August 5, 2019

Governor Tom Wolf
Office of the Governor
508 Main Capitol Building
Harrisburg, PA 17120

Re. Pennsylvania Liquor Control Board "Flexible Pricing" Model

Dear Governor Wolf:

We are writing to you today on behalf of a broad coalition of leading wine and spirits industry trade associations with an important export interest in the Commonwealth of Pennsylvania. These include representative bodies of Australia, Canada, the European Union, New Zealand, Scotland and the United Kingdom.

We share a deep concern with the move away from transparent, posted and standardized product mark-ups by the Pennsylvania Liquor Control Board (PLCB), to a "flexible pricing" model.

To be entirely clear, we do not question the right of Pennsylvania to establish a monopoly importer, distributor and/or retailer of wine or spirits for the state. However, as a statutory monopoly[1], we would suggest the PLCB does have certain obligations pursuant to its preferential market position. In addition, the PLCB fits squarely under the definition of a state trading enterprise (STE) under international trade rules.

Essentially, STEs are defined[2] as governmental and non-governmental enterprises which have been granted exclusive or special rights or privileges, including statutory or constitutional powers, in the exercise of which they influence through their purchases or sales the level or direction of imports or exports.

As a state trading enterprise, the PLCB has certain mandatory requisite levels of transparency in its operations so that all can be assured that it is operating in a non-discriminatory manner and is not pursuing trade impairment or other WTO inconsistent measures.

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[1] PLCB established under Pennsylvania Liquor Code
[2] Article XVII GATT 1994

Liquor board product mark-ups are imposed by state enterprises such as the PLCB in order to generate revenue for governmental purposes. In this respect, these mark-ups are no different that other government taxes or charges and are subject to similar principles and disciplines.

Under its historic transparent, standardized pricing model if the PLCB wished to raise its product mark-up rates, it would have to impose its new rate across the board on all products and notify each supplier. A full, open debate would have ensued to ensure the democratic process was fulfilled appropriately.

Instead, with its new "flexible pricing" model an estimated $80 million increase in PLCB mark-ups were imposed in Fiscal 2018 versus Fiscal 2015[3], all largely hidden from view and in secret. Such stealth tax increases risk undermining public confidence in the role of state liquor monopolies moving forward.

More specifically, under international trade law, the PLCB is required to provide imported Spirits treatment no less favorable than the treatment provided the most-favored domestic product[4]. In practice, this means that all imported spirits must be subject to the **lowest PLCB product mark-up applied on any U.S. sourced Spirit**.

The proper role, structure and application of liquor board mark-ups have been reviewed extensively over the years under the WTO and its predecessor GATT.

In fact, the United States government has successfully challenged discriminatory internal tax policies on various alcoholic beverages on a number of occasions including the 1995 Japan, 1997 Chile, 1997 Korea, and most recently the 2010 Philippines Spirits and Alcoholic Beverages Taxes GATT/WTO disputes.

Germane to the PLCB flexible pricing model, the 1988 Panel on the "Import, Distribution and Sale of Alcoholic Drinks by Canadian Provincial Marketing Agencies", for example, refuted suggestions that the application of differential mark-ups whose primary purpose was a policy of revenue maximization by liquor boards was acceptable. Similar to the PLCB's contention, certain Canadian liquor boards had claimed that their differential mark-up policies were designed to exploit less-price elastic demand for certain products and thus should be considered justified by normal commercial considerations.

The Panel rightfully concluded, however, that a monopoly profit margin resulting from policies of revenue maximization could not normally be considered as a "reasonable margin of profit" in the sense of Article II:4 and that a reasonable profit of margin was a margin of profit that would be obtained under normal conditions of competition in the absence of the monopoly.

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[3] Source PCLB Annual Reports (Income Before Operating Transfers $109,324,324 in F2015 to $188,775,769 in F2018).
[4] Article III GATT, United States – Measures Affecting Alcoholic and Malt Beverages

We understand the PLCB may believe it is easier to raise additional revenues for the citizens of Pennsylvania in secret, behind closed doors, but we believe such an approach is inconsistent with the operation of an open and fair market. In addition, such a pricing model is clearly inconsistent under international trade law as enumerated in the attached summary analysis (Trade Law Assessment Pennsylvania Flexible Pricing Model).

We respectfully suggest, a better solution is to reinstate the PLCB's historic approach of transparent posted, standardized mark-ups, the same approach embraced and used by Pennsylvania for its other government taxes and charges.

We would be please to discuss this important matter with yourself, relevant officials in your office and/or the Legislature at the earliest opportunity.

Thank you and sincerely,

Jan H. Westcott
President & CEO
Spirits Canada

Robert Brewer
Chief Executive
Spirits New Zealand Inc.

Ulrich Adam
Director General
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Tony Battaglene
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Karen Betts
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Senator James Brewster
Representative Jeff Pyle
Representative Daniel J. Deasy
Mr. Tim Holden, Chairman, PLCB
Mr. Charles Mooney, Executive Director, LCCB

Australian Wine and Grape Inc. is the peak national grape & wine industry body of Australia and operates as a not-for-profit organization.

The CEEV – Comité Européen des Entreprises Vins was founded in 1960 and represents the wine companies in the industry and trade in the European Union.
CEEV's members produce and market the vast majority of quality European wines, both with and without a geographical indication, and account for over 90% of European wine exports.

FIVS is a global organisation designed to serve the wine, spirits, and beer sectors from around the world on public policy issues. Its members include producers, distributors, importers, exporters, and trade associations.

The Scotch Whisky Association (SWA) represents 95% of the Scotch Whisky industry including distillers, bottlers, blenders and brokers. As a trade association, we work to sustain Scotch Whisky's place as the world's leading high quality spirit drink and its long-term growth worldwide.

Spirits Canada is the national trade organization representing the interest of Canadian Spirits manufacturers, exporters and consumers.

SpiritsEUROPE proudly represents one of Europe's most valuable agri-food export sectors and, with it, the interests of 31 associations of spirits producers as well as 9 leading multinational companies. Distilled spirits are as diverse as the EU itself, spanning 47 product categories and including a host of geographically-specific products that contribute to the culture of their regions (240 GIs).

Spirits New Zealand is the national trade organisation representing New Zealand's leading producers, distributors, brand owners, importers and exporters of premium spirits and spirit-based drinks. We represent over 98% of spirit industry interests in New Zealand.

The WSTA represents over 300 companies producing, importing, exporting, transporting and selling wines and spirits in the United Kingdom. WSTA members range from major retailers, brand owners and wholesalers to fine wine and spirit specialists, logistics and bottling companies.

Trade Law Assessment Pennsylvania "Flexible Pricing" Model

Article 1:1 GATT

GATT Article I covers most-favoured-nation treatment and requires WTO Members to treat "like" (e.g. all spirit) imported products equally without regard to their origin.

Article 1:1 imposes an obligation to ensure that like products of all countries receive unconditionally and immediately any advantage that has been granted to any product originating in any country.

Specifically, under Article a Scotch Whisky must be provided the lowest PLCB mark-up applied on any Irish Whiskey, Mexican Tequila or Russian Vodka.

Article 11:4 GATT

Paragraph 11:4 prevents import monopolies like the PLCB from operating in a way that undermines the value of tariff concessions.

The PLCB's flexible pricing policy by its very nature imposes a higher mark-up and profit margin on an imported spirits than on a domestic spirit, and thus provide a higher margin than would be available in the absence of its monopoly and thus would be contrary to Article 11:4 read in light of Article 31 of the Hanava Charter.

Article III:2 GATT

Article III covers national treatment and prohibits the imposition of internal taxes or other internal charges that discriminate against imported spirits in favor of "like" domestic products.

A 1992 GATT Panel concluded that liquor board mark-ups constitute internal government charges borne by products[1] and thus imports must be provided the best treatment and lowest mark-up applied on any "like" of "directly competing and substitutable" products.

We also note that a separate Panel[2] concluded that "even the smallest amount of excess was too much and the prohibition not to tax import products in excess of domestic like products had no de minimis condition".

Article XVII, GATT

Article XVII is an anti-circumvention provision designed to prevent countries from using state trading enterprises (STEs) to avoid its obligations to provide non-discriminatory treatment.

In a number of GATT and WTO adjudications liquor boards established at the sub-national level have been confirmed as state trading enterprises under the agreements.

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[1] GATT Panel Report – Canada – Import, Distribution, and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies".

[2] WTO Panel Report – Japan – Alcoholic Beverages