its Closing Statement (that is, the co-complainants would need to show that all imported products are substitutable with all domestic products) was incorrect and went against established jurisprudence. In fact, for a breach of Article III:2 GATT is enough that *some* foreign products are like or substitutable with *some* domestic products and are not treated equally. This meant that the EU would not need necessarily to prove that e.g. a nipa liqueur competes with "Hennessy Cognac" or "Talisker Scotch Whisky". The EU would have made its case and established a violation of Article III:2 if it proves that, e.g., Gran Matador Brandy competes with Fundador Brandy.

ANNEX F-5

EXECUTIVE SUMMARY OF THE OPENING ORAL STATEMENT OF THE UNITED STATES AT THE SECOND SUBSTANTIVE MEETING

1. We are now in the later stages of the litigation process, and the issues are clear. As the Philippines stated in its second written submission, it is indeed a moment to reflect.

A. THE UNITED STATES CLAIMS CONCERN PARTICULAR MEASURES OF THE PHILIPPINES, NOT ITS FISCAL POLICIES OR ECONOMIC DEVELOPMENT

2. 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 question before the Panel is 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 US claims make no statement on the Philippines' broader fiscal policies, its needs, or what specific changes the Philippines should adopt to its tax system. All the parties to this dispute – including the Philippines – recognize that, as the Appellate Body in *Japan – Alcohol* stated:

> "Members of the WTO are free to pursue their own domestic goals through internal taxation or regulation so long as they do not do so in a way that violates Article III or any of the other commitments they have made in the *WTO Agreement."*

4. However, the Philippines' defense of its measure neglects the second part of that citation – the one which is critical to the parties' claims: *so long as they do not do so in a way that violates Article III or any of the other commitments they have made in the WTO Agreement.*

5. In the first paragraph of its most recent submission, the Philippines states that the "central issue" before the Panel is "whether Article III of the GATT 1994 should be interpreted and applied in a way that prohibits the Philippines from following a fiscal policy that best fits its needs." To the contrary, that is not the central issue in this dispute: the central issue is whether the Philippine measures are consistent with its WTO commitments.

6. In our statement today, the United States will discuss several specific aspects of the Philippine arguments:

- First, the Philippines' grouping of distilled spirits into "sugar based" and "non sugar based" does not accurately reflect its measures or its own arguments;

- Second, Article III of the GATT 1994 does not require a showing of discrimination in a "majority" market segment;

- Finally, the size of the tax differential between imported and domestic products is sufficient to determine whether the differential is "de minimis".

B. THE PHILIPPINES' "SUGAR-BASED" AND "NON-SUGAR-BASED" TERMS DO NOT ACCURATELY REFLECT ITS MEASURES OR ITS OWN ARGUMENTS

1. The measures favor alcohol produced from several typical Philippine raw materials – not just "sugar"

7. From its very first submission to this Panel, the Philippines has used the terms "sugar based" and "non sugar based" broadly to describe two groups of distilled spirits sold in the Philippines. But these terms not only are very rough shorthand for products of the different raw materials favored by the Philippine measures, they also are misleading in the context of the Philippine economic arguments.

8. The Philippines acknowledges that "sugar-based" is not a precise description of the criteria its measures use to distinguish between products. That much is true.

9. Section 141 of the Philippines' Internal Revenue Code neatly divides the universe of distilled spirits into two categories "A" and "B". "A" describes lower-taxed products and "B" includes everything else.

10. The measures do not define the products eligible for inclusion in Category "A" and therefore entitled to the lower tax rate as "low cost" or "sugar-based." Rather, it has two specific requirements.

11. First, a category A product must be manufactured from one of six different raw materials – nipa, coconut, cassava, camote, buri palm, or sugar cane. As the complainants have shown, about the only thing these materials have in common is that they are produced in the Philippines.

12. Second, the raw material must be commercially produced in the country where the distilled spirit is manufactured. The Philippines has described how this does not require that the raw material actually be produced in the Philippines; yet the United States is not claiming that it does. Rather, as the United States has explained, this requirement further limits the imported distilled spirits that might qualify for favorable tax treatment and prevents producers in many Members from being able to qualify for the lower tax rate even if they use one of the favored raw materials. For example, a distilled spirit made from palm or camote fails to qualify for the low tax rate if the producer is unable to show that it is located in a country that commercially produces palm or camote. Any Philippine producer, on the other hand, need not worry about this requirement because all the favored raw materials are produced in the Philippines.

13. In short, category "A" is a proxy, not for "sugar based," but for "local." In fact, this is evident from the annexes in the Philippines' own regulations, which repeatedly refer to products classified under category "A" as "local". It is important to take a step back from the submissions and consider this terminology, because the Philippines' defense of its measures depends on accepting the premise that its measures are designed to provide more favorable tax rates to preserve the affordability of certain distilled spirits – in fact, its measures are designed to provide lower taxes to local products, *i.e.* protect domestic production.

2. Notwithstanding differences in raw materials, imported and domestic products are "like" or "directly competitive or substitutable"

14. When the Philippines examines physical differences between imported and domestic products, it focuses almost exclusively on attributes of the raw materials. Yet even as it claims that products made from different raw materials are distinguishable because there is an "inextricable link" between a product and its raw materials, it acknowledges that there is "some comparability" between

products made from different raw materials, and that additives may be added to sugar cane products to "create a flavor comparable to the flavor of a non-sugar-based spirit."

15. Indeed, in the Philippines, raw materials are reduced to ethyl alcohol, a "neutral spirit" for which the attributes of the raw material have been eliminated as much as possible. Ethyl alcohol can be made from the sugars *of any raw material*, as pointed out by the responses to the Panel's first question to the parties. In the Philippines, this stripped down, neutral product is transformed into more recognizable consumer products through the use of additives. As the Philippines noted with regard to whiskey in its first written submission, "the original flavour of the sugar material is extinguished as much as possible" and "local distillers add the relevant flavourings and ingredients" to neutral spirits "to generate the taste of whiskey".

16. Unlike the products at issue in *Japan – Alcohol*, which were not reduced to a neutral spirit only to have flavors added to produce the final product, in the case of the Philippines, the products are reduced to a neutral ethyl alcohol, which is then used to produce a variety of products that are like or directly competitive or substitutable with imported products. To the extent there is a link between a distilled spirit and its raw material, Philippine producers have done their best to break it.

17. The nature of the Philippine products at issue also informs the structure of the particular measures at issue. Unlike measures such as those examined in earlier alcohol tax disputes that protected one "type" of distilled spirit such as sochu or pisco, the Philippine tax system enables Philippine producers to make essentially any type of end product and enjoy favorable tax treatment, as long as they start with a stripped down, neutral spirit made from the right kind of raw material. The examples provided by the complainants – including information regarding labels, store displays, end use, etc. – show that the types of products that Philippine producers create from neutral spirits made from local raw materials are essentially the same type of products that importers offer to Philippine consumers.

18. The United States has presented evidence to the Panel demonstrating the similarities between imported and domestic products in the Philippine market. The United States has also provided evidence demonstrating how the measures apply to these products. The measures cover all types of distilled spirits, and group together products from local raw materials in one category, and all other products in another. Accordingly, the United States has provided evidence with respect to different types of products (such as whiskey and gin) from both categories, demonstrating that imported and domestic products are like and directly competitive or substitutable and that the measures accord less favorable treatment to imported products.

3. The Philippine measures do not distinguish between products based on price

19. The Philippines uses the term "sugar based" not only as shorthand for the longer list of six local raw materials named in its measures, but also in its arguments concerning the purported lack of competition between domestic and imported products due to differences in price. These arguments are equally flawed.

20. As an example, at paragraph 53 of its second written submission, the Philippines asserts that the "price differential between non-sugar-based distilled spirits and sugar-based distilled spirits compared to the income of the great majority of Filipinos prevents consumers from the majority market from considering non-sugar-based distilled spirits as an 'alternative way[] of satisfying a particular need or taste.'" Yet the Philippine measures discriminate on the basis of raw material, not price. In fact, the only differentiation by value included in the Philippine measures is the three progressively higher rates applied to products not made from local types of raw materials.

21. Indeed, if the measures were designed to favor consumers of a certain income level or purchasing power, there would be no reason to structure the tax around the raw material used to manufacture the distilled spirit – the measure could just distinguish between products based on their price without regard to raw material.

22. Two things are clear: the Philippines applies lower taxes to products made from local raw materials, and Philippine producers go to great lengths to obscure the differences between products manufactured from different raw material sources. The raw materials that make products eligible for favorable treatment under the Philippine measures do not distinguish between products that are not like, but distinguish between products that are domestic and imported. The measures "afford protection to domestic production".

4. The Philippine tax measures are difficult to administer

23. The Philippines has made several points about administrative capacity – suggesting that the current system may be justified or necessary as a matter of what is feasible for its government in order to meet its objectives. These assertions, when one looks at the measures themselves, simply do not ring true.

24. The tax system imposed through the Philippine measures is actually extremely complicated. The system is set out not only in the basic provisions of the Internal Revenue Code, but also in a number of regulations predating and subsequent to the 2004 law, as well as implementing annexes. These measures set out in detail, brand by brand, applicable tax information involving assessments of raw material, price, and alcohol content. In addition, to maintain currentness, the Philippine measures provide for regular surveys.

25. It is not particularly obvious how the system works, and the Philippine differentiation of products based on raw materials – when the price information is also collected and employed – adds an additional layer with no apparent purpose except the protection of its domestic industry.

26. Moreover, the repeated updates to one of the Philippines' key exhibits bears scrutiny in light of its assertions about administrative capacity. The Philippines has updated Exhibit PH-19 twice, once of its own accord and then, at least in part, apparently in reaction to specific data highlighted by the complainants.

27. The data in the exhibit are the kind of information the Philippine government is apparently supposed to keep track of simply in order to maintain its current system. Yet in the context of the current dispute, the exhibit with this cross section of products – not even all products as listed in the multiple regulations and annexes of the Philippine measures – has been beset with problems. Plainly it is not a simple task to keep all this straight.

28. We would like to make one additional point about the "corrected" exhibit. The Philippine correction changes the information that the United States used to identify a product that – but for the discriminatory taxation imposed by the Philippines – would be less expensive than a domestic product of the same type. Even setting aside this one example does not disturb the larger point the United States was making: the Philippine "sugar based" and "non-sugar based" categories are not reasonable proxies for affordable versus expensive products, nor are its markets so segmented as to prevent competition between imported and domestic products.

29. There are domestic products in the Philippine market at higher costs, and also a range of prices for imported products. Even the "corrected" Exhibit-77 includes relatively higher-priced domestic brands (*e.g.* Napoleon VSOP) and relatively lower priced imports (*e.g.* Myers Rum Original

Dark). The range of prices in the Philippines own regulations also is revealing. For example, Revenue Regulations 23-2003 lists net retail prices for a long list of imported brands, including low-price (*e.g.*, Cherry Brandy Walsh at 61.43 pesos, net of taxes, for 750 mililiters and Jose de Soto Brandy de Jerez Solera, at 185 pesos, net of taxes, for 700 mililiters) along with high-price brands like Hennessy cognacs. The regulations also reflect higher-priced domestic brands such as Napoleon VSOP (with a price net of tax for 750 mililiters of 127.98 in Revenue Regulation 02-07 of 1997).

C. A FINDING OF WTO-INCONSISTENCY UNDER ARTICLE III OF THE GATT 1994 DOES NOT REQUIRE A SHOWING OF DISCRIMINATION IN A "MAJORITY" MARKET SEGMENT

30. The United States would now like to draw the Panel's attention to another aspect of the Philippine approach that is not consistent with the GATT 1994. The Philippines argues, particularly in its most recent submission, that the United States must show competition among imported and domestic products in the "majority" of the Philippine market in order to demonstrate that imported products are directly competitive or substitutable with local products.

31. There is no such requirement in Article III of the GATT 1994, nor is the Philippine position supported by the reasoning of prior panels or the Appellate Body. First, prior panels have been clear that latent, or potential, demand is a consideration in determining whether goods are directly competitive or substitutable. Thus, the fact that a majority of Filipinos – or any Filipinos – might not currently purchase imported distilled spirits does not mean that the products are not directly competitive or substitutable. Further, the factors for whether goods are directly competitive or substitutable focus on the goods themselves – particularly attributes like end-use. Under the Philippine proposed interpretation, a Panel would discount the attributes of the goods themselves, whether they are substitutes and how they would be used by consumers.

32. The United States notes that a measure may be WTO-inconsistent even where 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. As such, the Philippine arguments about the "majority" market would not change the appropriate findings in this dispute, even if they were valid. And even under the Philippine proposed approach, the Philippines implicitly concedes that the imported and domestic distilled spirits compete in at least "part" of the Philippine market since the Philippine references to a "majority" market concedes that there is a "minority" market.

33. In understanding how the Philippine proposed approach proceeds from the wrong basis not only legally but also economically, it may be helpful to consider the distilled spirits market in the Philippines generally as it is affected by the tax measures. In response to the Philippines' characterization of its majority market as lower-income consumers, and, by assumption, consumers of lower-taxed local brands, the United States would like to offer some further analysis of the Philippine market.

34. The Philippine market is dominated by less expensive domestic brands. Imported brands are largely absent at any price point. According to the Philippines, the reason for this is the low purchasing power of the majority of Filipino consumers. However, a closer look at the brands sold in the Philippines bears out the significant barrier that the Philippine taxes present to importers seeking to sell products at a lower price point in the Philippines. The lack of imported brands at the lower end of the price spectrum should not signify that they do not have potential to do so.

35. The top five brands (all domestic) accounted for 86% of the Philippine market in 2010. While price, as measured in cost per liter, will vary according to package size, brand and retail outlet, the mid-point of each brand was between 80 and 116 Pesos per liter.

36. With 86% of all volume selling well below 250 Pesos per liter, the low end segment of the Philippine market is clearly important.

37. As of 2011 the excise tax on spirits produced from favored raw materials was only 14.68 Pesos per proof liter, while the *lowest* possible excise tax on other products was 158.73 Pesos per proof liter.

38. For almost every individual brand in the top 86 percent of sales, the difference between the domestic tax and the tax that would be paid on a comparable imported brand is more than 50% of the retail price. For 13 of the 23 brands the difference between the tax on domestic and imported distilled spirits is more than 80% of the retail price. The simple average is 73%.

39. The impact of the tax on imported products is clearly a barrier to imported products seeking to sell at a lower price point. For example, if a brand were imported at the same supplier price as Ginebra San Miguel, it would sell for 86 Pesos per liter *if* the domestic tax were applied. However, the higher tax rate would add 115 Pesos to the retail price. Thus, an imported product would have a retail price of 201 Pesos per liter – 133% higher than the domestic brand.

40. Clearly, the excise tax on imports currently precludes imported products from competing with domestic brands in this segment of the market. The Philippine measures create significant price differences for these products. On the Philippines' theory of showing competitiveness in the majority market, imported products would need to have made further progress in market penetration already, simply to make a case under the national treatment provisions of the GATT 1994.

41. The United States offers this information to demonstrate the challenge that the Philippine taxes present to importers whose products are subject to higher taxes. Beyond these taxes, the Philippine market presents significant opportunities for imports. There is a generally well-developed market for distilled spirits in the Philippines. Consumer choices have changed over time, showing dynamism in the market. For example, Philippine consumers switched from gin to brandy in significant volumes between 1999 and 2009, even though brandy was consistently priced at levels much higher than that of gin. And Philippine producers continue to introduce new vodkas and whiskies into the market, including premium brands.

D. THE SIZE OF THE TAX DIFFERENTIAL BETWEEN IMPORTED AND DOMESTIC PRODUCTS IS SUFFICIENT TO DETERMINE WHETHER THE DIFFERENTIAL IS "DE MINIMIS"

42. Finally, the United States would like to make a few comments on the Philippine proposed approach to "de minimis" and "direct competition".

43. A finding that a measure is WTO-inconsistent under the second sentence of Article III:2 of the GATT 1994 requires a showing that the difference in taxation between directly competitive or substitutable products is more than "de minimis." The Philippines argues that "de minimis" is a market-based concept.

44. By this, the Philippines means that the Panel should examine whether the difference in taxation between the so-called "sugar based" and "non sugar based" distilled spirits affect consumers' choices. This reading could lead to extreme results – for example, a Member could have an explicitly discriminatory measure and, so long as the measure was put in place before there was significant

import penetration, the Member could with impunity use that measure to prevent imports from competing on an equal footing and gaining market share.

45. The Philippines claims that one cannot use the size of the tax differential to determine whether it is "de minimis" – but this plainly does not make sense. The tax rates concerned are at the heart of its measures, and indeed, past panels have found that the size of the tax differential alone may be sufficient to show that the discrimination under a measure is more than de minimis.[102]

46. Accordingly, the US suggestion that the Panel focus on the size of the differential is sound. Here, again, focusing on the specific Philippine measures, the tax per proof liter for products not made from local types of raw materials is from ten to forty times higher than that applied to local raw materials and dwarfs the price differentials found to be over "de minimis" in other disputes on Article III:2 of the GATT 1994.

47. The Philippine approach is similar to a "trade effects" test, as the United States described in its response to questions from the Panel and in spite of the Philippine claims to the contrary. In this, it is similar to the Philippine approach on the issues of like product and directly competitive or substitutable products – that is, if consumers might not purchase more imports in the absence of the discriminatory tax, the products are not substitutes or like for the purposes of GATT Article III.

E. CONCLUSION

48. To conclude our remarks this morning, the United States would ask the Panel to reflect on the interpretation of the measures which makes the most sense. The Philippine approach would present its measures as an easily administrable, progressive tax system for low-cost distilled spirits. The United States sees a complex tax structure which effectively distinguishes between local and imported products and taxes the imported products at much higher rates. The United States sees a group of measures that afford protection to domestic production in breach of Article III of the GATT 1994.

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[102] *Japan – Alcohol (AB)*, p. 29-30. *See also Korea – Alcohol (Panel)*, para. 10.101.

ANNEX G

VARIOUS RELEVANT DOCUMENTS

ANNEX G-1

WORLD TRADE ORGANIZATION

WT/DS396/4
11 December 2009

(09-6455)

Original: English

PHILIPPINES – TAXES ON DISTILLED SPIRITS

Request for the Establishment of a Panel by the European Union

The following communication, dated 10 December 2009, from the delegation of the European Union to the Chairman of the Dispute Settlement Body, is circulated pursuant to Article 6.2 of the DSU.

The European Union (the "EU") hereby requests the establishment of a panel pursuant to Articles 4.7 and 6 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU") and Article XXIII of the *General Agreement on Tariffs and Trade* ("GATT 1994").

This request concerns the excise tax regime in force in the Philippines with respect to distilled spirits and more particularly the measures evidenced *inter alia* by the following legal provisions, as such and as applied, in law and in fact, insofar as they relate to distilled spirits:

– Section 141 of the *National Internal Revenue Code of 1997* (Republic Act No. 8424, *an Act amending the National Internal Revenue Code as amended and for other purposes*, Official Gazette 1 June 1998, as subsequently amended, particularly by Section 1 of Republic Act No. 9334, an Act *increasing the excise tax rates imposed on alcohol and tobacco products, amending for the purpose Sections 131, 141, 142, 143, 144, 145 and 288 of the National Internal Revenue Code of 1997, as amended*); and, to the extent relevant with respect to the implementing measures set out below, Section 1 of the preceding and related Republic Act No. 8240, *an Act amending Sections 138, 139, 140 and 142 of the National Internal Revenue Code, as amended and for other purposes* (Republic Act No. 8240);

– Sections 3.I, 4 and 5 of the preceding and related *Revenue Regulations No. 02-97 Governing Excise Taxation on Distilled Spirits, Wines and Fermented Liquors*, implementing the relevant provisions of Republic Act No. 8240;

– Section 1 of *Revenue Regulations No. 17-99, Implementing Sections 141, 142, 143 and 145(A) and (C) (1),(2), (3) and (4) of the National Internal Revenue Code of 1997 relative to the Increase or the Excise Tax on Distilled Spirits, Wines, Fermented*

Liquors and Cigars and Cigarettes Packed by Machine by Twelve Per Cent (12%) on 1 January 2000;

– Section 3 of *Revenue Regulations No. 9-2003 Amending Certain Provisions of Revenue Regulations No. 1-978 and Revenue Regulations No. 2-97 Relative to the Excise Taxation of Alcohol Products, Cigars and Cigarettes for the Purpose of Prescribing the Rules and Procedures To Be Observed in the Establishment of the Current Net Retail Price of New Brands and Variants of New Brands of Alcohol and Tobacco Products*;

– Section 2 of *Revenue Regulations No. 23-2003 Implementing the Revised Tax Classification of New Brands of Alcohol Products and Variants Thereof Based on the Current Net Retail Prices Thereof as Determined in the Survey Conducted Pursuant to Revenue Regulations No. 9-2003*;

– Sections A, B and C(2)(a) of *Revenue Regulations No. 12-2004 Providing for the Revised Tax Rates on Alcohol and Tobacco Products introduced on or before 31 December 1996, and for those Alcohol and Tobacco Products Covered by Revenue Regulations No. 22-2003 and 23-2003, Implementing Act No. 9334*; and

– Sections 1 to 9 of *Revenue Regulations No. 3-2006 Prescribing the Implementing Guidelines on the Revised Tax Rates on Alcohol and Tobacco Products Pursuant to the Provisions of Republic Act No. 9334, and Clarifying Certain Provisions of Existing Revenue Regulations Relative Thereto*.

For each of the measures referred to above, this request also covers any amendments, replacements, extensions, implementing measures or other related measures.

Section 141 of the *National Internal Revenue Code of 1997* as amended and implemented, provides in part as follows[103]:

"Distilled Spirits. – On distilled spirits, there shall be collected (…) excise taxes as follows:

(a) If produced from the sap of *nipa*, coconut, cassava, *camote*, or *buri* palm or from the juice, syrup or sugar of the cane, provided such materials are produced commercially in the country where they are processed into distilled spirits, per proof liter, Eleven pesos and sixty-five centavos (P11.65).

(b) If produced from raw materials other than those enumerated in the preceding paragraph, the tax shall be in accordance with the net retail price per bottle of seven hundred and fifty milliliter (750 ml.) volume capacity (excluding the excise tax and the value-added tax) as follows:

(1) Less than Two hundred and fifty pesos (P250) – One hundred twenty-six pesos (P126), per proof liter;

(2) Two hundred and fifty pesos (P250) up to Six hundred and Seventy-five pesos (P675) – Two hundred and fifty-two pesos (P252), per proof liter; and

[103] National Internal Revenue Code of 1997 as amended and consolidated up to 1 March 2009.

(3) More than Six hundred and seventy-five pesos (P675) – Five hundred and four pesos (P504), per proof liter."

The Revenue Regulations referred to above, when setting out the excise tax rate applicable to each brand of spirits introduced into the Philippines market, distinguish between "local distilled spirits" (see, for example, Section A of Revenue Regulations No. 12-2004, referring to "Local Distilled spirits Brands Produced from Sap of Nipa, Coconut, etc. covered by Section 141 … ") and "imported distilled spirits" (see, for example Section B of Revenue Regulations No. 12-2004, referring to "Imported Distilled Spirits Brands Produced from Grains, Cereals, and Grains covered by Section 141 …"). The EU claims relate to the different excise tax rates applicable by the Philippines to local and imported whisky, gin, brandy, rum or rhum, vodka and other distilled spirits.

Under Section 141 of the *National Internal Revenue Code of 1997*, and the other measures referred to above, the Philippines establishes and applies a discriminatory excise tax regime that adversely affects imports of distilled spirits (code 22.08) of the Harmonised System to the Philippines. In essence, under this regime, distilled spirits produced from the sap of nipa, coconut, cassava, camote or buri palm, or from the juice, syrup or sugar of the cane, provided that such materials are produced commercially in the country where they are processed into distilled spirits, are subject to a flat tax rate (of 11.65 Pesos in 2009). These raw materials are indigenous to the Philippines. At the same time, imported spirits produced from other raw materials are subject to a system of price bands at substantially higher tax rates (between 126 Pesos and 504 Pesos in 2009).

These measures, individually and in any combination, as such and as applied, in law and in fact, are inconsistent with the Philippines' obligations under the GATT 1994 and are therefore presumed to (and do) nullify or impair the benefits otherwise accruing, directly or indirectly, to other WTO Members, including the EU. In particular, the Philippines has acted inconsistently with the first sentence of Article III:2 of the GATT 1994, by making distilled spirits imported from other WTO Members, including the EU, subject, directly or indirectly, to internal taxes or other internal charges in excess of those applied, directly or indirectly, to like domestic products. Moreover, separately and in combination with the first sentence of Article III:2, by applying internal taxes or other internal charges to imported and/or domestic products in a manner contrary to the principles set forth in paragraph 1 of Article III of the GATT 1994, the Philippines has acted inconsistently with the second sentence of Article III:2 of the GATT 1994.

On 29 July 2009, the EU requested consultations with the Philippines with a view to reaching a mutually satisfactory solution to the matter. The request was circulated in document WT/DS396/1 dated 30 July 2009. The consultations were held in Manila on 8 October 2009 on the above-mentioned measures. They have not led to a satisfactory resolution of the matter.

Therefore, the EU respectfully requests that a panel be established, with standard terms of reference under Article 7 paragraph 1 of the DSU, to consider the above complaint with a view to finding that the above measures adopted or maintained by the Philippines are inconsistent with the first and second sentences of Article III:2 of the GATT 1994, as such and as applied, in law and in fact, and are therefore presumed to (and do) nullify or impair the benefits otherwise accruing, directly or indirectly, to other WTO Members, including the EU.

ANNEX G-2

WORLD TRADE ORGANIZATION

WT/DS403/4
29 March 2010

(10-1710)

Original: English

PHILIPPINES – TAXES ON DISTILLED SPIRITS

Request for the Establishment of a Panel by the United States

The following communication, dated 26 March 2010, from the delegation of the United States to the Chairman of the Dispute Settlement Body, is circulated pursuant to Article 6.2 of the DSU.

On 14 January 2010, the United States requested consultations with the Philippines pursuant to Article 4 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU") and Article XXII of the *General Agreement on Tariffs and Trade 1994* ("GATT 1994") with regard to the taxation of distilled spirits by the Philippines (WT/DS403/1). Consultations were held on 23 February 2010, but have failed to resolve the dispute.

The Philippines taxes distilled spirits at rates that differ depending on the product from which the spirit is distilled. Distilled spirits produced from certain materials that are typically produced in the Philippines are taxed at a low rate. Other distilled spirits are taxed at significantly higher rates (for example at a rate that is approximately from 10 to 40 times higher than the rate for the domestic product). The tax rate also depends on whether the product from which the spirit is distilled is produced commercially in the country where it is processed into distilled spirits. The Philippine taxes on distilled spirits do not appear to tax imported distilled spirits and directly competitive or substitutable domestic distilled spirits similarly. The taxes appear to be applied in a way that affords protection to domestic production. In addition, the taxes appear to subject imported distilled spirits to internal taxes in excess of those applied to like domestic products.

The United States understands that the instruments reflecting the Philippine measures include:

– Section 141 of the *National Internal Revenue Code of 1997* (Republic Act No. 8424, *an Act amending the National Internal Revenue Code as amended and for other purposes*, as subsequently amended, particularly by Republic Act No. 9334, an Act *increasing the excise tax rates imposed on alcohol and tobacco products, amending for the purpose Sections 131, 141, 142, 143, 144, 145 and 288 of the National Internal Revenue Code of 1997, as amended*);

– Republic Act No. 8240, *an Act amending Sections 138, 139, 140 and 142 of the National Internal Revenue Code, as amended and for other purposes*;

– *Revenue Regulations No. 02-97, Governing Excise Taxation on Distilled Spirits, Wines and Fermented Liquors*;

– *Revenue Regulations No. 17-99, Implementing Sections 141, 142, 143 and 145(A) and (C) (1),(2), (3) and (4) of the National Internal Revenue Code of 1997 relative to the Increase of the Excise Tax on Distilled Spirits, Wines, Fermented Liquors and Cigars and Cigarettes Packed by Machine by Twelve Per Cent (12%) on 1 January 2000*;

– *Revenue Regulations No. 9-2003, Amending Certain Provisions of Revenue Regulations No. 1-97 and Revenue Regulations No. 2-97 Relative to the Excise Taxation of Alcohol Products, Cigars and Cigarettes for the Purpose of Prescribing the Rules and Procedures To Be Observed in the Establishment of the Current Net Retail Price of New Brands and Variants of New Brands of Alcohol and Tobacco Products*;

– *Revenue Regulations No. 23-2003, Implementing the Revised Tax Classification of New Brands of Alcohol Products and Variants Thereof Based on the Current Net Retail Prices Thereof as Determined in the Survey Conducted Pursuant to Revenue Regulations No. 9-2003*;

– *Revenue Regulations No. 12-2004, Providing for the Revised Tax Rates on Alcohol and Tobacco Products introduced on or before December 31, 1996, and for those Alcohol and Tobacco Products Covered by Revenue Regulations No. 22-2003 and 23-2003, Implementing Act No. 9334*; and

– *Revenue Regulations No. 3-2006, Prescribing the Implementing Guidelines on the Revised Tax Rates on Alcohol and Tobacco Products Pursuant to the Provisions of Republic Act No. 9334, and Clarifying Certain Provisions of Existing Revenue Regulations Relative Thereto*;

as well as any amendments, replacements, related measures or implementing measures.

The Philippine measures appear to be inconsistent with the first and second sentences of Article III:2 of the GATT 1994.

Accordingly, the United States respectfully requests, pursuant to Article 6 of the DSU, that the Dispute Settlement Body establish a panel, with standard terms of reference as set out in Article 7.1 of the DSU, to examine the matter described above.

ANNEX G-3

WORKING PROCEDURES FOR THE PANEL

28 July 2010

1. In its proceedings the Panel shall follow the relevant provisions of the Dispute Settlement Understanding (DSU). In addition, the following Working Procedures shall apply.

2. The Panel will provide the parties[1] and third parties[2] with a timetable for its proceedings. The timetable may be modified by the Panel as appropriate, after having consulted the parties.

3. The panel shall conduct its internal deliberations in closed session. The parties to the dispute, and interested third parties, shall be present at the meetings only when invited by the Panel to appear before it.

4. The deliberations of the Panel and the documents submitted to it shall be kept confidential. Nothing in the DSU shall preclude a party to a dispute from disclosing statements of its own positions to the public. Members shall treat as confidential information submitted by another Member to the Panel which that Member has designated as confidential. As provided in Article 18.2 of the DSU, where a party to a dispute submits a confidential version of its written submissions to the Panel, it shall also, upon request of a Member, provide a non-confidential summary of the information contained in its submissions that could be disclosed to the public. Non-confidential summaries shall be normally submitted no later than one week after the written submission is presented to the Panel, unless a different deadline is granted by the Panel upon a showing of good cause. The Panel may adopt additional procedures for the protection of business confidential information (BCI) submitted by the parties in the course of the proceedings.

5. Before the first substantive meeting of the Panel with the parties, and in accordance with the timetable approved by the Panel, the parties to the dispute shall transmit to the Panel written submissions in which they present the facts of the case and their arguments. Third parties may transmit to the Panel written submissions after the first submissions of the parties have been filed, and in accordance with the timetable approved by the Panel.

6. At its first substantive meeting with the parties, the Panel shall ask the European Union and the United States, in that order, to present their respective cases. Subsequently, and still at the same meeting, the Philippines will be asked to present its point of view. Parties will then be allowed an opportunity for final statements, in the same order.

7. All third parties shall be invited in writing to present their views during a session of the first substantive meeting of the panel set aside for that purpose. All such third parties may be present during the entirety of this session.

8. Formal rebuttals shall be made at a second substantive meeting of the Panel. The Philippines shall have the right to take the floor first to be followed by the European Union and the United States.

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[1] Throughout this document, the term "party" refers to the European Union, the United States or the Philippines, as appropriate. The term "parties" refers to the European Union, the United States and the Philippines.

[2] Throughout the document, the term "third parties" refers to Australia, China, Colombia (for DS403), the European Union (for DS403), India, Mexico, Thailand, Chinese Taipei and the United States (for DS396).

The parties shall submit, prior to that meeting, and in accordance with the timetable approved by the Panel, written rebuttals to the Panel.

9. The Panel may at any time put questions to the parties and ask them for explanations either in the course of a meeting with the parties or in writing. In addition, the parties shall be permitted to ask questions to each other and to third parties. Replies to questions shall be submitted in writing by the date specified by the Panel. Third parties shall not be permitted to ask questions to the parties or to other third parties. Replies of the parties and third parties to questions, and parties' comments on each other's replies to questions, will not be attached to the Panel report as annexes. They will be reflected in the findings section of the Panel report where relevant.

10. The parties to the dispute and any third party that presents its views orally shall make available to the Panel and the other party a written version of their oral statements, preferably at the end of the meeting, and in any event not later than the working day following the meeting. Parties and third parties are encouraged to provide the Panel and other participants in the meeting with a provisional written version of their oral statements at the time the oral statement is presented.

11. All oral presentations of any party shall be made in the presence of the other parties. Moreover, each party's written submissions, including any comments on the descriptive part of the report, responses to questions put by the Panel and comments on responses made by other parties, shall be made available to the other parties. Third parties shall receive copies of the parties' first written submissions.

12. Parties shall submit all factual evidence to the Panel as early as possible and no later than during the first substantive meeting, except with respect to evidence necessary for purposes of rebuttals, answers to questions or comments on answers provided by others. Exceptions may be granted by the Panel upon a showing of good cause. In such cases, the other parties shall be accorded a period of time for commenting, as appropriate.

13. Within seven (7) calendar days following the submission of a written submission or oral statement to the Panel, each party and third party shall provide the Panel with an executive summary of the respective submission or statement. These executive summaries will be used only for the purpose of assisting the Panel in drafting a concise factual and arguments section of the Panel Report so as to facilitate timely translation and circulation of the Panel report to the Members. Executive summaries shall not serve in any way as a substitute for the submissions of the parties. Each summary to be provided by each party shall not exceed ten (10) pages in length. Third parties' executive summaries shall not exceed three (3) pages in length. The Panel may, in light of further developments, allow the parties or third parties to submit longer summaries.

14. To facilitate the maintenance of the record of the dispute, and for ease of reference to exhibits submitted by the parties, parties are requested to number their exhibits sequentially throughout the stages of the dispute. For example, exhibits submitted by the European Union should be numbered EU-1, EU-2, etc. If the last exhibit in connection with the first submission was numbered EU-5, the first exhibit of the next submission thus would be numbered EU-6. Exhibits submitted by the United States should be numbered US-1, US-2, etc. Those submitted by the Philippines, PH-1, PH-2, etc.

15. The parties to the dispute have the right to determine the composition of their own delegation. The parties shall have the responsibility for all members of their respective delegations and shall ensure that all members of their delegations act in accordance with the rules of the DSU and the Working Procedures of this Panel, particularly in regard to confidentiality of the proceedings. Parties shall provide a list of the participants of their delegation to the Secretary of the Panel and to each other no later than 5:30 pm, local Geneva time, the working day before any meeting with the Panel.

16. Following issuance of the interim report, the parties shall have two (2) weeks to submit written requests to review precise aspects of the interim report and to request a further meeting with the Panel. The right to request such a meeting must be exercised no later than at that time. Following receipt of any written requests for review, in cases where no further meeting with the Panel is requested, the parties shall have the opportunity to submit written comments on the other parties' written requests for review. Such comments shall be strictly limited to commenting the other parties' written requests for review.

17. Any request for a preliminary ruling (including rulings on jurisdictional issues) to be made by the Panel shall be submitted no later than in a party's first written submission. Exceptions to this may be granted by the Panel upon a showing of good cause. Should there be a request from any of the parties for a a preliminary ruling, the Panel will consult the views of the other parties, within a time period to be specified. The Panel shall inform the parties promptly of any preliminary rulings it might make in the course of the proceedings. In addition, the Panel may also choose to inform third parties of such preliminary rulings, if appropriate.

18. The following procedures regarding service of documents will apply:

(a) Each party and third party shall serve any document submitted to the panel directly on all other parties, and on third parties as appropriate and confirm that it has done so at the time it provides its document to the Secretariat.

(b) Each party and third party shall provide its documents to be filed with the panel to the Secretariat by 5:30 p.m., Geneva time, on the deadlines established by the Panel, unless a different time is set by the Panel.

(c) The parties and third parties shall provide the Secretariat with seven (7) paper copies of each of their written submissions. These copies shall be filed with the Dispute Settlement Registrar, ********* ******** (Office 3178) by 5:30 p.m. on the due dates established by the Panel. The Panel may allow the submission of exhibits in less than eight hard copies, as in the case of exhibits that do not lend themselves to being submitted on paper, upon a reasoned request by a party made with a notice of at least three WTO working days in advance of the respective deadline, copying the other parties.

(d) Each party and third party shall also provide electronic copies of any document submitted to the Panel at the time it provides the document to the Secretariat, in a format compatible with the WTO Secretariat's text-editing software. If the electronic version is provided by e-mail, it should be addressed to DSRegistry@wto.org, and copied to *****.******@wto.org and *****.*****@wto.org. If a CD-ROM is provided, it should be delivered to Mr. Ferdinand Ferranco at the WTO Secretariat DS Registry.

19. These working procedures may be modified by the Panel as appropriate, after having consulted the parties.

ANNEX G-4

WORKING PROCEDURES FOR THE PANEL

Annex

Additional Working Procedures Concerning Business Confidential Information

31 August 2010

The following procedures apply to business confidential information (BCI) submitted in the course of the Panel proceedings.

20. For the purposes of these proceedings, business confidential information (BCI) means any financially or commercially sensitive information, that is: (a) clearly designated as such by the party submitting it; and, (b) not otherwise accessible to the general public.

21. As required by Article 18.2 of the DSU, a party having access to BCI submitted in these Panel proceedings shall treat it as confidential and shall not disclose that information other than to those persons authorized to receive it pursuant to these working procedures. Any information submitted as BCI under these working procedures shall only be used for the purposes of this dispute and for no other purpose. Each party is responsible for ensuring that its employees and/or outside advisors comply with these working procedures to protect BCI.

22. Employees of the European Union, of the Governments of EU member States, of the Government of the United States and of the Government of the Philippines, who are directly involved in their official capacity in DS396 or DS403 proceedings, shall have access to BCI submitted in these Panel proceedings. Parties may give access to BCI to outside advisors acting on behalf of the parties in these proceedings and their clerical staff. Employees, officers or agents of enterprises engaged in the production, export or import of the products concerned in this dispute shall not be given access to BCI.

23. Without prejudice to the provisions on non-confidential summaries in paragraph 4 of the Working Procedures, third parties to these Panel proceedings shall receive non-confidential versions of the first submissions of the Parties to the Panel. Employees of the Governments of Australia, China, Colombia (for DS403), India, Mexico, Thailand, and Chinese Taipei, and outside advisors under the terms set forth in paragraphs 21 and 22, above, may request access to BCI contained in the first submissions of the parties to the Panel for the purpose of participating effectively in the Panel proceeding. The Panel shall decide whether to grant access to such BCI in consultation with the parties. In the absence of a showing of good cause, any such third party access to BCI will take place on the premises of the WTO Secretariat. Third parties shall be entitled to review, but not to copy, the BCI accessed on the premises of the WTO Secretariat. Third parties granted access to BCI through this paragraph will be given an additional period, if needed, to allow them to comment on BCI.

24. Panel Members and employees of the WTO Secretariat assigned to the present dispute shall have access to BCI submitted in these proceedings.

25. A party submitting BCI in any written submission (including in any exhibits) shall mark the cover and the first page of the document containing any such information with the words "Contains Business Confidential Information". The specific information in question shall be enclosed in double brackets, as follows: [[xx.xxx.xx]] and the notation "Contains Business Confidential Information"

shall be marked at the top of each page containing the BCI. A non-confidential version, clearly marked as such, of any written submission (including any exhibits) containing BCI shall be submitted to the Panel no later than the next working day after the submission of the confidential version containing the BCI. In the case of an oral statement containing BCI, the party making such a statement shall inform the Panel before making it that the statement will contain BCI, and the Panel will ensure that only persons authorized to have access to BCI pursuant to these procedures are in the room to hear that statement. A written non-confidential version of an oral statement containing BCI shall be submitted no later than the working day following the meeting where the statement was made. Non-confidential versions of both oral and written statements shall be redacted in such a manner as to convey a reasonable understanding of the substance of the BCI deleted therefrom.

26. Any BCI information that is submitted in binary-encoded form shall be clearly marked with the statement "Business Confidential Information" on a label on the storage medium, and clearly marked with the statement "Business Confidential Information" in the binary-encoded files.

27. The Panel will not disclose in its report any information designated as BCI under these working procedures. The Panel may, however, make statements of conclusion based on such information.

28. After the circulation of the Panel Report to WTO Members, and within a period fixed by the Panel, each party shall return all documents in its possession submitted as BCI in the Panel proceedings to the party that originally submitted the BCI. Alternatively, within the above-mentioned period fixed by the Panel, a party may certify in writing to the Panel and the other parties that all such documents have been destroyed, consistent with the party's record-keeping obligations under its domestic laws. The WTO Secretariat shall have the right to retain copy of the documents containing the BCI for the archives of the WTO.

29. Submissions containing information designated as BCI under these working procedures will be included in the record forwarded to the Appellate Body in the event of any appeal of the Panel's report.

30. At the request of a party, the Panel may apply these working procedures or an amended form of these working procedures to protect information that does not fall within the scope of the information set out in paragraph 20.