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Economics of Wine Import Duty and Excise Tax Drawbacks

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The wine drawback program allows a refund of 99% of import duties and excise taxes on wine for which the importer has matching exports of commercially "interchangeable" wine. Because per-unit import duty and excise tax rates are substantial compared to the price of bulk wine, use of the program is high for bulk wine imports, which compete with wine from low-price Central Valley grapes. Bulk wine exports dominated imports until 2009 and the program stimulated import growth. Now, with imports and exports roughly in balance, the program stimulates both exports and imports—leaving net trade in bulk wine roughly in balance.

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Drawbacks go back to the Second Act of Congress, July 4, 1789, which allowed a 99% drawback on duties paid on merchandise imported into the United States if the merchandise was exported within a year. Rules covering drawbacks differ by industry and have changed many times in the past 220 years, but the guiding purpose remains to facilitate import of items that will be subsequently re-exported in order to encourage domestic value added.

Current laws governing drawbacks are found in 19 USC 1313 and are administered by U.S. Customs and Border Protection (CBP). Against this long history, drawbacks for wine have only been significant for just over a decade and have grown substantially over that period.

For about a decade, the United States has offered a refund of import duties and federal excise taxes on imports of non-sparkling wine of 14% alcohol or less whenever firms match imports with exports of wine legally defined as "interchangeable." U.S. regulations define interchangeable exports of wine for drawback eligibility as those of the same color and within 50% of the price of the imports (and of 14% alcohol or less and non-sparkling wine). A firm has up to three years to match imports with subsequent exports and claim the drawback.

The U.S. Bureau of Customs and Border Protection administers the drawback and enforces the rules of the program, mainly through audits. All discussion of wine and wine markets in this brief article refers to the broad category of wine to which the drawback applies. Wine exported to Canada or Mexico is not eligible to use as a match for imports in applying for drawbacks.

Imports, Exports, Duties and Taxes

Import duty schedules are complex. Duty rates differ for wine by specific product and country of origin, and have changed over time, especially with the implementation of free trade agreements (FTAs). For wine, the important FTAs are those applying to Australia and Chile.

Table 1 provides a summary of wine import duties and excise taxes. The total of import duty and excise tax reaches more than $0.42 per liter for large container sizes from non-free trade sources, with the excise tax larger than the import duty in all cases. These import duties compare to import prices that average more than $4.00 per liter for imports in containers of two liters or less (typically bottles) and less than $1.00 per liter for the large-container imports (most of which arrive in 1,000-liter bladders, not in consumer-ready packages).

For bottled wine imports, the duty and excise tax together account for about 10% or less of the import price. However, for bulk wine imports, the duty rate and excise tax eligible for drawbacks are often close

Table 1. Excise Taxes and Import Duty Rates

	Two liters of less[1]	Over four liters (MFN)	Over four liters from Chile or Australia[2]
	-----(cents/liter)----		
Import duty rate	6.3	14.0	4.8
Excise tax	28.27	28.27	28.27
Total	34.57	42.27	33.07

Source: U.S. International Trade Commission. 2011. "Interactive Tariff and Trade DataWeb." http://dataweb.usitc.gov/

[1] *Very little wine is traded in the two to four liter size containers.*

[2] *Import duty rates have been declining gradually for Australia and Chile in accordance with the Free Trade Agreements. Here we report and use the 2010 rates.*

to 50% of the import price—clearly large enough to affect trade.

Since an import quantity must be matched with an interchangeable export quantity in order to receive the drawback, table 2 compares U.S. imports and exports of wine by container size over the eight years from 2004 through 2011. For both imports and exports, the quantity shipped in smaller containers has declined slowly while the quantity imported and exported in bulk containers has grown rapidly.

As drawbacks have become a more prominent feature in the industry, bulk wine imports and exports both expanded. Moreover, bulk exports exceeded bulk imports by a large margin as recently as 2008, but jumps in bulk imports mean that they exceeded exports in 2009 and again in 2011.

Although we compare imports and exports year-by-year in table 2, we emphasize that drawbacks for an import shipment may be matched against exports that occur within three years. This means that a firm may qualify for the drawback so long as it ships enough eligible exports within three years of the import date.

No export data are available by color, so we are not able to compare imports and exports by that interchangeability criterion. Since there are large differences between the prices of wine by container size, we use the size category as a proxy for price in determining whether imports and exports might be considered interchangeable.

Table 3 uses data on imports by container size and source, together with data on import duty rates and excise tax rates, to calculate the approximate value of duties and taxes due from 2005 to 2010. Total duty and excise taxes over this period ranged from about $207 million in 2005 to a high of $293 million in 2009. Most of the payments are for excise taxes because of the high tax rate and most are associated with bottled imports because bottle imports are still more than three times the volume of bulk imports.

Drawbacks and Implications for Markets

There are two reasons that drawback applications are likely to be relatively small for bottled imports. First, the import quantity eligible for a drawback is limited by the quantity of matching exports and, given the price-range requirement, exports in containers of two liters or less are likely those that could be used to qualify imports in this container size for the drawback. Also

Table 2. Volume of U.S. Wine Imports and Exports, Excluding Exports to Canada and Mexico, by Container Size

	Exports				Imports			
	Container size				Container size			
Year	Two liters or less	Over two liters	Total sum	Share of exports in large containers	Two liters or less	Over four liters	Total sum	Share of imports in large containers
	----------(million liters)----------			(%)	----------(million liters)----------			(%)
2004	243.3	47.1	290.4	16.2	549.1	20.1	569.2	3.5
2005	160.2	82.9	243.1	34.1	593.7	39.6	633.3	6.3
2006	163.9	122.9	286.7	42.8	607.8	84.2	692.0	12.2
2007	175.1	150.1	325.3	46.2	659.9	92.0	751.9	12.2
2008	175.4	178.8	354.3	50.5	614.7	111.6	726.3	15.4
2009	143.7	157.5	301.1	52.3	604.6	218.1	822.7	26.5
2010	142.9	182.5	325.3	56.1	593.3	168.1	761.4	22.1
2011	144.8	174.6	319.4	54.7	672.4	215.6	888.0	24.3

Source: U.S. International Trade Commission. 2011. "Interactive Tariff and Trade DataWeb." http://dataweb.usitc.gov/

Table 3. Approximate Excise Tax and Import Duties Levied on Wine Imports, 2005–2010

	Two liters or less			Over four liters			
	Excise taxes	Import duties	Sum	Excise taxes	Import duties	Sum	Total
Year	($U.S. millions)						
2005	157.1	35.0	192.2	11.2	3.4	14.6	206.8
2006	170.1	37.9	208.0	23.8	7.5	31.3	239.3
2007	174.3	38.8	213.2	26.0	10.6	36.6	249.8
2008	186.9	41.6	228.5	31.5	12.7	44.2	272.7
2009	176.4	39.3	215.7	61.7	15.7	77.4	293.1
2010	173.4	38.6	212.0	47.5	12.7	60.2	272.2

Sources: U.S. International Trade Commission. 2011. "Interactive Tariff and Trade DataWeb." http://dataweb.usitc.gov
U.S. Customs and Border Protection, Department of Commerce. Special data request, 2011.

Note: Approximate excise tax and import duty values obtained by multiplying import quantities of wine in particular container sizes and countries of origin with excise tax rate of $0.2827/liter and relevant import duty rates in Table 1.

as shown in table 2, exports of bottled wine have remained less than one-third the volume of imports for this category.

Second, since the duty and excise tax rates are set per liter, there is much less competitive pressure to assure that bottled wine imports qualify for a drawback. The drawback is usually worth less than 10% of the import value for bottled wine. Two further complications are: First, importers of bottled wine may not be closely associated with the exports of U.S. wine and so do not have an easy way to qualify for the drawback. Second, bottled wine is often imported in relatively small lots (by volume) and so the transaction cost for qualifying for the drawback may be large relative to the benefit.

For bulk wine, these considerations are reversed. Export volumes were larger than import volumes until 2008; and in the last three years these volumes have been roughly in balance. Second, the potential drawback is large compared to the import price, so a firm that takes advantage of the drawback would have a significant net price advantage relative to the competition. Finally, some large U.S. wineries have significant roles in importing wine and producing and exporting U.S. wine.

Table 4 displays U.S. Customs data on drawbacks by container size and year of the drawback (not year of the import). Drawbacks on bottled wine have remained in the range of about 56 to 86 million liters, with no evident trend since 2005. Drawback volume has remained between 10% and 15% of import volume, and less than half of export volume, of bottled wine over the seven-year period for which data are available.

At the same time, drawbacks on bulk wine have grown from about 13 million liters to 121 million liters as imports and exports of bulk wine have both grown. Drawbacks have been claimed on about two-thirds or more of the volume of imports.

The implications of wine drawbacks for wine and grape markets in California follow from their effects on providing incentives for international trade. Most of the effects are in the bulk wine category and on the Central Valley grapes that provide the raw material for this wine.

During the period when exports already exceeded imports by a wide margin, the drawback acted as a kind of import subsidy, reducing the net price that buyers would have otherwise paid. In that situation, California wine and grape prices were lower than without the program. But, for the bottled wine category and in any period when imports would have already exceeded exports with no drawback, the program acts as a kind of export subsidy and the effects on California wine and grape

Table 4. Drawbacks by Import Container Size

	Container Size		
	Two liters or less	Over four liters	Sum
Year[1]	-----(million liters)-------		
2005	69.5	13.2	83.1
2006	78.2	43.6	122.5
2007	86.2	77.6	165.3
2008	55.6	68.3	124.5
2009	80.3	96.0	178.7
2010	66.0	121.4	188.1

Source: U.S. Customs and Border Protection, Department of Commerce. Special data request, 2011.
[1] Year in which drawback was claimed, not year of importation.

Bulk wine imports and exports have both expanded since drawbacks have become a more prominent feature in the wine industry.

prices are positive. In this case, imports would use drawback funds to stimulate the needed exports in order to allow imports to qualify for the drawback.

Under recent conditions, when imports and exports of bulk wine are roughly in balance, the drawback stimulates imports and exports by roughly the same degree and the effects on California wine and grape prices are offsetting, leaving only a small net effect.

Application of a simple simulation model shows how the effect of the drawback program for wine imports and exports, U.S. wine production and price, and U.S. grape production price depends on the pre-existing balance between import and export quantities.

How much drawbacks affect market prices and quantities depends on import and export shares, and the relevant supply and demand elasticities for wine and wine grapes—in other words, the responsiveness of wine quantity sold to price and of grape production to expected price. For example, our illustrative simulations find that during the period when exports exceeded imports, the bulk wine drawbacks probably suppressed California Central Valley wine grape prices by a few percent and, consequently, discouraged expansion of wine grape production.

The same simulation model shows that under the current situation in 2012, with imports at or exceeding exports, the program may stimulate slightly higher grape prices and production because drawbacks effectively stimulate wine exports. These aggregate implications mask benefits and costs to some firms or farms that are best suited to exports or compete most directly with imports.

Firms that produce and trade wine, and already export and import significant quantities, find the drawback program easy to implement. Firms that are small or operate solely in the domestic market, or are only importers or only exporters, must establish new business collaborations to access the drawback program.

Conclusions

Drawbacks are one of the oldest features of U.S. international trade policy, but are new to the wine industry. The drawback program was one stimulant of the rapid increase in bulk wine imports over the past decade and probably suppressed grape prices in the California Central Valley in the early to middle years of the past decade.

Currently, with imports at or exceeding exports, the drawback does as much to stimulate exports as imports and thus has, at most, small impacts on the relevant wine and grape markets in aggregate. Nonetheless, data on drawbacks are difficult to obtain and much more in-depth empirical research is needed to fully understand the operation of the program and its implications.

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For additional information, the authors recommend:

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