

## Walpole Response to USTR Consultation – 24.7.20

### 1. Walpole and The British Luxury Sector

Walpole is the UK's Luxury Goods sector body and represents more than 270 member companies from the high-end creative and cultural industries with members spanning brands including Alexander McQueen, Burberry, Claridge's, Glenmorangie, Harrods, NET-A-PORTER, Rolls-Royce Motor Cars, Wedgwood and numerous small and medium-sized enterprises (SMEs), which currently make up 60% of the sector, such as, Chapel Down, Ettinger, Floris, Savoir Beds and Temperley London. Walpole and the British luxury sector's work is underpinned by continuous innovation, a relentless focus on quality, sustainable business practises, highly skilled employment and strong exports abroad. Our members strive for the highest quality in all they do, from products and services to the customer experience.

Prior to the Covid-19 lockdown, the British luxury sector was growing at 9.6% annually, outpacing UK annual growth of 4%. The UK's high-end creative and cultural industries – of which the luxury sector is part – performed strongly with the overall contribution rising 49%, from £32.2bn to £48bn between 2013 to 2017<sup>[1]</sup>.

The US is one of the largest luxury markets in the world and British luxury's largest export market behind the EU, with 23% of its goods leaving our shores destined for North America. 75% of British luxury brands identify the US as their priority growth market and the ability to export is key to UK luxury business' growth and international expansion.

On behalf of our members we welcome the opportunity to participate in the USTR review, to submit comments on the items included in the three annexes and to highlight the impact of the tariffs on both US / UK trade and American customers.

### 2. US & UK Luxury Goods Trading Relationship

Despite China's rising dominance in the global luxury goods market, the US remains the largest luxury market in the world worth in the region of \$85bn Bain-Altgamma - Worldwide Luxury Market Monitor 2019).

Following a centuries old trading relationship, the American customer is recognized for being highly discerning with a long-standing appreciation of the quality, craftsmanship, creativity and

heritage of British luxury goods. For the most part choosing to purchase domestically, due to pricing, American customers appreciate the finest cashmere and whisky from Scotland, world class sparkling wines; innovative and distinct gins, hand-crafted leather goods and bespoke tailoring.

Distributed through a carefully managed network of well-known US owned department stores, independent boutiques, digital players and the brands' own stores from New York to LA, British luxury brands on average export 20% – 25% of their products to North America.

In recognition of the importance of the market, British brands have invested heavily in their North American operations – nurturing long-standing relationships with the leading department store chains and smaller retailers, creating thousands of sustainable jobs and employment in the thriving luxury sector, providing continuous training for employees as well as investing heavily in marketing which in turn drives the revenues of US-owned media houses and digital players.

Additionally, British and American businesses have invested in national brands and businesses - providing capital, sharing expertise as well as the established routes to market and networks to realize the potential of those businesses internationally. An example of this exchange is the whisky industry - American companies have invested in Scottish companies and British companies have invested in American companies to produce whisky. UK producers share knowledge on how to craft the world's best whiskies, move talented employees between different sites, and trade in oak casks in which the whiskies have matured. The development of the trans-Atlantic spirits industry over the last 25 years has been an important free trade success story.

This commercially successful relationship is also underpinned by a strong cultural relationship – customers on both sides of “the Pond” valuing the cultural ties between the brands, cultural partners and customers.

The US and UK luxury goods markets enjoy a positive trading relationship, recognizing the mutual value brought to both economies and the range of product choice offered to American customers through decades of investment.

### **3. Mounting Trade Tensions and the Impact of Tariffs**

Unfortunately, the long-standing American and UK luxury goods trading relationship has been caught in the cross fire of mounting trade tensions including both the Boeing Airbus dispute (the focus on this consultation) and also the Digital Services Tax. Both disputes involve sectors outside of the luxury and high-end industries but sadly this long-established and mutually beneficial trading relationship is a collateral victim and is suffering as a result.

In relation to the Boeing Airbus dispute following approval from the WTO in autumn 2019, retaliatory tariffs of 25% have been directly targeted at European luxury goods imports including whisky, liqueur and wine, cashmere, bed linens and men's and women's clothing as identified in Annex 1. In addition, the potential introduction of tariffs for goods listed in Annexes 2 and 3, which include china and glassware, handbags, sparkling wines, gin and vodka could affect a significant proportion of the UK luxury goods imports to the US.

The implementation of the tariffs has a number of unforeseen and damaging effects on the American and UK luxury goods trading relationship as highlighted below and a number of examples are included in Appendix 1.

### **Rising costs can only be passed on to US consumers and will lead to contraction in goods volumes**

Unfortunately, the impact of the tariffs will punish the American customer either as a direct result of price increases, as businesses are no longer able to absorb the costs of the tariffs or through limiting choice as businesses become increasingly unable to distribute those goods to the US as the cost of doing business continues to be prohibitive. Tariffs generally lead to higher prices and for the luxury industry, which has a relative price elasticity, there is a real risk of a contraction in volumes. The artisanal nature of luxury products results in small profit margins and smaller economies of scale, particularly for SMEs. Other industries may partially recover tariff costs via purchase flows, but this is not always possible in the luxury market. American customers value and appreciate the quality of European luxury goods and while alternatives are available, they lack the allure, quality, heritage and cache of the European brands for this highly discerning customer base.

### **Impact on US jobs**

Businesses are already under financial pressure in these early recovery stages of the economic impact of the Covid-19 crisis. A continuation of the existing tariffs or the implementation of tariffs on items in Annex 2 and 3 or potential increases in tariffs will drive up operating costs at a time when every business is necessarily managing costs closely and looking for areas for growth.

The majority of UK luxury goods businesses are small to medium enterprises (SMEs) and are disproportionately affected by these tariffs and face difficult decisions in this climate should the tariffs continue to be applied or increased. The smaller players who supply a network of US based stores and boutiques have informed Walpole that they will need to look at restructuring their US

operations, leading to job losses and we have heard of businesses considering closing their US offices as operating costs have become commercially unviable. These businesses may necessarily instead look to opportunities in fast-growing regions, where demand is growing rapidly and operating costs are lower.

### **A blocker to the success story of free trade**

European high-end and luxury brands recognize the value of the American market and have invested heavily in their operations and marketing, nurturing the network of distributors and providing exceptional customer choice and service. The trading relationship is an incredibly positive one with mutual benefit for both economies and the American customer. However, the impact of the tariffs and the potential widening of the items to be included and/or the increasing of the percentage is a barrier to further support and investment at a time when businesses are responding to the immediate impact of the Covid-19 crisis.

Furthermore for many SMEs, the US is their first international market, importantly supporting the US luxury goods market with a pipeline of innovative new brands which are particularly appealing to American customers. The side effect of tariffs is to create barriers to market entry at a time when businesses are carefully looking at their strategic investments and where they are most likely to be able to maximize their returns. Unfortunately, the consequence of these tariffs and the potential of further increases diverts investment to other fast-growing regions, where the barriers to entry are lower.

### **A disproportionate effect on particular manufacturing regions and an imbalance between different markets**

Another theme that should not be underestimated is the possible disorder in the pricing map if tariffs persist, which aims to maintain the balance between the different markets. The differentials between one country and another could change, with a shift in consumption and consumer flows in different areas<sup>1</sup>.

Scotland – the producer of cashmere and whisky – is disproportionately affected by US tariffs. US independent retailers have long supported Scottish cashmere. It is an important revenue stream for them and Scottish production allows them to differentiate themselves from mass retailers who

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<sup>1</sup> Ferruccio Ferragamo [https://www.repubblica.it/economia/affari-e-finanza/2018/04/09/news/il\\_top\\_del\\_made\\_in\\_italy\\_alla\\_prova\\_dei\\_dazi\\_tra\\_usa\\_e\\_cina\\_a\\_rischio\\_50\\_miliardi\\_di\\_export-193375531/](https://www.repubblica.it/economia/affari-e-finanza/2018/04/09/news/il_top_del_made_in_italy_alla_prova_dei_dazi_tra_usa_e_cina_a_rischio_50_miliardi_di_export-193375531/)

sell Chinese produced product. The US is also an important market for Scottish Whisky, responsible for 22% of global exports and worth over £1 billion at export value. The sector is paying over 60% of the UK's tariff burden: 6 times more than metals and construction, 8 times as much as dairy.

#### 4. The Need to Support Free Trade and Abolish Tariffs

The US is a priority market for the UK luxury sector – American customers highly value quality, heritage and artisanal luxury goods and the potential for mutually beneficial trading has been well demonstrated prior to the introduction of the tariffs. The benefits to the US are significant - they include an increase in consumer choice, a lessening reliance on Chinese manufactured goods, investment and support of the US retail and media sectors, support for US based jobs and the opportunity to share expertise which supports homegrown US luxury goods producers.

The luxury business model is export-orientated but involves high levels of investment given the importance of retail operations into offering the level of service and experience that is expected of luxury brands and is particularly sensitive to the effect of tariffs. Prior to the COVID-19 pandemic UK luxury businesses were in significant expansion phases, with the US a priority, but at a time where businesses have been hit hard by this global crisis, the imposition of tariffs on their products could be a fatal blow to further local investment.

Walpole urges the US and EU authorities to act quickly to de-escalate this trade war which unnecessarily harms a commercially and culturally important trading relationship that dates back centuries and has a positive mutually prosperous future.

## Appendix I

### Examples of the damaging effects of the tariffs on the US and UK Luxury Trade Relationship

#### Scottish Cashmere

The tariffs disproportionately effect the small number of Scottish cashmere manufactures, imposing an additional 25% import duty. Initially the Scottish cashmere manufacturers have taken the hard choice of absorbing costs not wanting to pass them onto the businesses they manufacture for or to the American customer. However, this is not a long-term solution. Manufacturers may have consider restructuring their US offices as well as price hikes which will be felt by the American customer. The unforeseen effect of the tariffs will punish the consumer and may also impact US jobs.

#### Whisky

The development of the trans-Atlantic spirits industry over the last 25 years has been an important free trade success story. In many instances, American companies have invested in Scottish companies, and conversely UK companies have invested in American companies. They share knowledge on how to craft the world's best whiskies, move talented employees between different sites, and trade in oak casks in which whiskies are matured. However, distillers on both sides of the Atlantic are now losing, as a result of this trade dispute. Within the EU, US whisky has seen a 21% loss in market share. Within the US, Scotch Whisky exports fell 25% between October 2019 and March 2020. The US is an important market for Scottish Whisky, responsible for 22% of global exports and worth over £1billion at export value. The sector is paying over 60% of the UK's tariff burden: 6 times more than metals and construction, 8 times as much as dairy. All distillers are calling for a return to zero-tariffs and a fast resolution of the trade disputes.

#### British Gin

The US is an important market for British gin. Exports were worth £206.5m last year (an increase of 8% on 2018). British Gin accounts for approximately 40% of the total market share in the US, and so the sector would be disproportionately affected in the same way that Scottish whisky is by the current tariffs.

W A L P O L E

## Bespoke Tailoring

US customers have reported that they were surprised by import duty and that it seemed high. If they were to increase to above 25% and up to 100% customers would be dissuaded from ordering new garments. This is neither fair nor reasonable for producer and customer. It would impact severely on the UK's bespoke tailoring industry and provide no positive benefit for job numbers in the US.