

ECONOMY, ENERGY AND FAIR WORK COMMITTEE

COVID-19 – impact on Scotland’s businesses, workers and economy

SUBMISSION FROM

Scotch Whisky Association (SWA)

Introduction

The Scotch Whisky Association (SWA) is the Scotch Whisky industry's representative body and we welcome the opportunity to submit evidence to the Economy, Energy and Fair Work Committee's inquiry "COVID-19 – impact on Scotland's businesses, workers and economy".

The SWA's 75 member companies, all of whom are distillers, blenders, owners of proprietary brands, brokers or exporters, together comprise around 95% of the industry's distilling and blending capacity. Our membership includes companies of all sizes, from large multinationals to very small enterprises. The SWA works to sustain Scotch Whisky's place as the world's leading high-quality spirit drink and its long-term growth globally. This includes ensuring that Scotch Whisky has fair access to all markets worldwide and taking action to prevent unfair competition from fake products.

Scotch Whisky is the world's number one internationally traded spirit. 90% of all Scotch Whisky produced is exported, with 42 bottles of Scotch Whisky shipped every second to 180 countries around the world. The value of Scotch Whisky exports in 2019 reached a record £4.91 billion, an increase of 4.4% compared to 2018.

The Scotch Whisky industry is a significant contributor to the Scottish and UK economies. The industry supports 40,000 jobs across the UK, and employs 11,000 people directly in Scotland, 7,000 of whom work in rural areas. With £5.5 billion economic impact across the UK economy, the sector is one of the largest net contributors to the UK balance of trade in goods. Scotch Whisky represents 75% of all Scottish food and drink exports, 20% of all UK food and drink exports, and 1.3% of all UK exports.

The COVID-19 crisis

The Scotch Whisky industry operates globally, and a global pandemic like COVID-19 impacts our export-driven sector very significantly. Our largest export regions (by value share) are the European Union (30%), North America (26%), and Asia & Oceania (25%).

The current global health crisis comes at a time when the industry is already facing other headwinds. Significant among these is the 25% tariff imposed by the United States on Single Malt Scotch Whisky and Scotch Whisky liqueurs in October 2019. The US is Scotch Whisky's largest and most valuable market. As a consequence of the imposition of tariffs, Scotch Whisky exports to the US fell by 27% in the final quarter of 2019.

Reduced routes to consumers in markets around the world will have a direct impact on the industry's contribution to the Scottish economy. While we expect demand to start to increase in the weeks and months ahead, it will not be a 'V' shaped recovery. While it is too early to quantify the impact of COVID-19, we believe it will be some time before routes to market return to pre-crisis levels.

Impact of COVID-19 on the Scotch Whisky industry in Scotland and UK

Operational capacity

The health and safety of our workforce is the industry's overriding priority as coronavirus has spread through the UK and our export markets.

As a result, the industry has either closed operational sites or significantly scaled-back activity to ensure that all companies can strictly adhere to Food Standards Scotland and Scottish Government guidance on social distancing, additional hygiene measures, and travel to and from work. Consequently, nearly two thirds of employees normally required to work at company premises are now not required to do so. Where companies continue to operate in a limited capacity, all are compliant with social distancing guidance.

In taking measures to ensure the safety of our staff where they continue to work at industry sites, companies have consulted staff and unions in detail, and that dialogue continues. We have also shared best practice between companies, and smaller companies have benefited from the experience of larger ones who had introduced innovative distancing measures in facilities overseas before the virus spread to the UK. Distillery visitor centres closed in advance of government advice to do so and remain closed.

Hand Sanitiser Production

The Scotch Whisky industry has quickly pivoted to produce significant quantities of ethanol and hand sanitiser to support the fight against COVID-19.

The SWA launched an [online portal](#) on 25 March to help with the supply of hand sanitiser to frontline NHS, care and social services; emergency services; Councils and local service providers; local communities; and other industries in need of sanitiser across the UK. A number of Scotch Whisky producers are either supplying high-strength alcohol for the production of hand sanitiser or producing hand sanitiser themselves, with some distillers able to do this at scale, to help meet unprecedented demand.

SWA members have now committed 13.5 million litres of ethanol, equivalent to more than 54 million bottles of hand sanitiser, and we expect this figure to continue to rise. This is in addition to the hand sanitiser that many distilleries are providing to support local services and their local communities.

In addition, Scotch Whisky companies have provided funds to charities and foundations which support on-trade staff affected by the shutdown of the hospitality sector. Many are also engaging in other initiatives, such as providing online training for bartenders.

Responsible Drinking

The industry remains fully committed to promoting responsible consumption during the crisis, and this is reflected in company marketing. Companies are repurposing responsible drinking programmes focussed on people who choose to do so consuming alcohol exclusively in the home while the hospitality/on-trade sector remains closed.

The sector continues to support Drinkaware, the UK's independent alcohol education charity. Drinkaware has, with the support of their independent Medical Advisory Panel, developed a range of information and resources relating to alcohol-related risk during the coronavirus pandemic. This includes specific content on the Chief Medical Officers' low risk drinking guidelines; information on alcohol and isolation, anxiety and mental health; alcohol and sleep; alcohol and the immune system and alcohol and medication is available on their website <https://www.drinkaware.co.uk/alcohol-facts/drinking-habits-and-behaviours/alcohol-and-coronavirus/>.

The Scotch Whisky Action Fund, established in 2013 by the SWA, has made over 50 awards to initiatives across Scotland working to reduce alcohol-related harm. By 2023, the Fund will have provided £1m of support to charities and has recently announced ongoing support to four initiatives aimed at tackling alcohol misuse in Scotland. More information here: <https://www.scotch-whisky.org.uk/newsroom/scotch-whisky-action-fund-announces-further-support-to-projects-across-scotland/>

The SWA is also promoting this across our social media platforms. In addition, member companies are actively engaging in responsible drinking campaigns through the International Alliance for Responsible Drinking (IARD).

Government Guidance

As guidance for businesses is updated as we move from the 'response' phase of the crisis to 'reset', 'restart' and 'recover', we support where possible a clear and consistent approach across the UK. We would urge the UK, Scottish, Welsh, and Northern Irish governments to co-ordinate their approaches as far as possible, and where they cannot to ensure that knock-on impacts are fully understood. Our companies and our UK supply chain operate in a single, UK market and differing guidance causes confusion.

Varying advice across the four nations can also lead to market distortions. It could cause Scotch Whisky to become less competitive across the spirits category in the UK, not least if it led to imported spirits becoming easier for consumers to buy. If companies are unable to resupply overseas markets, this could lead to a loss of market share against competitor whiskies (e.g. American, Canadian, Japanese, and Irish), which have continued to produce and export throughout the crisis. Losses in market share will impact Scotch Whisky's ability to recover from the crisis, which could in turn impact jobs.

Supply Chains

The resilience of the Scotch Whisky industry is vital to our supply chain partners. The Scotch Whisky industry has a close relationship with the Scottish agricultural community. Scottish farmers provide the industry with high-quality cereals for distillation; and the industry supplies by-products, such as draff and pot ale, which are used as animal feed.

In 2018, approximately 1.2m tonnes of cereals were used in distillation, with 93% of malted barley and 91% of wheat used at Scotch Whisky distilleries coming from Scottish sources. Over 875,000 tonnes (moist basis) of the industry's by-products were available for animal feed.

We support the NFUS submission to this enquiry which states: *“NFUS believes that for those breweries and distilleries that can continue production under safe social distancing guidelines then there could be scope for Scottish Government to incentivise them to remain open and in production.”*

Other supply chain partners, including glass manufacturers and hauliers, need also to be considered since government policy for one sector will impact others.

Government support

The SWA welcomes the range of business and export support that has been offered so far by the UK and Scottish Governments in response to the coronavirus crisis; this is giving much needed assistance to our member companies and our supply chain.

However, further support may be needed the longer the lockdown lasts at home and in export markets. For example, while we welcome the Job Retention Scheme (JRS), staff costs are only a proportion of the costs companies must continue to honour and does not account for the thousands of employees working for our member companies in overseas markets.

The Scottish Government has announced a series of economic and financial measures on business rates and loan support, closely replicating measures taken by the UK Government. However, so far these have not covered distillery visitor centres, which do not neatly fit within the business rates definition of “leisure, retail and hospitality”. A number of smaller companies, particularly in rural communities, rely on tourism for up to 70% of their income, which helps them to build their brands and is also a significant source of income. Distillery visitor centres, now closed, are key to their businesses, especially in the early years before they can release their whisky after the mandatory minimum three-year maturation period. Many of these companies are finding it difficult to access financial support beyond the JRS. Therefore, we believe it is important that the existing business rates relief and the grants packages are extended to recognise this.

Smaller and/or newer Scotch Whisky producers are particularly exposed during this crisis, given the loss of income due to the impact of COVID-19 on tourism and on travel more broadly, which prevents companies conducting their businesses internationally, including meeting international customers (at home or overseas) and opening up and building new markets. Also, reduced production capacity during the lockdown means they will have less product to sell in three years' time (post-maturation).

Deferring the payment of excise duties to HMRC would help sustain the liquidity and cash flow of Scotch Whisky businesses. Together with fellow trade bodies, the SWA has written to the Chancellor of the Exchequer to ask for the deferment of duty payments for at least three months to help our sector with cashflow pressures. This is particularly important to small and mid-size producers, many of whom are facing serious financial pressures with continued overheads and starkly reduced revenue. A deferment of excise duty payment would be in line with action taken by other governments around the world, including the US, Germany, Belgium, and the Netherlands. As a sector operating in international markets and competing with other international spirit categories, it is important to us that government supports our industry in a not dissimilar way to the support received by our competitors during the crisis.

Furthermore, disruption to international freight and travel operators has a knock-on effect on the Scotch Whisky industry's ability to move stock to export markets. The SWA encourages the UK and Scottish Governments to take measures to support these sectors to keep trade flowing.

Regulatory Environment

The Scottish government's 'State of the Economy' report (April 2020) states that the *"cumulative impacts...appear greatest for manufacturing, construction, retail & wholesale, accommodation & food services and arts, entertainment and recreation. For these sectors, overall risk exposure to the economic effects of COVID-19 may be greatest."*

As an important part of the Scottish manufacturing, retail and tourism landscape, we believe that the Scottish and UK governments should suspend policy measures that will hamper the Scotch Whisky industry's recovery and our ability to contribute to Scotland's broader economic recovery. For example, alcohol marketing restrictions – which would limit the industry's ability to encourage consumers to visit distillery visitor centres and so build their brands - and the Deposit Return Scheme, which presents a number of challenges as currently designed and could slow the industry's ability to meet its sustainability targets as well as limiting the supply of high-quality glass available in Scotland.

The industry would welcome further discussions with the Scottish and UK governments on the regulatory environment, which we believe should be geared towards economic recovery with existing policy proposals reviewed to ensure they are fit for purpose in a post-COVID-19 context.

Tourism

Tourism has been particularly hard-hit in the COVID-19 crisis, and this will impact our sector. In 2018, there were over two million visits to Scotch Whisky visitor centres, making distilleries collectively the third most popular tourist attraction in Scotland. Visits to distillery visitor centres have increased by 54% since 2012, underpinned by significant investments by Scotch Whisky companies. This has boosted employment in rural Scotland: in 2018, 710 people were directly employed in Scotch Whisky tourism across Scotland.

We expect whisky tourism to be hugely impacted in 2020 and well into 2021 as a result of COVID-19. Any rise in domestic tourism – if this becomes possible this summer – will not compensate for the loss of international tourism, with a corresponding impact on our sector's ability to contribute to economic recovery, particularly in rural Scotland, in the short to mid-term.

At the right moment, we would urge the Scottish and UK governments, as well as Scotland Food & Drink, Visit Scotland/Scotland Is Now, to invest heavily in promoting the UK, and Scotland in particular, in key export markets as a great destination to visit – promoting the tourism offer of the Scotch Whisky industry whenever possible.

This underscores the importance of extending business rates relief and the grants package to include whisky distilleries.

Pubs and Hospitality Sector

Spirits, including Scotch Whisky, play a key role in the UK pub and hospitality sector. Spirits account for 34% of all sales in UK pubs.

Our industry fully supports the measures put in place to close the hospitality sector to slow the spread of COVID-19 and to protect the NHS; as well as the financial support put in place for businesses that had to close. Even when pubs and the wider hospitality sector start to re-open, we think it will be some time before trade returns to pre-crisis levels; and consumer confidence will take time to build. Some estimates suggest that footfall in the UK hospitality sector could be reduced by half when premises are able to re-open. This will impact the Scotch Whisky industry's recovery too. We fully support the consideration that governments are giving to the long-term impact on the UK on-trade, and specific measures to support the sector.

Investment

Over the last five years, the Scotch Whisky industry has invested over £500m in capital projects across Scotland; for example, in expanding production capacity in order to scale-up exports. This has boosted employment and local supply chains, adding to the significant contribution the industry makes to the Scottish economy.

COVID-19 means that we are likely to see a reduction in capital expenditure in the short to mid-term, as companies refocus financially.

Impact of COVID-19 on the Scotch Whisky industry in export markets

There are four main routes to market for Scotch Whisky to reach its global consumer base, which are of varying significance in terms of export value and volume:

- On-trade, e.g. bars, pubs, restaurants, hotels etc;
- Off-trade, e.g. supermarkets and other retailers, off-licences, specialist shops, or alcohol retail monopolies where they exist;
- Global travel retail, i.e. airports;

- E-commerce, i.e. online sales of alcohol in countries where this is permissible. This is still a relatively small but increasingly growing sales channel for our sector.

To stop the spread of COVID-19, strict social distancing measures have been introduced by governments across the globe. As a consequence, the hospitality, tourism, and aviation industries have come to an almost complete halt in many parts of the world. With the closure of bars, pubs, restaurants, and hotels, and the grounding of planes, two of our industry's four sales channels are, temporarily, no longer available. Consequently, the on-trade and global travel retail sales of Scotch Whisky in markets around the globe, which account for 31% of total consumption volume, have seen a stark decline.

Some governments have gone further and banned the sale of alcoholic beverages altogether, e.g. in South Africa, India, and Thailand, while Panama is imposing a ban on alcohol consumption in private homes.

Impact on On-trade (hospitality industry)

Before the outbreak of COVID-19, 25% of global in-country Scotch consumption (excl. travel retail) was accounted for by on-premise sales. In some of our key export markets the on-premise volume share can be significantly higher, e.g. China (68%), Brazil (36%), India (35%), and Taiwan (29%).

In the first of its COVID-19 impact snapshot series, issued on 21 April, the IWSR (International Wine and Spirits Research, the leading source of data on the alcoholic beverage market worldwide) notes that the near complete loss of the on-premise sector has had a significant impact in 10 key markets, including the US, China, India, France, and South Africa. Losses have not been compensated for by an increase in sales through other channels (e.g. retail).

It is not clear how on-trade sales will recover when the restrictions on the hospitality sector start to be eased. It seems likely that restrictions will remain in place on restaurants and bars longer than on other sectors of global economies. Economic reports suggest that many, especially smaller, establishments may go out of business before they can re-open. The IWSR analysis forecasts that in the US, 20-40% of bars and restaurants may not survive the COVID crisis.

We anticipate that, when the on-trade reopens, social distancing measures will remain in place. We believe that consumer behaviour will probably also be impacted as people might hesitate to visit venues to sit, eat and drink in relative proximity to others.

There are some signs of slow recovery in China where the Hubei lockdown has been lifted and restrictions have gradually been eased elsewhere, including the reopening of parts of the on-premise. Yet, as the IWSR reports, strict social distancing rules slowed trade in re-opened bars in Shanghai and Beijing in the first week of April.

Global Travel Retail

Another key outlet for Scotch Whisky is global travel retail. Global travel retail sales are focussed on high-end and speciality products not usually available elsewhere, so these products cannot immediately be sold on other channels. If global travel retail were a country, it would be Scotch Whisky's third-largest market by volume and largest market by value.

Travel bans and lockdowns around the world have led to a marked drop-off in air travel. It is as yet unclear when air travel will start to recover and when airport retail will start to come back onstream. Passenger revenues are estimated to fall 55% in 2020, meaning a \$314 billion decline for global airlines, and many airlines are warning they may face bankruptcy. Global air travel for April is 93% down on last year, and expectations are it will be 94% down in May. That being the case, we do not believe demand in global travel retail will recover for at least two years.

Retail and E-Commerce

In most of our global markets, consumers are still able to purchase Scotch Whisky from supermarkets and alcohol retailers. In some developed markets, such as the US there has been an increase in sales – up 10% year on year in March.

In markets with a functioning e-commerce structure, this has become an important channel to meet consumer demand. SWA member companies have confirmed a significant increase in e-commerce in a number of markets, albeit often from a low level.

COVID-19 Recovery

In the early COVID-19 recovery phase, we anticipate a period where routes to market and supply chains remain fragmented, and companies may be pausing or reducing market investments and protecting cash flows. This will have a material impact on their ability to develop exports.

In normal trading conditions the sale of fake products carries multiple risks: consumers are misled; there are potential health risks; governments lose revenue as a result of unpaid tax and duty; and legitimate products face loss of sales and damage to reputation. The crisis exacerbates all these risks. Distribution channels and supply as well as availability are all severely disrupted. When we come out of the crisis, it will take time to re-establish channels and, with consumers likely to have less to spend, counterfeiters will seek to take advantage of supply chain weaknesses and consumers trading down to cheaper products. Producers of premium products, such as Scotch Whisky, will need to be vigilant in protecting their interests in their brands and in the Scotch Whisky geographical indication. Our industry will need to work closely with enforcement authorities at home and abroad where problems arise, and we will need their active engagement and support.

It is important to ensure that once COVID-19 restrictions have been lifted, trade-restricting measures put in place to combat the disease should be removed. This applies to measures such as alcohol sales bans and other restrictions, e.g. reduced sales hours, or a prohibition of alcohol sales online, where these have been introduced in response to the crisis.

Where governments have introduced regulatory relaxations that have worked well, such as allowing e-commerce in the beverage alcohol sector where this has not been possible before (e.g. in South Korea and Latvia), we believe that regulators should consider making those permanent after the crisis has passed, with appropriate controls. Given the likelihood that the disruption to the on-trade will remain in place for some time, enabling e-commerce opportunities in key export destinations will help the Scotch Whisky industry navigate the post-crisis period.

In the medium and longer term, as countries move into the recovery phase, we could see protectionist measures, tax and/or tariff increases, or the (re-)introduction of discriminatory taxes emerging as governments try to support domestic industries and raise revenue to shoulder the economic burden of the pandemic. Where this is the case, and especially if it is in violation of WTO rules, it will be important for the Scottish Government to urge the UK Government to engage on behalf of our sector.

In addition, to facilitate exports further and mitigate the economic impact of the pandemic, it will be critical for the Scottish and UK government's trade networks to put adequate resource into their market access work to remove recently introduced or longstanding trade barriers in export markets around the world. Scotch Whisky exporters face a number of barriers to trade in global markets, including high tariffs, discriminatory taxes, burdensome customs procedures etc. The removal of such barriers to trade would facilitate economic recovery. Successfully addressing market access barriers can deliver results quickly, especially in our industry's priority markets. The SWA's immediate priority markets to tackle on-going barriers to trade include the US, India, China, Thailand, Vietnam, Brazil, Mexico, South Africa, and Nigeria. In the longer term we hope the UK Government will work closely with our sector on future Free Trade Agreements with key trading partners.

US tariffs

Even before the COVID-19 crisis, we had started to see a significant drop in exports as a result of tariffs imposed on Single Malt Scotch Whisky and Scotch Whisky Liqueurs under the Airbus/Boeing dispute (exports of Scotch Whisky to the US fell by 27% in the final quarter of 2019).

In the context of the global economic damage caused by the pandemic, the use of retaliatory tariffs is counterproductive. Economic recovery will rely on stable trade flows. The immediate suspension of US tariffs on Single Malt Scotch Whisky and Scotch Whisky liqueurs would give valuable breathing space to our industry.

It is critical for our sector that the UK government ensures the lifting of the tariffs on both Scotch Whisky exports to the US and American whiskey exports to the UK through the bilateral trade negotiations with the US as soon as possible. We believe that a firm pledge from both sides to return to tariff-free trade on whiskies could set the tone for constructive, broader bilateral talks.

Conclusion

The Scotch Whisky industry has proved resilient in the face of past crises. We believe that the sector will adapt and cope in the face of the current COVID-19

pandemic. However, the size and shape of our sector could well change, as has been the case in previous crises.

Different companies will manage in different ways; and some companies may find it very difficult to sustain operations through the crisis. This will be particularly true for younger companies and start-ups.

The COVID-19 presents a number of challenges for the industry, some immediate and some longer term. We want to play our full and vital part in the economic recovery, and to work constructively with governments and policy makers in ensuring that damage to our industry, and to the livelihoods and communities we support, is minimised.