

Reform of the CMO for grape and wine production: What model of organisation for the *Appellations d'origine*?

Study carried out by



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The purpose of this document is to reach a complete analysis of the proposals of the European Commission relating to the development of a reform of the CMO for wine production.

It concerns the management requirements for regional products bearing a geographical indication of established reputation.

This document is a study of proposals. It aims to produce ideas and not to formulate political proposals.

Notice

This document aims to clarify the **legitimacy of the practices of market regulation for wines bearing a geographical indication and enjoying a high level of established reputation, which will hereafter be referred to as 'Appellation d'origine'**. From this point of view, we refer not only to the French AOC category, but also to Spanish, Portuguese and Italian DOC or other wines from countries enjoying a good reputation.

The document is so structured to concentrate on current and foreseeable practices for the regulation of markets, as well as on desirable developments of the CMO for wine production to reach a long term organisational target for the sector which the authors judge would be effective in the context of the greater liberalisation expected for 2013. The CMO is here seen as a framework tool for transition to this model and it is from this perspective that the recommendations given are to be understood.

The economic arguments (chapter 2) on which our reasoning are based are developed in detail in the annexes, in particular as far as results shown by the economic literature are concerned.

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Reform of the CMO for wine production

What model of organisation for the *Appellations d'origine*?

1. Introduction

The necessity for an in-depth reform of the current wine CMO is motivated by the observation of the failure of the current system: despite the strong support dedicated to the wine sector, it is confronted today to

- a durable structural imbalance between production and marketing, the consumption of wines from the EU being in retreat not only in the Member States but also in third countries, despite an overall (though admittedly weak) growth in world consumption;
- the existence of surpluses, including surpluses of *Appellation d'origine* (AO) wines, resulting from losses of market share.

In its report to the European Parliament, the European Commission proposes reform through the concept of a CMO for transition, the aim of which should be to provide a framework for the progressive liberalisation of the sector, as desired for 2013. It has therefore pronounced itself in favour of a simplification, involving immediate suspension of financial assistance for market support measures (distillation in particular), and foresees an arrangement for non-competitive operators to leave the sector through subsidised grubbing-up vineyards, with the grubbed-up areas then becoming eligible for Single Farm Payments¹. Finally, with the aim of improving the sector's competitiveness compared with wines from third countries, it aims to make those elements which are immediately restrictive for operators more flexible: with liberalisation of planting rights, opening-up of oenological practices, access for table wines to label markings which add value, such as grape varieties and years, etc.

As for competition between the European Union and third countries, there are two rival models for organising this sector and for the related public policies, the four main points of rupture being:

- European-level management of the potential of production by the public powers through the limitation of planting *versus* liberty of planting encouraged by investment aid mechanisms (example of Australia)
- Choice of a European position stressing the link to *terroir* through public signals of quality like AOC or DOC and the protection of such origin (which may be to the detriment of other categories not possessing such markings) *versus* little or no regulation of indications of origin
- Vertical separation of production and marketing in European wine-making, with vinification mainly carried out by highly fragmented production structures *versus* upstream/downstream integration with vinification at the stage of first marketing carried out by large-scale enterprises
- A relative weakness of financial resources and skills for sales and marketing in Europe among regional wholesalers which are often small-scale, *versus* access to external financing for massive investments in these areas by multinationals.

Starting from this analysis, a simple explanation of the statement of the 'failure' of the European model may consist of saying that the choice of an orientation explicitly or implicitly resting on a model of *Appellations d'origine* and of strong regulatory constraints has deprived the sector of a capacity to offer appropriate and competitive products to new consumers.

¹ The reform of the Common Agricultural Policy (CAP) introduced the principle of decoupling direct aid. Starting in 2006, decoupling will be applied in France, with two types of aid being available: aid that is coupled to production and a new, decoupled, type of aid. The latter is based on a mechanism for rights to single payments, which are individual and linked to a surface area. Payment, whether there is any production or not, is conditional on keeping these areas in a satisfactory agronomic condition (conditionality). These rights to single payments are established, for each operator, on the basis of historical references from 2000, 2001 and 2002. This historical reference is understood as a record of the average aid received between 2000 and 2002 on the basis of surface areas and animals. Those areas used for perennial plants, fruit and vegetables, edible potatoes, forests and non-agricultural use are not eligible.

In fact, a solution would consist in liberalising the potential for production (planting rights) and the fixing of yields, together with the liberalisation of oenological practices and the possibilities for label marking.

If the need for a more liberal orientation is clearly required for the wine sector in the long term, the problem of the competitiveness of the *Appellations d'origine* and, secondarily, of those other wines which might be marketed in a similar manner (for example, *vins de pays* in France) remains untouched, as much as preserving this segment of the range of wines available makes sense with regard to worldwide competition.

Three questions remain:

- Is the future of the *Appellations d'origine* under threat and is their capital of reputation not also threatened with devaluation if there is to be a total liberalisation of the markets?
- Is there no new model of organisation which takes account of these assets of reputation and allows a better answer for the potential of European production in the face of competition from third countries?
- Will the Commission's proposals favour or impede the emergence of such a model?

2. What place is there for the *Appellations d'origine* in the future organisation of the sector?

If one sets aside the 'top of the range' appellations, which are little concerned by the problems of surpluses identified by the European Commission, the *Appellations d'origine* today are confronted by two major difficulties (see annex 1):

- Problems of guarantees of quality, indicated at the same time by:
 - o the extremely low rate of refusal for authorisation for production contrasted with the quality audits carried out by taking samples through the distribution chain ('downstream quality oversight by sectoral organisations');
 - o the wide distributions in prices of *Appellation d'origine* wines between producers and wine sellers, indicating heterogeneous qualities, with a trend towards a growth in volumes sold in the low-price areas of the market.
- Difficulty in avoiding significant variations in stocks, generating situations of shortages and surpluses, linked to variations in production but also to insufficient reaction to variations in demand. In fact, the combined effects of variations in production and of vertical separation (of variable extent) between production and sales generate large variations in available volumes and in prices on the intermediary markets.

We set out here the economic mechanisms which explain why the conjugation of these two phenomena in the end makes it impossible to put in place ambitious long term investment strategies for marketing and for production (qualitative efforts), and at the same time penalises the development of marketing for the *Appellations d'origine* and for specialised marketing companies alike, in spite of the real attractions for consumers of products enjoying a reputation linked to their origin.

2.1. What place is there for the *Appellations d'origine* in consumption (see annex 2)

Since the food crises of recent years, consumers' requirements for health factors and for the quality of agricultural products have increased, which translates indirectly into seeking guarantees covering production practices and the origin and traceability of products. In this connection, the public signals of quality (*Appellations d'origine*, certification of conformity, labels, etc.) constitute important guarantees in the eyes of consumers and, more generally, a way of differentiating between those products which are authorised to bear them and those which are not.

The *Appellations d'origine* are naturally included in this logic of differentiation: attached to a set of technical specifications for production and for *terroir* of origin, they are spontaneously associated with a superior quality in the minds of purchasers. Thus, the global fall in the consumption of wines first of all concerned table wines and only later on continued into the *Appellations d'origine* (the VQPRD² have only seen a stagnation of sales at the world level).

At present, after several decades of regression, the world consumption of wines seems to have stabilised at about 240 million hl, and is even showing a slight increase (of about 1% per year). At present, some notable facts should be mentioned:

- The European Union, the world's principal producer and consumer of wine, clearly dominates when it comes to sales (68% of consumption), but with a trend rather of stagnation or even of regression in the leading countries which are also the main world producers (France, Italy and Spain). Consumption is shared equally between VQPRD and table wines, the VQPRD having maintained their position while the table wines have regressed: in fact, ¾ of consumption is of wines with a notice of origin (VQPRD & table wines with geographical indication). The INRA ONIVINS observatory of wine consumption has shown in particular that in France we are seeing a recovery of interest in the wines called 'quality wines', and that consumption in the Mediterranean countries has developed in the direction of high quality wines, often associated to *Appellations d'origine*.
- The growth is mainly seen in the United States, the United Kingdom and Germany (25.4% of world consumption in 2004, 38.7% estimated for 2008), to which in future will be added Asia, Scandinavia and Russia, all areas in which we see levels of growth significantly higher than the world average. Consumption in these countries mainly concerns branded wines and wines identified by variety, even if at the world level the share of VQPRD and GI wines is growing slightly.

Despite the difficulties in evaluating the consumption of wines with a notice of origin (in the sense of the AO or GI systems) at the global scale, it still seems that, in a generally gloomy context, these products are succeeding in maintaining their positions with consumers. In fact, from the economic literature we can see that some economic experiments have shown that consumers of wine are also and above all consumers of labels, strongly attached to a brand or a place of origin. Thus, **indicators of quality (including geographical indications) contribute to improving the perceived value of these products, the consumers' willingness to pay for these products being greater than their willingness to pay for a product without geographical indication.**

It could be argued at this stage that the notion of origin is relatively vague for consumers: for example, only one purchaser in two estimates that there is any difference between *vins de pays* and AOC wines, and price does not constitute an indicator of the differentiation between these products. It is clear that one of the major challenges for operators in the world of *Appellations d'origine* lies in their capacity to inform consumers about the real significance of these notices: the value ascribed to a place of origin is the result of consumers becoming attached to a historical know-how found only in the *Appellations d'origine*, because only these are attached to traditional methods and a traditional *terroir*.

It seems in the end that by means of appropriate communication efforts, there is a real potential for the *Appellations d'origine* to enjoy a market value at least equal to that created by private brands acting as guarantees of quality. It will therefore be appropriate to examine the conditions according to which wine-sellers and the authorities concerned will be able to invest in such

² We are using the acronym VQPRD to refer to all European terms, to include the notices of origin discussed in our arguments.
Study carried out by Ykems for the CNIV – original version in French

communication, in particular in expanding markets which are to date not very used to the idea of a regional origin.

2.2. Legitimacy of the regulation of *Appellations d'origine*

Notice: we recall in this part the principal economic arguments pleading in favour of a regulation of Appellations d'origine. The details of the reasoning and the references to the economic literature are given in annexes 2 and 3.

2.2.1. Collective reputation, quality and regulation (see annex 3)

The *Appellation d'origine* constitutes a capital of reputation linked to the fame of its region of provenance, **accessible to all the operators in the sector without specific commercial investment**. It makes it possible for them to guarantee and communicate to the consumer a set of characteristics specific to the product, thus facilitating its marketing despite its nature as a 'good of experience' (ie of unknown quality at the moment of purchase).

This reputation is the historical result of individual quality strategies, from which the same operators seek to benefit. Thus, to benefit from a certified collective reputation, a wine should be of high average quality, and various conditions must be satisfied to avoid the failure of this reputation:

- **install systems of quality control for the products:** traceability, and respect of the technical specifications and organoleptic quality of products bearing the notice of origin;
- **protect the notice of origin from all possibility of confusion** by the consumer with products which do not support the costs of this guarantee;
- **control the supply to avoid all deviation from demand** which, through the impact on the market price, (i) would prevent the remuneration of individual quality efforts, (ii) would lead to a direct loss of reputation linked to the price signal (which would affect the perception of quality by the consumer), (iii) would eventually lead to a reduction in or even the disappearance of the efforts to maintain quality, which are basic to very existence of the *Appellation d'origine*.

If such a regulation may appear as a distortion of competition between the producers inside the appellation, we show in annex 3 that it is socially preferable to an absence of regulation, since the gains linked to the control of quality and the maintenance of reputation it offers outweigh the negative effects linked to co-ordination among producers. It moreover allows a retention of the value created at the level of production (by holders of the AO) which makes it possible to maintain a numerous population of owner-growers, while encouraging an organisation of the sector which can counterbalance the pressure of the market towards ever more concentrated distribution.

When the conditions for constitution and management of the *Appellations d'origine* are met, they allow consumers to benefit from a diversity of range within an umbrella 'brand' guaranteeing a minimum of typicality and a high quality.

2.2.2. Vertical relations, competition and regulation (see annex 4)

Regional *Appellation d'origine* (AO) products constitute are essential for the future of the European wine-producing sector, owing to the quantities concerned³. In all these sectors, marketing is essentially undertaken by operators who are not integrated upstream (regional wholesalers). Regional wholesalers thus constitute the principal interface with the distribution networks and ensure the *blending*, bottling and marketing of the wines. In France, for example, they sell between 70% and 90% of AOC wines, 80% of vinification being generally performed by the wine-growers who are members of the appellation (Champagne excepted).

By referring to the results of the economic literature and their application to the wine-production sector, one can show under what conditions this *de facto* vertical separation⁴ is compatible with the efforts for marketing and promotion of the wines offered under the *Appellation d'origine*. In this framework, there is also an interest in having interprofessional regulation

³ in France : Bordeaux, Côtes du Rhône, Provence, Burgundy, ... ; in Spain : Rioja, Mancha, Ribera, ... ; in Italy : Chianti, Emilia-Romagna, Asti, Valpolicella, ... ; in Portugal : Douro, VIno Verde, Alentejo, Dao, Ribatejo, ...

⁴ In France, this separation is the result of a 'voluntarist' policy among producers, expressed through the SAFER and the *Comités Départementaux de Structure*

Of the interest of the brands associated to the AO for the consumer and the wine seller

The growing concentration of distributors downstream of the chain and their requirements for the (qualitative and quantitative) regularity of the products and for the ability to react to orders impose upon wine sellers a grouping of the supply of wines of the same *Appellation d'origine*. They are also led to develop simple signals (marketing brands), added to the *Appellation d'origine*, allowing them simultaneously to benefit from the reputation of the *appellation* while differentiating themselves from their competitors. **The signal made up of the association between the brand and the appellation indeed adds a guarantee and a readability to an offer which is potentially heterogeneous, while counter-balancing the market power of the distributors.** On this last point, the creation of a demand from consumers for a product where the brand is owned by the sector is necessary to conserve a robust power for negotiation and face up to the growing development of 'distribution brands'⁵, which in the long term are negative for obtaining long term profitability for the *Appellations d'origine* (see annex 4).

Necessary conditions for supply allowing the development of a brand name added to an Appellation d'origine

Taking account of the elements described above, the seller who invests, through his own brand, in the marketing of a range including a significant percentage of AO wines should be able to ensure:

- a **sufficient and regular quantity** so as not to create disruptions in the distribution networks leading to durable losses of market;
- the possibility of obtaining, possibly by *blending*, a **regular quality** for the wines being offered;
- the possibility of maintaining an **organoleptic identity** distinguishing his AO-brand from the rest of the AO

Thus, if the supply of the AO is subject to disruptions and proves to be uneven in quality, contracts based on sets of specifications provided by wine sellers will be necessary to guarantee these three key factors for the development of brands associated to the AO. However, we show in annex 4 that **the vertical separation between production and marketing in the context of production problems may cause such private and contractual regulation to fail**: one could argue that the AO should therefore be perfectly regulated and its quality supported by controls involving a right to use the AO to limit as far as possible the shocks due to disruptions of production and to competition from other wine-growers both for final distribution networks and for the supply of raw materials.

Range policy in international competition

These conditions, however, are not sufficient: sellers must:

- be able to make a **competitive offer**, notably with regard to operators supplying their networks from the new producing countries. They must therefore be able to offer a wide range of products under their own brands, including not only appellation wines but also wines identified by variety. The volumes offered, linked to the width of the range, thus allow them to benefit from economies of scale and reduced costs for sales and distribution.
- obtain gross margins sufficient to remunerate them for their investments in reputation and their efforts in marketing. With this aim, a clear **differentiation** of their offer (a 'unique' offer), obtained by relying on the *Appellation d'origine* will constitute a non-negligible advantage.

Due to their proximity to the places of production of AO wines, regional sellers have an effective capacity for selection, assemblage and development of AO products of international reputation. They should therefore be able to enter into such a development scheme, by putting together ranges **leaning on the Appellations d'origine**⁶.

The gains associated with this positioning must however be sufficient to permit significant commercial investments and marketing efforts, which are indispensable for the support and development of the brand: it will also be necessary for this that the cost of supply should be controlled in the context of the vertical separation and the involvement in the 'AO collective brand' by producers which prevails today.

⁵ 25% of wines in France, 50% in Great Britain

⁶ We may refer here to the example of Castel, where 55% of the wine supply is made up of AOC, and which is the 3rd largest supplier in the sector world-wide, also having a presence in spirits, beer and mineral water.

Risk of Hold-Up and necessity for regulation of the regional AO market

The acquired reputation of the AO, supported by mutual investments, is a springboard making it possible to produce a leverage effect on the investments by the seller in the brand, indicating a capacity to provide supplies in a region whose production is demanded by consumers, while offering guarantees of quality and regularity.

However, **if he opens up new markets for the products of the AO**, which he neither owns (the appellation is attached to the land and therefore to the vineyard), nor enjoys monopoly over, **the seller exposes himself to a double risk:**

- **competition from other suppliers** of the same AO, notably the producers themselves if they have the means to assure the same functions of grouping their supply and optimising logistics.
- **a requirement to increase the payments for the raw material** (which bears the *Appellation d'origine*), in parallel with the development of markets.

In both these cases, **the seller risks not obtaining the expected remuneration to reap the profits from his investments in marketing**, unless he:

- has a sales area and a range of products making him indispensable for access to large commercial networks seeking to minimise their costs of supply;
- manages to make a clear distinction between his 'AO/brand' product from the simple AO product (cf the great Champagne brands), thus developing a captive demand from consumers for his product, so as to reinforce the possibility of a balanced, long-term contractual agreement upstream, the AO/brand association becoming a common asset of reputation.

Now, as has been seen before, this supposes that the seller should be capable of ensuring a regular supply to the distribution networks both in terms of quantity and quality. **In a context of vertical separation between production and marketing, and of disruptions to production, the regulation of the supply by an authority associating production and wholesaling therefore appears as a necessary condition to limit the risks of hold-ups and to encourage the long-term stability of the motives to invest in a brand which markets the AO. In the end, the vertical separation is not in itself an obstacle to investment in the marketing of the AOC, but some regulation of the supply of AO wines is indispensable.**

2.3. Return to the statement of the Commission and conditions of success for a model leaning on the development of *Appellations d'origine*

If we return now to the starting position of the Commission, the current crisis in the wine production sector, which includes the *Appellations d'origine*, combines:

- A regression of sales which has contributed to the formation of structural surpluses in spite of repeated crisis distillation measures in the last few years
- A weakness in investment in marketing by European operators in comparison with the investments carried out by the large brands of the new producer countries.

With regard to the problems of quality control and regulation of the supply described above, this state of affairs may then be explained as the result of three main elements, which do not challenge the model of *Appellation d'origine*:

- The uneven quality of the products, which creates a problem for marketing and sales, and results (at least in part) in a failure to control wine production. In France, however, it may be that the reform of the systems of authorisation which is under way at the INAO, and the separation between control organisations and professional organisations should permit a stricter policy and a better guarantee for the consumer.
- The failure to match supply and demand which generates surpluses is explained by the absence of a coherent mechanism for regulation which, beyond the question of what measures can be or have been taken raises the question of the organisation of production chains in terms of power of decision over the management of potential, the fixing of yields, and crisis distillations. More generally, we see a lack of integration of estimates of sales potential when such decisions are taken.

- Finally, contrary to what one might expect, the support provided by the EU in the framework of the CMO, almost never targeting the downstream operators, has not helped to solve the problems existing upstream either (and has even generated opportunistic behaviour, such as 'free riding' on the distillations for example)

Thus, the lack of effectiveness of the existing regulation measures limits the capacity of the operators to develop the reputation of market brands leaning on the *Appellations d'origine* and to reward increased efforts in quality⁷. However, while there are real difficulties in managing the *Appellations d'origine*, and while these may explain the current crisis of the sector:

- **There is no insurmountable handicap in the vertical separation between production and marketing if the regulation of supply favours contracts over many years and a differentiation between classes of product: *Appellation d'origine* and *Appellation d'origine* + brand**
- **This should allow a synergy of the investments in reputation between *Appellation d'origine* and marketing brand (effective investments at the stage of marketing, which also benefit from the reputation of the appellation, while limiting the hold-up problems)**
- **The amortisation of investments in promotion/marketing efforts for private brands supposes important volumes particularly as the private brand still needs to build its own reputation and as the value of the products of the *Appellation d'origine* remains relatively modest.**

Without pre-judging the best available strategy, it is therefore essentially a matter of increasing the range of possibilities for the operators putting wine on the market. Various marketing strategies should be explored by private brands, depending on the targeted distribution networks and the state of competition (AO of a region + wines identified by variety, AO of several regions/countries, etc...).

3. The interest of a bipolar model of organisation: regulated *Appellation d'origine* / de-regulated non-*Appellation d'origine*

Let us now project ourselves deliberately into the **post CMO context (2013)** as far as we may imagine it today: increased liberalisation of the wine production sector, with complete abandonment of market support measures (support for distillation, aids for private storage, etc.).

The object of this chapter is to define a **target model of organisation which should be effective in such an economic context**.

This will then allow us to deduce the orientations to be given to the reform of the CMO which will constitute a transitory period (2007-2013) of preparation for executing this new model of organisation and whose major objective for our purposes will be to supply the professionals with the means to position themselves and to be competitive in the long term.

3.1. Consequences of a totally deregulated system (no regulation of the *Appellations d'origine* or of other wines)

A total deregulation of the markets would suppose:

- **The total abandonment of management of planting rights**, including those in the AO (within the limits of the appellation area);
- **No management of markets** at any level.
- For the *Appellations d'origine*
 - o Maximum target yields dictated solely by the imperatives of quality/typicality desired for the appellation;

⁷ This is probably a partial explanation of why operators such as Pernod Ricard are more interested in the new producer countries to supply their wines. (French wines represent only 7% of the group's products, a large part of which is Champagne - Perrier Jouët and Mumm).

- A set of technical specifications setting out the authorised technical standards and oenological practices;

In this case, the disappearance of the AO system (as an indication of quality) seems probable to us since, in the absence of public aid, discrepancies between supply and demand will be fatal under the pressure of the non-AO wines which enjoy total freedom as far as yields, planting rights, etc. (see annex 3). A scenario illustrating the developments of the wine production sector after the end of the current market support measures could then be as follows:

- A situation of temporary surplus for a regional AO would lead to a lowering of price calling into question the positioning of the AO in relation to the other wines;
- This lowering of price will be felt as an incapacity by the operators to bear the cost of the residual constraints linked to the AO, and therefore as a pressure towards relaxation of the constraints on production;
- The alternatives proposed for the non-AO wines (cost competitiveness + quality control for the private brands) would become dominant in such cases
- The loss of reputation plus price pressure would lead to the progressive development of a bottom-of-the-range offer which would become emblematic of the *Appellation d'origine*;
- It would become impossible for operators downstream of the producers to make a profit from investments in sales and marketing by relying on an image of quality created in consumers by the AO notice;
 - Expected consequences: For the 'quality' AO segment, the only remaining producers will be those who can create value for their product around their name by themselves, which clearly represents only a small fraction of the current supply, and will reduce the visibility of the *appellation's* quality on international markets (low volumes, no grouping of the supply, low representation in the large distribution networks).
 - If producers leave the AO system this will inevitably lead to a considerable reduction in the number of viable structures (i.e. a rationalisation of the production tool), under the pressure of competition, a result of the liberalisation of supply and of the opening up of oenological practices and labelling rules.

In time, we could expect a refocusing of the *Appellations d'origine* at the very top of the range, with wines which have been able to develop an independent reputation, and with the other wines swinging into the less demanding 'no appellation' sector.

3.2. Consequences of a totally regulated system (*Appellations d'origine* and 'no appellation')

The vine being a permanent plant, once the investment in planting has been made, this is irreversible and not re-deployable. Under the pressure of over-capacity for production, producers may be persuaded to forget this investment cost, and also a part of the fixed costs (i.e. the remuneration of the grower): this is chiefly true for producers with little or no debt, while those with debts would then clearly be under threat.

One can immediately understand the interest of a system of regulation aiming to limit the risks of over-investment in capacity and the price wars that could result.

However, looking back at the last few years shows clearly that such a control of supply exercised in the framework of the European Union alone would not shelter the producers from over-capacity at the world level, which creates strong price pressures. The internationalisation of markets indeed renders all attempts to limit the European supply inoperable if they are aimed at adapting the potential for production to marketing, since all such measures do is to create more room for competing wines which are not subject to such constraints.

In this context, hoping to control the whole potential for production (i.e. of GI and table wines) does not seem very relevant:

- As soon as a fraction of the wines of a given region is not protected by the differentiation provided by a marking (i) having a sufficient reputation and (ii) attached to a geographical origin,

like the AO, then any attempts at control will only lead to replacement strategies by multi-regional or multi-national operators (seeking similar products not subject to constraints limiting the available volumes).

- Also, at the level of competition policy, it seems difficult to justify such control of the potential for production when operators are confronted by an open market.
- Finally, such a position would very certainly make it more difficult to defend a regulation system based on the *Appellations d'origine*.

3.3. The chances of success for a mixed range against a range of single varieties, if the *Appellation d'origine* is a differentiating concept

As we have seen above, in a context of increased international competition, wine-sellers must provide a wide range of products in order to have a significant weight in relation to a final distribution system which is increasingly more concentrated (cf. II.3.4.). This supposes that they are capable of supplying a range under their brand which combines grape-variety-based wines and products which are differentiated from those offered by the new producer countries (in this connection, the *Appellations d'origine* constitute a definite advantage from the point of view of the consumer (cf.2.3.1.))

To offer the maximum growth potential to private brands constructed on the basis of an offer of this type:

- the grape-variety-based wines must be competitive in comparison to those offered by the new producer countries, since they will be confronted directly with competition from these; and it should be possible to obtain this competitive advantage through de-regulation of the sector (liberalisation of the management of the potential for production, opening up of œnological practices, notices giving grape varieties and years, etc.);
- the appellation wines should play the card of quality/typicality guaranteed by public signals which, if we take account of the elements evoked in II.3., pre-supposes effective regulation of the market and better quality control.

At the level of the CMO, this assumes:

- a combination of stronger support for the promotion of appellations and investment in private brands (based on the appellations or not);
- organisation of the co-existence of a regulated model of production for the appellations and a more liberal model for other wines.

3.4. What is the frontier between appellation wines and no-appellation wines: the case of the Vins de Pays and the limit between AOC and non-AOC wine in France

Notice: here we are in the framework of the French example, which distinguishes 'vins de pays' from AOC (Appellations d'Origine Contrôlée) wines. We will therefore speak of AOC here and not of AO as in the rest of the document.

In many wine-growing regions, the regional *Appellation d'origine* creates a problem of economic coherence between

- The potential for production
- The costs associated with the technical specifications and the control system
- The market price levels being targeted

Today, the imbalances seen between the supply (although steered by yields which are often below the target yields for the appellation) and its sale through the markets clearly show that this coherence has not been achieved: the costs associated to respecting the technical specifications in particular are no longer remunerated by the price levels, which are markedly lower than the expectations of the operators. This may essentially be linked to a defect of the systems for managing AOCs (notably at the level of the effectiveness of quality controls and regulation of the supply)

This economic coherence should also be in line with the Definition of the AOC which, apart from the link to the *terroir* (zoning by parcel of land), defines the target yields and the technical procedures supposed to encourage the production of wines with appropriate typical features and which fulfill a minimum of quality requirements. Here too, the heterogeneity of the products bearing one single appellation shows that this objective is not always reached.

The major goal for regional AOC wines today therefore consists of re-establishing this coherence by working on the different criteria determining the desired objectives for the AOC as far as economic and qualitative factors are concerned. This supposes in particular that the control systems will perform better and, in certain cases, there will be a re-definition of the norms for access to the AOC.

Inversely, it could be considered that some *vins de pays* have reached a critical mass, with a sufficient reputation to mean that their development requires support through the mutualisation of promotional efforts and control of the supply and, for this reason, they should become AOC wines.

If we suppose that the economic coherence of the AOC system will be reconstructed (and, aiming at the liberalisation of the sector and a reduction financial support, the CMO should favour transition to this target), it will not in our opinion be necessary to maintain a second regulated category of wines relying on geographical origin as a sign of differentiation

- This does not mean that no notice of origin may be used outside the AOC system, but that such a notice used for an AOC necessarily be reserved so as to maintain the reputation associated with the AOC and to make the investments in the promotion and defence of the AOC more effective.
- This does not prevent the construction of new AOCs, or of *appellations* which may become IGPs: the producers of a particular region, notably if they have a capacity for direct, local sales may have an interest in forming a new AOC.

In other words, the reference to a geographical origin will remain possible outside the AOC system but it will not aim to become an 'AOC clone'. Areas of production without any previous capital of reputation, especially in overseas markets, and dependent on wine sellers for sales and marketing, will probably not have any interest in following the AOC route. It is of course understood that they may benefit from a geographical notice which may be added to other promotional notices, the use of which will essentially be driven by the downstream operators and the private brands.

3.5. Difficulties of executing the regulated AO / non-regulated non-AO model

Beyond these principles, what are the problems of execution?

- 'Rehabilitating' the *Appellation d'origine* system should logically take place through a re-definition of the area of production in question (rationalisation of the proposed surface areas, yields and volumes/prices). Political feasibility, however, is far from guaranteed.
- Even in the absence of a re-definition of the conditions for production in the decree, those farms not covered by an AO should, under pressure from the strengthening of controls, either renounce any such claim and move into the world of free yields and the proposed opening of oenological practices, or invest in bringing their tools and practices into conformity, or finally be encouraged to grub up their vines during the next CMO.
- A mixed status is not incompatible with the proposed organisation, although the conditions for setting up the controls should be carefully examined, and although the division of the surfaces (AO and non-AO) should be guaranteed at least for several years to avoid supply/demand discrepancies. This mixed status would favour adaptations and possible entry into or exit from the AO system.
- The combination of grant-aided grubbing up of vines, reinforcing of actions for collective promotion and aid for downstream operators, and improved quality controls should have the effect of avoiding a situation where regions find that the potential production of the AO would be much too large. It seems unlikely that after this there would remain producers needing to leave the AO for reasons of economic profitability (who would then find it difficult to accept losing a notice with an international reputation).
- For those *Appellation d'origine* areas enjoying a potential for further planting, new entries into the system will be possible and should be planned with regard to the development of the AO in its markets. Objective criteria should be established by the regulating authority in the first place to assign planting rights.

3.6. Conclusion

In the end there would be a dual organisation of the zones of production, resting on a segmentation of the wines, clearly separating:

- Wines whose competitiveness has been improved according to the model of the 'new countries' (i.e. liberalisation of markets, opening to the oenological practices authorised at the international level), the potential for production and the technical specifications being fixed by private contracts between wine-growers and those selling wine;
- *Appellations d'origine*, which benefit from improved mutual efforts at promotion and from a 'public' signal of quality which should provide the consumer with a guarantee of typicality, traceability, and organoleptic quality. In this framework, access to new oenological practices should be possible, with the choice to be piloted by the authority in charge of the regulation of the supply and the promotion of the collective 'brand'.

As for the CMO, if the regulation of all segments of supply (wines with and without GI) seems doomed to failure, the total deregulation of the sector would lead in the end to a 'sanctuarisation' of the AO around a few products of very high reputation, these alone being able to enjoy a remuneration allowing them to bear the high costs of production.

Now, the constitution of wide ranges of products based on a differentiation created by the *Appellations d'origine* supposes that a significant supply will be maintained in this segment. For this purpose, the CMO should organise the coexistence of a model of regulated production for the AO and a model driven by private brands for wines without GI. It is therefore necessary to examine how far the Commission's proposal for reform favours transition towards this model, and what paths of development will be desirable.

4. Compatibility of the proposed reform of the CMO with the organisation of transition towards the target model

4.1. A reform which should favour the transition towards a target model associating regulated AO and the liberalisation of other markets

Independently of the constraints arising from the national organisation of the wine production sector, the CMO should supply tools and means for a transition towards the target model: for the *Appellations d'origine*, it should therefore favour

- The strengthening of the means of regulation and promotion
- The adoption by professionals of a real collective strategy for development of the *Appellation d'origine*
 - o Improved positioning in terms of quality: conditions of production, but also authorisation of products, oversight and control of quality, traceability of products
 - o Management of the potential for production (surfaces, yields, reserve stocks...)
 - o Contracts between growers and sellers
 - o Management of grants for promotion / marketing // financing

4.2. Compatibility of the stated orientations of the Commission with this objective

4.2.1. Return to the proposals of the Commission

The proposals of the Commission demonstrate its desire to construct a CMO which should accompany the wine sector towards a liberalisation of wine production markets in the period 2007-2013. This represents a response to various issues:

- resolution of the problem of surpluses through adaptation of the potential for production
- improvement of the competitiveness of wines from the European Union with regard to their competitors from the new producing countries
- compatibility of the CMO with the constraints imposed by the WTO, or even anticipation through the CMO of expected future requirements: in particular, the desire to move a part of the grants towards the second pillar translates into requirements which may be greater than the demands of the WTO, which recommends mere division of the financial support into a blue box and an orange box⁸. In fact, the Commission anticipates that the probable result of the next round of negotiations of the WTO will be not only the total suppression of the orange box but also the transfer to the blue box of all the measures not related to rural development (SFP for example), which explains its insistence on the financing of some of the measures via the FEADER⁹, which is a non sectorial fund.
- In the end, reduction of the budget allocated in the framework of the first pillar

It therefore includes various measures moving in this direction, in particular:

- the liberalisation of planting rights in the long run
- the cancellation of grants for 'market support', essentially meaning distillation and aid for private storage

⁸ The OMC aims at greater liberalisation of exchanges and thus seeks to eliminate measures for internal support enacted by Member States, which could give competitive advantages to private operators which could be considered illegitimate. It thus classifies the existing aid measures into three boxes, orange (prohibited), blue (tolerated) and green (authorised and acceptable), with the long-term goal of eliminating the orange and blue categories:

- The green box thus for the time being contains all the measures for direct support to the income of producers which are decoupled from production. Aid for investment is considered as acceptable: investment in material goods and non-material investment (training, for instance), aid for agriculture in difficult circumstances or aiming to help balance rural areas, and certain kinds of aid to promotion;
- The blue box has not so far been called into question by the CMO: this includes partially coupled aid (intervention based on surface areas, for example), but it should not include more than 10% of the aid distributed;
- The orange box contains all the measures coupled to production which should disappear between now and 2013

⁹ Fonds Européen Agricole pour le Développement Rural/ European Agricultural Fund for Rural Development

- authorisation for indications of vine variety and vintage of the wine on *vins de table* and the opening up of the authorised oenological practices
- the integration of wines into the PDO / PGI logic

If the transition to the intended target includes temporarily maintaining voluntary, grant-aided grubbing up of vines, this will have the aim of offering non-competitive operators a way of leaving the sector before the planned liberalisation. Eventually, this type of support will also disappear.

4.2.2. Some orientations *a priori* compatible with this positioning

To the extent that they make possible a regulation of the *Appellations d'origine*, the conclusions drawn by the Commission seem generally in agreement with these objectives:

- Support for abandon / reconversion for the operators who wish to leave the system via grants for definitively leaving the sector is a good solution to re-balance the potential for production and the current sales and marketing, while at the same time preparing the implementation of a more liberal model, which consumes less financial support upstream:
 - o separation of problems of a social order from the true economic issues for the sector
 - o a solution which is simple in execution and which allows a rapid restructuring
- The suppression of the systematic financial aid structures (distillation, enrichment) also seems necessary, to the extent that they:
 - o consume a large share of resources without resolving the fundamental problems of competitiveness and of matching supply to demand,
 - o generate perverse effects in the functioning of the markets,
 - o artificially support activities or operators and delay necessary structural changes.
- Strictly from the point of view of economic efficiency and competitiveness in relation to the new producer countries
 - o the opening up of oenological practices
 - is indispensable for better competitiveness for the wines without *Appellation d'origine*
 - for the wines with *Appellation d'origine*, this question should be studied by the regulatory authorities who manage the collective brands and guarantee the degree of typicality, thus supporting the reputation of the *appellation*.
 - o the rules for labelling should authorise indication of grape variety and vintage for wines without *Appellation d'origine* presenting sufficient guarantees of traceability
- Finally, a reorientation of means towards the development of markets and the promotion of wines, the defence of the *Appellations d'origine* and the improvement of the guarantees offered to the consumer (quality, origin, procedures) is indispensable to improve the positioning of the wines of the European Union and of the *Appellations d'origine* both for internal markets and for export.

4.2.3. Modulations to be executed:

- Grubbing up: the objective of reducing the potential of production by 400,000 ha may be disproportionate for the purpose of reducing the supply and could consume too many resources:
 - o If it is really definitive, it risks limiting the possibilities for future growth of production, if we can assume that the model associating regulated *Appellations d'origine* + a liberalised sector will be competitive and capable of re-gaining market share (here we take a pessimistic vision of future markets, since the world market is growing slightly)
 - o Without moving in the direction of a public organisational framework for grubbing up, the latter should not restrict the quality potential of the *Appellation d'origine* wines. The feasibility (for example) of a system of exchange aimed at preserving the best parcels in the appellation deserves to be studied in this connection but has no direct connection with the CMO.

For this measure, as for all those which will consume the budget of the CMO, the important thing in the end is not to create constraints for the means which are necessary for actions to strengthen the position of the wines of the EU on the various markets during the transition phase, the risk in the end being to limit the effectiveness of the proposed post-CMO model.

- Distillation:
 - Should crisis distillation be maintained for as long as it fulfills its original purpose?
 - For the *appellation* wines, it should not *a priori* be necessary as long as the other proposed regulatory measures are used effectively
 - For the other wines, it should be possible to replace this measure by other methods of handling surpluses arising from private initiatives: management, selection...
 - Although the distillation of residues (marcs and lees) may present an environmental interest, it should not be paid for in its entirety and should not be used as an instrument for market support, as this may re-generate the negative effects linked to the policy of 'collectivism'. Removal of the budgetary commitment necessary for this measure may in our view lead to the producers taking some of the responsibility for financing the treatment of polluting waste products, and for opening new industrial outlets to make use of them (factories for production of fuel being studied in Beaujolais, production of electricity being studied in Bordeaux, etc.)

If the position of the Commission seems in the end to make a good starting point to organise the transition of the sector to the proposed organisational target, it should still be complemented, for the *Appellation d'origine*-type wines, by some reflections on the nature of the measures for market development and regulation of the supply to be promoted. Regulating these measures will be essential to increase the competitiveness of European wines in a context which will eventually become more liberal (in particular due to the prohibition of the current market support measures according to the orientations taken by the WTO, and the reduction of sectorial aid by transfer of financing to the second pillar of the CAP).

5. Some paths of development: what measures are there to promote the *Appellations d'origine* in the proposed bipolar organisation?

5.1. Analysis of the difficulties encountered in executing the existing aid mechanisms

5.1.1. Difficulties of executing the strategies of aid for marketing and sales

In recent years, the French inter-professional bodies have pushed for increases of Obligatory Voluntary Contributions in many regions with the aim of increasing the funds allocated to the financing of promotional actions. However, the benefits of such investments are difficult to quantify in the short term, something which may, perversely, make it difficult for operators to see the justification for them.

The regulations prohibit the association of private brands with this type of promotional operation, and the individual contributions are very unequal (Obligatory Voluntary Contributions are indexed according to the size of the structures, which are very heterogeneous), which may also create sentiments of inequality between operators (wouldn't it be better for the larger enterprises if they invested directly in their own brands?).

It is in the end difficult to mobilise the transverse financing foreseen in the European budgets, taking account of the constraints on eligibility for aid.

5.1.2. Difficulties of executing the regulatory measures

Notice: we set out here the principal difficulties met in executing the regulatory measures for appellation wines; a complete description of these measures is given in Annex 5.

- Regulation *ex ante*

- Voluntary grubbing up:

- Free riding by operators (waiting for the others to grub up)
- Late intervention in response to stated surpluses and a decision not to continue with sales
- Insufficiently motivating fundings in certain regions which implies the setting up of complementary private mechanisms, which are legally complicated and financially expensive.
- Too harsh a measure, since it causes long-term damage to the future capacity for production

- Yields:

- The reduction of yields often takes place too late due to a lack of economic visibility for the expected development of sales in the eyes of the authorities responsible for fixing such reductions.
- The difficulty of anticipating economic yields is complicated by the mixed character of the areas and of the variable allocations of surface areas which limit the possibilities of intervening *ex ante* (which also creates problems at the quality level, the conduct of the technical procedures being designed to offer the maximum of last-minute flexibility).
- The choices of yields are uniform within a single appellation, which may lead to absurd individual situations at the economic level due to the heterogeneity of the situations within an appellation. This type of approach may therefore trigger significant political tensions, which may make collective membership difficult:
 - In a model based on the maintenance of a collective reputation, it may be understood that young and indebted operators are bound, for their own survival, to undertake individual high quality strategies which are taken advantage of by operators who are less financially constrained. This inequality is then dramatically reinforced by the reduction of yields, which reduces

volumes, but does not reduce the costs of production, which are essentially fixed.

- Thus, an unilateral reduction of yields aimed at aligning production to sales may translate into an anti-selective effect, favouring operators who produce at lower cost and at the same time penalising operators who have invested in quality and those with commercial outlets allowing them to sell the whole of their production.
- From this point of view, a greater modularity of the measure would be desirable, but reflections on the individualisation of the management of yields are dashed for the time being against the constraints of administration and control inherent in such mechanisms.

In the end, operators with no problems finding outlets risk losing markets, which contributes to reducing the distribution of the AOC. This problem is made even more acute by the fact that it is then extremely difficult to recover these markets, above all when yields are reduced year by year.

- Regulation *ex post*

- Voluntary crisis distillation:

- Free riding of operators (waiting for the others to distill)
- The incentives are not necessarily correctly calculated to ensure the effectiveness of a measure based on individual wishes: the amount of aid can be questioned, as can the timing of the financing (late payment, subscriptions in the period before the operators have a correct view of what they will be capable of selling); and also, in certain regions, this leads to the creation of complementary private financial mechanisms, which creates legal complications.

- Retention

- This may be used, exceptionally, to limit the quantities available
- But this has no interest except as a palliative for purely temporary imbalances between production and commercialisation (*i.e.* the volumes subject to retention must be available later on to compensate for deficits of production; if not, the creation of the reserve is only a stage before the distillation of volumes, as has happened in various regions)
- Applied uniformly to all operators, it may generate perverse effects with regard to their individual situations (limitation of sales). Here too some reflection on the possible individualisation of such a measure is worth exploring (concerning both the creation of reserves and the release of volumes)

- Strengthening of the quality controls (authorisation, downstream oversight of quality)

- The strengthening of the quality controls is indispensable to guarantee that the objectives fixed for the *Appellations d'origine* will be met; it is clear that at present this would probably have a considerable effect with regards to volumes, but it should not be assimilated to an instrument for regulation of the supply.
- Independently of the problems of execution, increasing this type of controls raises two questions related to the sanctions / alternative solutions for operators in case of refusal of their wines:
 - Possibility of de-classification of the *appellation* wines to other categories if authorisation is refused
 - Compensatory measures for the refusal of authorisation have been tried in Beaujolais, but beyond an indemnity to the operator, should there be some other mechanism to help them either leave the *appellation* or increase the quality of their wine (and if so, how should it be implemented)?

Conclusion

The existing regulatory measures currently raise various questions:

- What possibilities are there for a coherent execution of a plan for regulation of supply? In the case of the French organisation, these possibilities are still weak: multiple actors are in charge of different types of measures, with no authority having the power to use the instruments at the right moment and at the right level, and little co-ordination among those making decisions.
- How best to take into account the perverse effects of the 'collectivism' at the individual level by means of more adjustable measures?
- How can truly motivating financing be organised for the measures which are necessary, in terms both of the amounts and of their release at the right time?
- How can operators be made to take more responsibility?

In the long run, correct co-ordination of yield levels and of decisions about creating reserves (or about release of volumes), guided by the marketing objectives of the *appellation* should make it possible to absorb temporary shocks, as long as a sufficient degree of individualisation can be associated to these measures, in order to avoid penalising the more dynamic operators. Taking account of the proposed organisational target for the European wine supply and for the *Appellations d'origine*, some mechanisms would no longer make sense in the long run:

- Crisis distillation
- Regulation of quantity through measures of authorisation by quality (the strengthening of the control mechanisms should eventually make it possible to obtain a reduction of the quantities withdrawn from the market for not meeting the expected quality norms)

5.2. What measures of intervention should be promoted?

5.2.1. Support for the development of brands leaning on *Appellations d'origine*

Favouring the target model associating a regulated AO sector and a more liberal sector for table wines supposes an active policy of support for the development of brands created by wine sellers (whether these are applied to AO or table wines) and, so that the AOC indication should clearly be perceived as a differentiating factor, of promotion of the guarantees it represents.

A better regulation of the *Appellations d'origine* and a liberalisation of the table wines sector should allow high levels of private investment in marketing: a tenable proposition as long as all the guarantees of stability of quality and volume may be made:

- either by private controls and the possibility of benefiting from extended supply zones (development of grape-variety-based wines for example)
- or by the authorities in charge of regulation and control

To this there should be added grants of public origin, resulting in particular from the reorientation of the credits of the CMO towards the downstream sections of the chain: at present, the European financing of aid for the promotion of wine is hardly appropriate for the development of the reputation of the VQPRD and more generally of other wines (with or without GI)

- relatively small (€ 3 million/year for promotion in the markets of the European Union, and of the same order for non-member countries).
- designed only for VQPRD and table wines with GI
- difficult to access, due to criteria of eligibility which favour operations with many products, involving many regions, and lasting many years, and which suppose at the practical level:
 - o a selection of dossiers by the Member State, which then sends this on to the Commission
 - o in case of acceptance financing is relayed through the Member State, which advances

the sums to be reimbursed by the Commission on presentation of the appropriate documents

A constant CMO budget and the abandonment of the tools for market support should make it possible to re-allocate the financing destined, beyond advertising to consumers, to improve the knowledge of markets (panels) to assist the operators in their strategy of international development. One may finally imagine that such assistance should be open to co-financing by private operators.

5.2.2. Balancing of the markets and regulatory measures for AO wines: what paths for development under Title IV?

To avoid the creation of new surpluses, the CMO should contribute to strengthening the link between adjusting the dimensions of the available supply (harvest + reserves/ releases), quality policy, promotion and marketing objectives. It should therefore favour:

- the capacity of managing the potential of production in relation with the strategic plans for development of the AO;
- the annual adjustment of the available supply of each AO to the capacity for sales.

Management of the potential for production

The total liberalisation of planting, even if this is done within the limits of an AO, threatens to penalise a coherent growth strategy for the AO (too much production capacity, too soon). A control of planting rights guaranteeing the coherence of the management of potential in relation to the objectives for development and quality positioning of the AO therefore seems indispensable. This steering of planting rights for each AO should take place at the regional level and outside all constraints linked to national or European quotas.

Annual adjustment of the available supply

On completion of the proposed campaign of grubbing up, the correct co-ordination of the yield levels and the decisions to retain volumes (or to release volumes), guided by the marketing objectives for the *appellation*, should prove sufficient to guarantee the correct adjustment of supply to demand.

For this to be achieved, the fixing of the authorised yields should be integrated into a response to the economic balances of the *appellation*, while remaining within the limits of a target quality yield as defined by the INAO, temporary imbalances being absorbed by systems of blocking / unblocking.

To guarantee the effectiveness of these measures, authorised yield levels and the retention or release of volumes must be individualised as far as possible so as to respect the heterogeneity of situations and avoid the perverse effects of 'collectivism' which can lead to economically nonsensical results¹⁰.

So as to encourage the development of the upstream-downstream contractual relations over several years (contracts between wine growers and sellers), the possibility of publishing the constitutive elements of the costs or prices should be considered. Even though such contracts may be subject to re-negotiation in the course of execution, making these elements public should stabilise exchanges and would encourage strategies of investment in production and promotion.

What level of intervention?

An AO may not be managed unless there exists an authority capable of co-ordinating the management of the potential production, the annual regulation of supply, the policy for quality control and the use of promotional methods. The list of its responsibilities should include all the types of actions given above and related to regulation, downstream assistance, and design and execution of controls/sanctions for quality, etc. In the post-CMO world, this authority should clearly be regional and focused only on AO wines:

- according to the areas of production and the great heterogeneity of the structures of the sector (proportion in co-operatives, degree of integration of production, proportion under contract...), including the distribution networks and market dynamics, the structure of the production area (mixed or not), the technical procedures, etc.
- The regional level concentrating all the participants, it is *a priori* the best level for the selection and execution of measures

¹⁰ For example, homogeneous restrictions on the volume available for sale (via reductions in yields or the creation of reserves) penalise individual operators who have invested in quality and who have their own commercial outlets, their growth dynamics being hampered under such circumstances.

This should in the end make it possible to associate the wine sellers to the definition of the strategy and to the steering of the AO brand: let us recall that for many of these wines, while the production of the *appellation* is the business of the grower, the wholesaling is mainly done either by wine sellers or by specific subsidiaries attached to the co-operatives, and it is these operators who have the best view of the development of the markets and, consequently, of the possibilities for the development of the *appellation*

6. Conclusion

The reform of the CMO for grape and wine production aims to improve the competitiveness of the sector while committing it to a broad liberalisation in response to the developments desired by the WTO in relation to regulation and financial support for agricultural products.

However, the degree of liberalisation of the markets should be defined in relation to the specifics of the products, in particular in the case of *Appellation d'origine* wines. In fact, in contexts where there is a high degree of random variation and where production and marketing are not done by the same operators, preserving the quality of the products on which the reputation of these wines rests (and which leads to high demand from consumers) imposes collective regulation of supply. This last may in fact be considered as a generator of competitive distortions in the form of the special dispositions it imposes (limitation of volumes, regulation of the circulation of products, etc.). For example, complaints have been recorded concerning various *Appellation d'origine* products on the hindrance to free circulation of the merchandise created by national regulations: this is notably the case with Parma ham (slicing and packaging in the region of production), Grana Padano (grinding and packaging in the region of production) or the wines of Rioja (bottling in the region of production). In each of these cases, the European Court of Justice found in favour of the holders of the *Appellations d'origine*¹¹, considering that the distortion of competition created by these obligations should be assessed taking into account its positive effects in preserving the quality and reputation of the products bearing a notice of *Appellation d'origine*. Thus, such dispositions are legitimate if it can be demonstrated that they constitute a necessary and proportionate method of such a nature as to preserve the reputation of the products. From this point of view, the regulatory measures are legitimate due to their essential role in maintaining the reputation of the *Appellations d'origine*.

On account of the above, we can argue for the interest of a post-CMO target organisation founded on a bipolar model associating

- wines with an *appellation*, whose reputation is linked to the *terroir* and whose purpose should be to distinguish the European wine supply when compared with its competitors in significant volumes: it has been shown in this case that the regulation of markets was necessary for the preservation of this reputation and of the quality of the products on which the reputation is based;
- wines without an *appellation*, whose purpose should be to encourage, by associating them with the *appellation* wines, the development of wide ranges of products under the marketing brand of the wine sellers, whose own competitiveness would rest on criteria comparable to those for products coming from other producer countries (opening up of oenological practices, indication of variety and vintage, etc.)

The reform of the CMO for grape and wine production should therefore make it possible to create a framework for the transition towards a wide liberalisation of markets while encouraging the increase in power of this target organisation.

¹¹ CJCE, case C-388/95, 16 May 2000, Kingdom of Belgium versus Kingdom of Spain (bottling of Rioja wines in their region of production)
CJCE, case C-108/01, 20 May 2003, Consorzio del Prosciutto di Parma and Salumificio S. Rita versus Asda Store Ltd and Hygrade Food Ltd (slicing and processing of Parma ham in the region of production)
CJCE, case C-469/00, May 2003; Ravil SARL versus Bellon Import SARL and Biraghi Spa (grating and processing of Grana Padano in the region of production)

In this connection, its principal objective should in our view be to strengthen the competitiveness of European products and European operators on the world market, by:

- facilitating the strengthening of the power to regulate appellation wines, and increasing the financial aid to support / construct their reputation on interior markets but also and above all for export.
- organising and giving support to the voluntary exit of operators who will not be competitive in a liberalised system (in particular for wines without *appellation*).

At the level of dividing the financing between these two types of activity, two points deserve to be examined attentively:

- the objectives for grubbing up and the corresponding financing must be defined with regard to the future needs for marketing and must not be a hindrance for the capacity for future developments
- the assignment of resources from national envelope
 - o should avoid all financing of support measures destined to disappear subsequently so as not to encourage the survival of the old system of support, which would be not only ineffective but also dangerous since it could have a negative effect on appeals for voluntary grubbing up and, more generally, would not increase the responsibilities of operators for the orientations to be chosen in the period covered by the CMO.
 - o would only make sense if it allowed the regional regulatory authorities to define for themselves the best use of this finance during the period of transition (supplementary aid for grubbing up, aid targeted on downstream operations, setting up of systems for managing *Appellations d'origine*)

Finally, establishing conditions which are favourable for the success of the proposed post-CMO model presupposes above all an assignment of finance during the transition phase with its priorities organised around:

- actions to promote the association between AOs and brands, and to promote knowledge / development of markets for the operators;
- the setting up of a skill base related to the regulation and economic management of the supply.

Reform of the CMO for grape and wine production:
What model of organisation for the *Appellations d'origine*?

Annexes

Annex 1 - Difficulties of managing regional *Appellations d'origine*

The management difficulties seen today in the regional *Appellations d'origine* result both from an absence of quality guarantees and from the variations of available volumes which limit the investment capacities of the operators.

Quality control

We see today extremely high rates of approval for the harvest (the harvest is approved almost in its totality). Even if the approval does not aim to guarantee an organoleptic quality (it is supposed to guarantee that the wine sold is healthy, honest and saleable, in conformity to the consumption code), and if one may impute the defects of quality to a still inadequate oversight of the production conditions (in particular at the level of the modes of treating the vines), it still appears that a more restrictive system of approval should lead to a selection of the wines corresponding to what consumers expect from the reputation of the AO. With the aim of improving the guarantees provided by the AO, a reform of the procedures for approval is currently under way at the INAO (completion foreseen for 2008), aiming to approve wines as close as possible to sale, and based on the independence of the certifying bodies. Also, the French inter-professional AOC bodies have in recent years set up mechanisms of downstream quality oversight. Relying on taking samples from retail display spaces and tasting, the results obtained show that about 20% do not satisfy the organoleptic criteria supposed to correspond to the appellation, with 6 to 7% being directly imputable to the quality of the wine itself.

At the level of markets, the absence of appropriate controls added to a context of production surpluses goes some way to explaining the slide of regional appellation wines exchanged on the wholesale markets towards lower-priced market bands. If we observe in particular the case of the Bordeaux red regional appellation, we see a marked growth in the volume of wines sold at around €700 a barrel, although there remain some markets which are probably of better quality and more profitable, but which only have a minority share (figure 1). At the level of sales and marketing, we find the same phenomenon, with a growth of volumes sold at between €1 and €1.5/bottle, to the detriment of the higher price bands (figure 2). On these two types of market (intermediary and sale to the final consumer), the 'low quality' segment has thus tended to grow in volume in recent years, penalising both the overall reputation of the AO and the efforts of those operators in the higher quality segment.

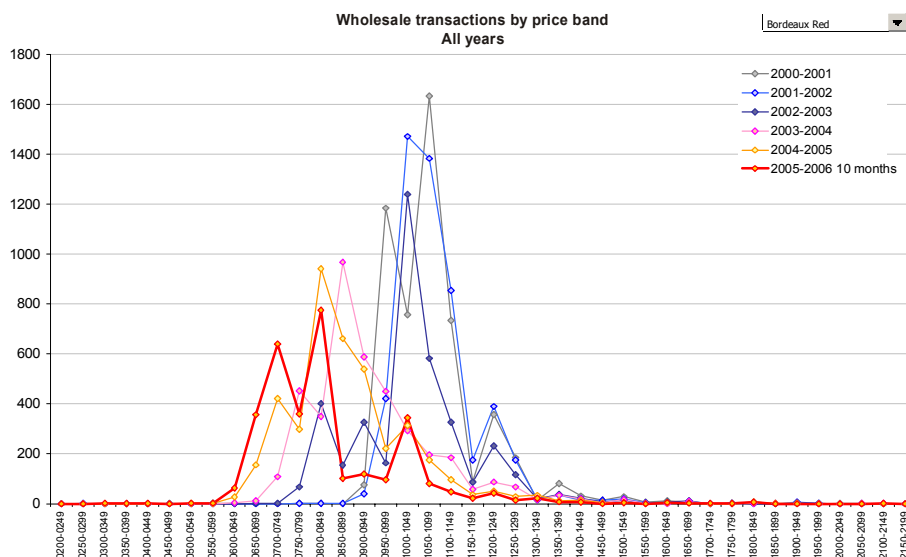


Figure 1. Volumes sold by price band on the wholesale market for Bordeaux red, all years together

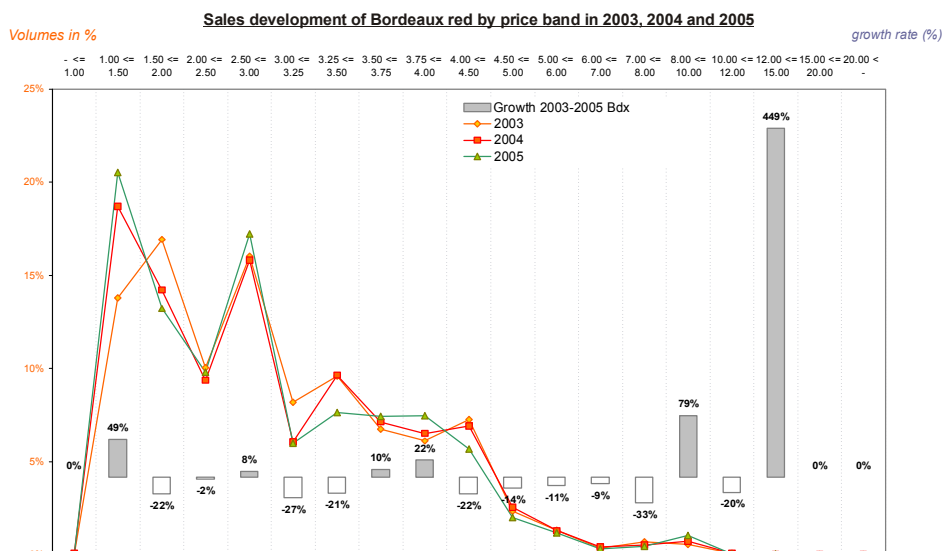


Figure 2. Volumes sold by price band in supermarket distribution (not counting hard discounts) – Appellation Bordeaux Red

Volume disturbances

The statement of structural surplus is estimated for all the French vineyards (with the exception of the Champagne vineyards) at 2,688,000 hl: the most affected vineyards are those of Bordeaux (surplus estimated at about 1 million hl, of which 625,000 hl are for the Bordeaux Red appellation¹²), followed by Languedoc with 670,000 hl, the Valley of the Rhône with 300,000 hl, Côtes de Provence with 250,000 hl and Beaujolais with 158,000 hl for the year 2005-2006¹³ (figure 3). These surpluses are partly linked to the maintenance of temporary surpluses which have not been dispersed in spite of the small harvests of 2003 and 2004 and all the attempts made at regulation (reduction in authorised yields, crisis distillation).

Thus, if we consider the history of the stated yields and of the yields actually put on the market (sales through final distribution networks in relation to surface, figure 4), we see a discrepancy which generates surpluses which have not been compensated for from one year to the next and which may be at least partially explained by the difficulty of integrating an economic justification in the decisions to fix authorised yields, and therefore by a low ability to adapt supply to demand. In general, the historical analysis of the development of stocks of regional appellation wines in relation to the harvest and to sales (see figures 5 and 6, covering the Beaujolais appellation and the Bordeaux Red appellation), shows an alternation of surpluses and ruptures between ill-matched harvest levels and levels of sales, leading in recent years to the creation of surplus stocks: the reduction of sales has not been accompanied by a sufficient revision of the yields for these appellations, in spite of years like 2002 and 2003 where the harvests were small in Bordeaux for climatic reasons. These variations in stock translate into a direct effect on the prices seen when the wines are first put on the market, which decrease as the levels of available stocks increase (cf. figure 7.)

¹² YKems has estimated the surplus for the Bordeaux Rouge appellation at 625,000 hL and has a figure of 840,000hL for the group of appellations Bordeaux Rouge + Bordeaux Supérieur + Côtes

¹³ Source : Report of the Assemblée Nationale of 26 June 2006 'Proposal for law relating to fixing yields for AOC wines for the agricultural year 2006-2007'.

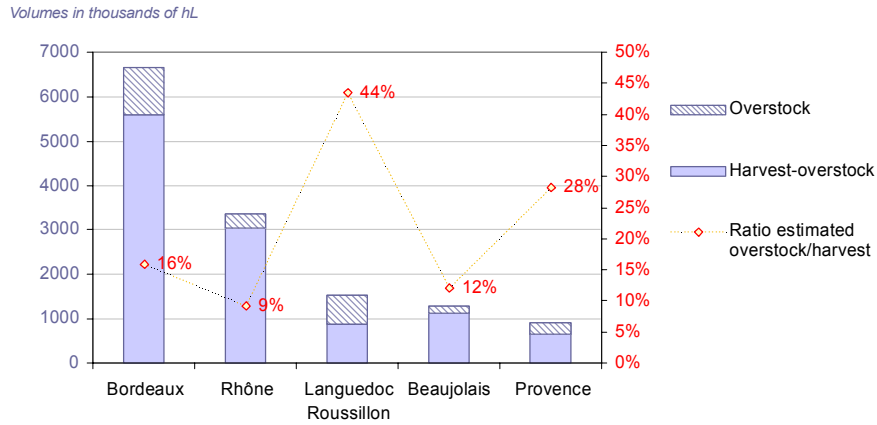


Figure 3: Estimated surplus stock for the whole harvest (2004-2005) – Example of some French AOC vineyards

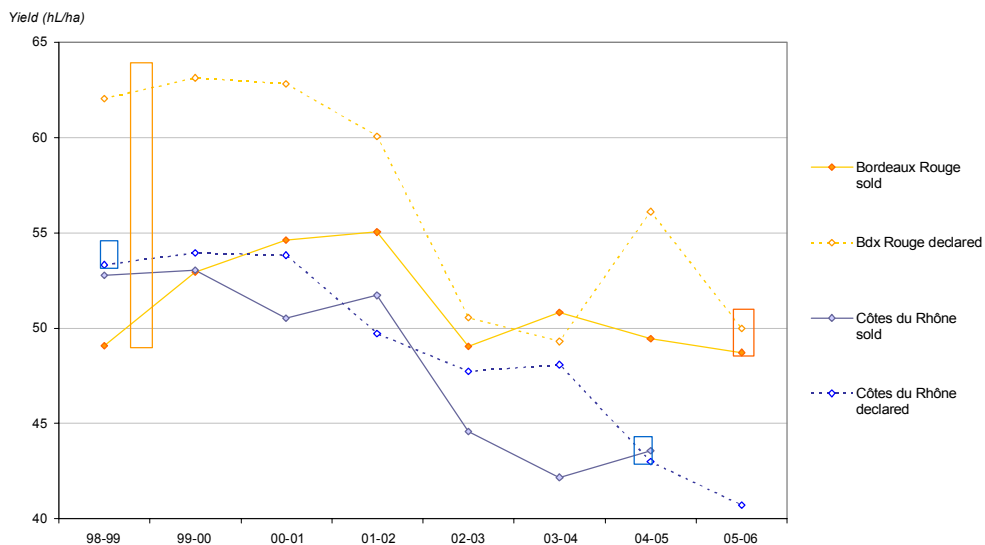


Figure 4: Development of yields sold and declared – Examples of Bordeaux Red and Regional Côtes du Rhône

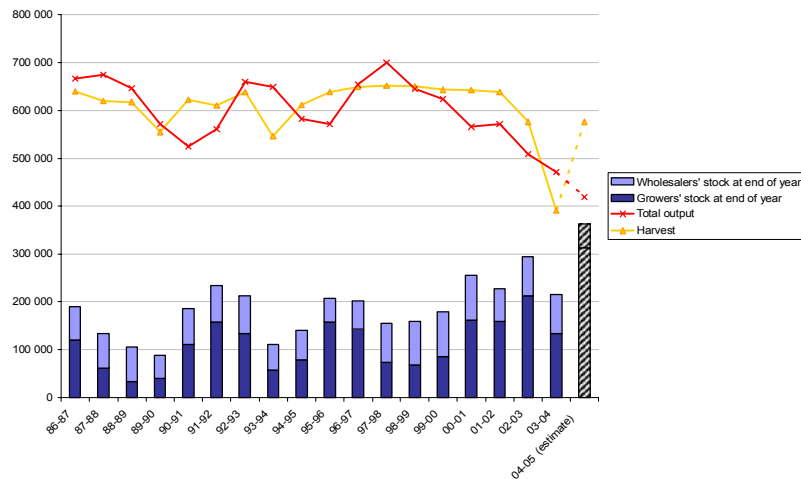


Figure 5. Harvest, sales and development of stocks of Beaujolais regional appellation

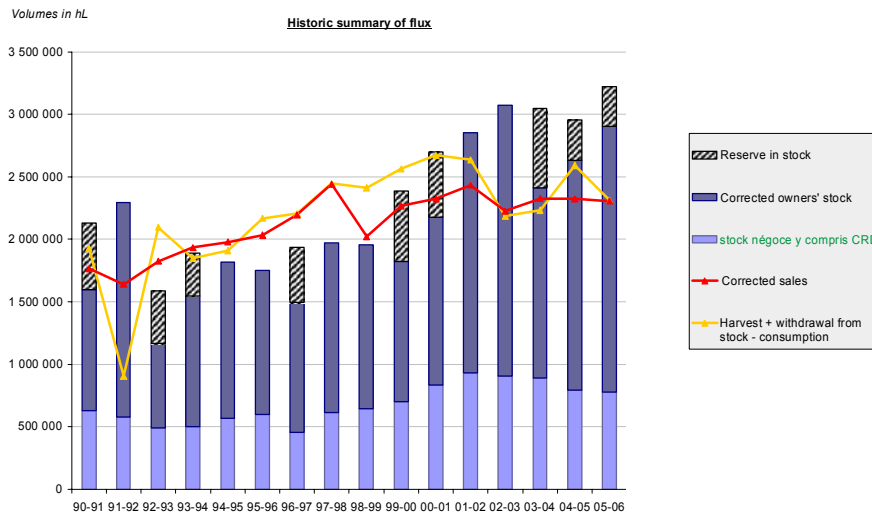


Figure 6. Harvest, sales and development of stocks of Bordeaux red regional appellation

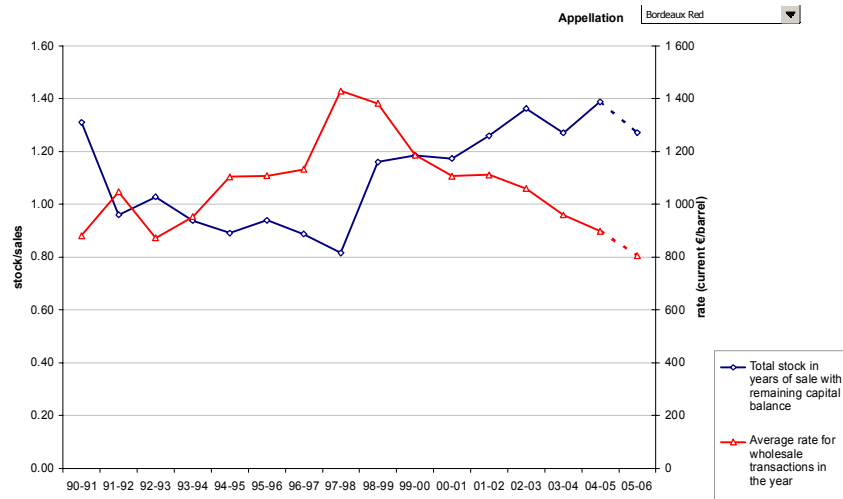


Figure 7. Price on the wholesale market and development of the stock / sales ratio - Bordeaux red regional appellation

Annex 2 – Place of the *Appellations d'origine* in the production and consumption of wine

Development of the world production of wine and the place of the *Appellations d'origine*

After a drastic reduction of the the areas planted with wine grapes, world production has shown an upward trend since 2000, despite significant annual variations, with 280 million hl produced in 2005 from a planted area of 7.9 million ha.

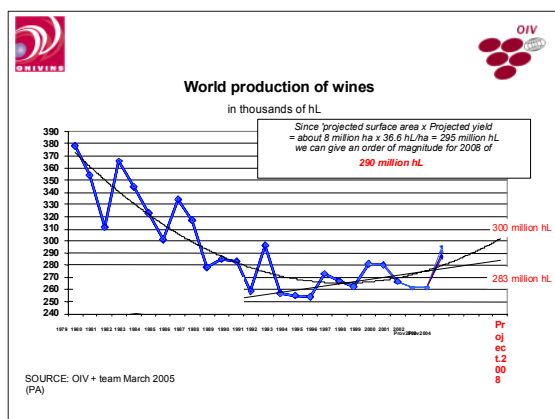


Figure 1 – Development of world production of wines

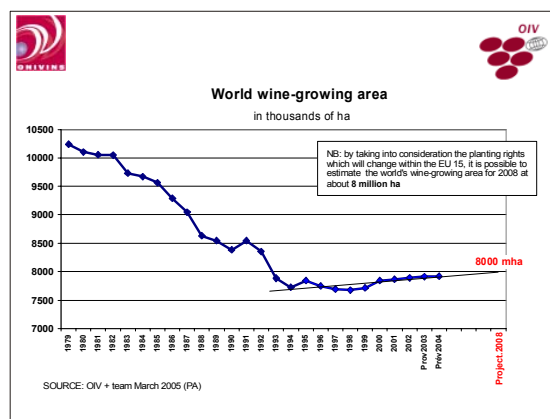


Figure 2 – Development of the world's wine grape area

The European Union remains the leading producer

With 3.2 million ha in 2005 (54% of the world's planted area), the European Union is the largest producer of wine, with France, Italy and Spain remaining the 3 leaders in 2004 with 18.6%, 22.5% and 15.6% of world production respectively. The growth of the EU's production is about 300,000 hl/year, which is compatible with the growth of world consumption. However, EU production has fallen by 11% for table wine and quality wine, with a policy of grubbing up of 700,000 ha between 1976 and 2005. It also shows strong fluctuations from one year to the next, which makes it difficult to balance markets: the strong production of 2004 created a crisis, above all for the large producers of wine like Italy, Spain (which initiated measures involving distillation) and France, which is still suffering the consequences (with surplus volumes evaluated at about 2.7 million hl in 2006).

The new producing countries

In the wine-producing countries of the New World, the overall production of wines remains stable and has reached 277 million hl since 2000, even if the years 2004 and 2005 were marked by spikes in production for Australia and the United States, while production from South Africa and New Zealand are decreasing.

The United States and Australia should see a slight growth of 6.3% and 7.3% respectively until 2008 and should therefore maintain their 4th and 5th places in the world ranking.

On the other hand, South Africa, last in the list of the top ten producing countries in 2004, due to its low production volume (6.47 million hl), will advance 3 places by 2008, moving to 7th position in front of Germany, Chile and Portugal, thanks to an explosion in production of 35.8% between 2004 and 2008. Asia (and China in particular) is also an important new actor, with 450,000 ha of the world's 7.5 million ha (of which 3.5 million are in the European Union).

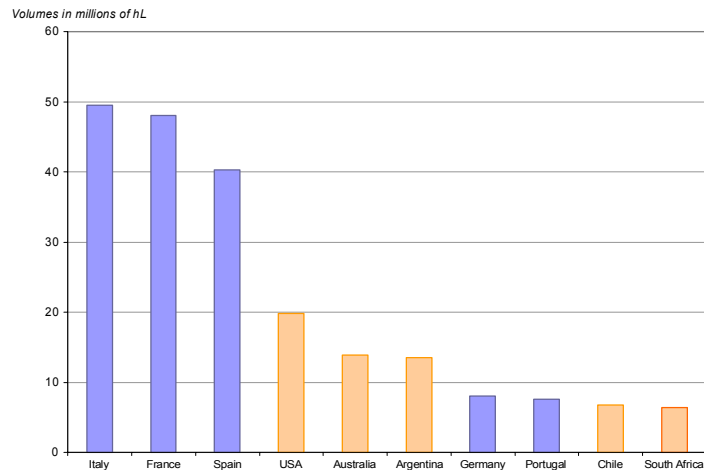


Figure 3 – Classification of the principal producer countries

Place of the AO and GI wines

In the main European vineyards, the areas planted with AOC represent about 37% (for Italy) to 57% (for France and Spain) of the total wine-growing area, and the number of AOC wines varies enormously from one wine-growing region to another: France, with 470 AOC wines, has the most appellations, followed by Italy with 331, Spain with 61 and Portugal with 32.

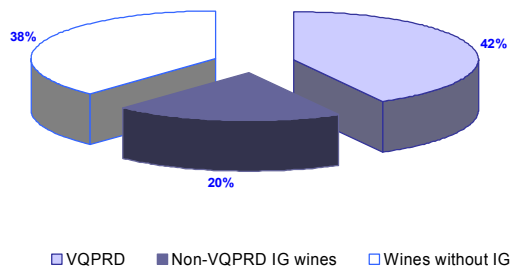


Figure 4 – Division of the wines produced in Europe according to their geographical identification (average 2000-2002, source ONIVINS)

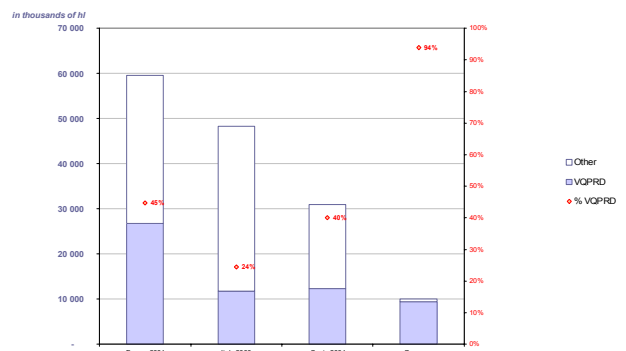


Figure 5– Structure of production in the leading European countries

Development of the world consumption of wine and place of the *Appellations d'origine*

After peaking at the end of the 1970s at nearly 286 million hl, the world consumption of wine fell sharply between the mid-1980s and the mid-1990s (to 223 million hl). Since 1996, we have seen a stagnation in consumption, and, with a total consumption of the order of 236 million hl, the year 2004 showed a slight increase over 2003 (234 million hl). This halt in the fall of consumption has been confirmed since then, but without this meaning that we can predict any durable reverse of the statistical trend: it is currently estimated that the growth is of the order of 1% per year.

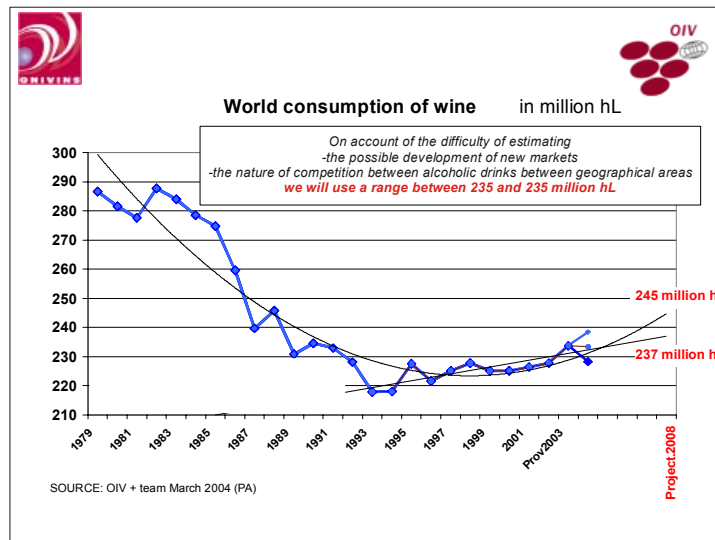


Figure 6 – Development of world consumption of wine

The European Union is clearly dominant when it comes to the share of sales, with 68% of the total consumption, with producer countries like France, Spain and Italy taking the lead: these three alone represent one third of sales. Next comes North America with 20% of world consumption, followed by Asia (7%), and then the other continents¹⁴.

World growth is principally seen in the United States, the United Kingdom and Germany. While in 2003 these three countries represented 25.4% of world consumption of still wine, it is estimated that in 2008 their consumption should reach 38.7 % in this market (27.7million hl for the United States, 23.6 million hl for Germany and 12.4 million hectolitres for the United Kingdom). Other markets may also see very rapid growth: it is estimated that Asia should represent 7.3 million hl by 2008 (vs 6.3 at present, which means more than 3.5% growth annually), while Scandinavia and Russia should reach 9.5 million hl (vs 7.5 million hl in 2004, i.e. more than 6% growth annually). In Russia, an annual growth in consumption of 20% is expected. China, the largest consumer country of the Asian zone, is continuing with a regular progression of its consumption (2.7% per year between 1999 and 2008) at a rate that is three times faster than the world level of growth in sales.

Despite these rather encouraging figures, wine consumption in the leading countries is in recession. While the consumption of the European Union has looked stable over the last ten years, oscillating between 126 and 132 million hl, it had fallen continuously in the previous decades. Thus, taking the criterion of consumption per inhabitant, the French consume an average of 57 litres/inhabitant (compared with 55 litres in Italy, 36 litres in Spain, 24 litres in Germany, 16 litres in England and 8 litres in the USA). Over 40 years, between 1961 and 2001, the consumption by inhabitant has fallen continuously in France and Italy, and while it has been cut in half over this period, it is the consumption of table wines which has been the most affected by this reduction. On the other hand, the consumption of VQPRD has risen, so that table wines and VQPRD are today consumed in equal proportions if we look at the 15-member European Union (reconstituted).

¹⁴ In total, the leading eight consumer countries consumed about 154 hL in 2004, which is 2/3 of world demand. The main consumer countries for wine are mostly countries which are also consumers. France is the first consumer country (about 34 million hL), followed closely by Italy (31 million hL). Then come the United States and Germany with a consumption of about 20 million hL each. Spain comes fifth with 14 million hL followed by Argentina with 12 million hL. The United Kingdom with more than 9 million hL is the leading market in a non-producing country.

Development of shares of VQPRD in European production and consumption

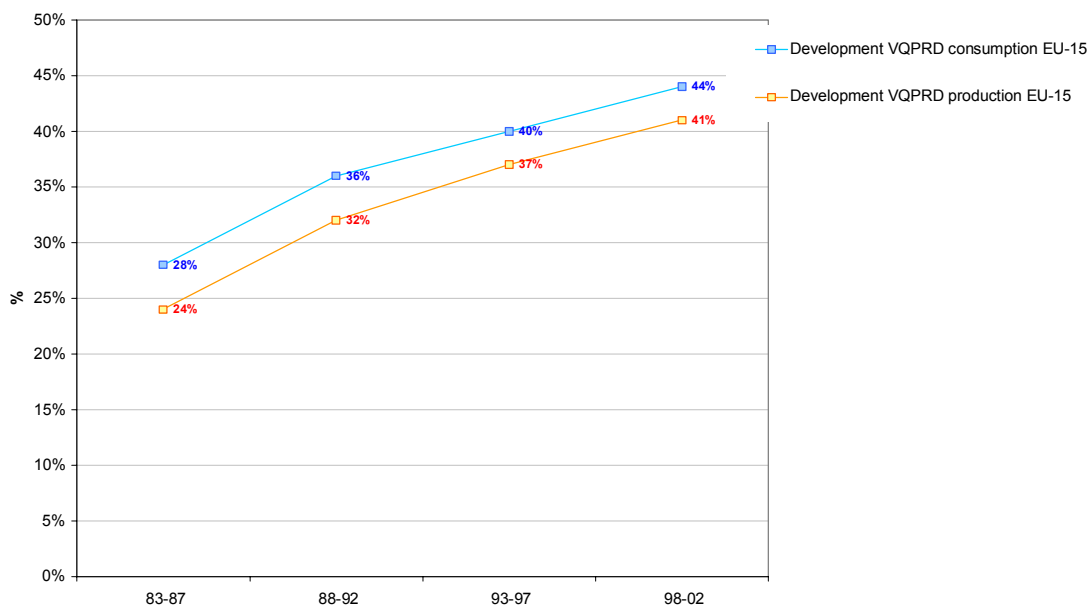


Figure 7 – Share of VQPRD in production and consumption in Europe

At the world level too, the share of sales of VQPRD is stable or slightly rising, while the consumption of table wines is in recession.

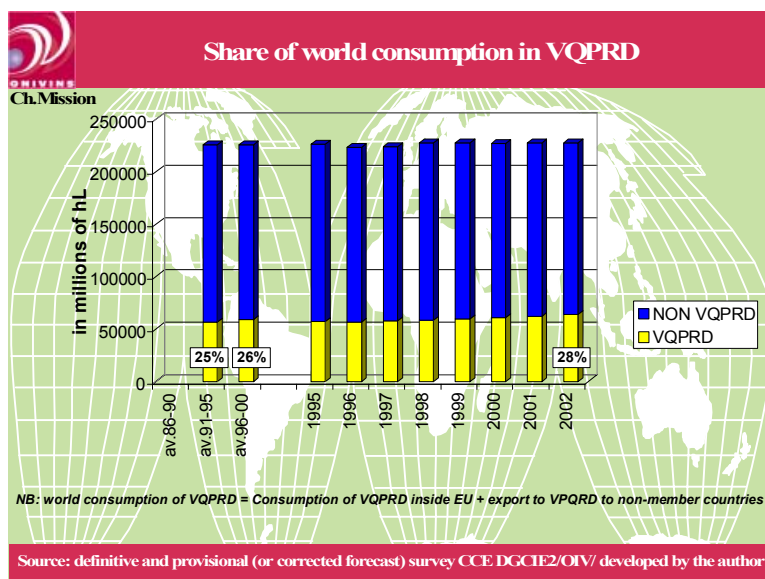


Figure 8 – Share of VQPRD in world consumption

In the end, three important facts are relevant for our arguments:

- i) The European countries remain the market leaders in a stabilised or growing international market.
- ii) These countries are experiencing a fall in consumption for table wine and are holding their positions for *Appellations d'origine*.
- iii) While world consumption of wine is dominated by table wines, the market share of VQPRD is growing slightly.

However, it is evident that consumption figures are not written in stone, and trends could reverse in the long run. The American market, and above all the Asian markets, could one day supplant the European market, and we should therefore be prudent when assuming or not that there is a demand from consumers for *Appellation d'origine* wines. Notwithstanding the fact that the public policies of the

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non-member countries are generally moving in this direction (expansion of the AVA system in the USA, delimitation of territories in Australia, etc.), we should rely on existing economic studies to confirm this point of view.

Socio-economic studies of wine consumption

Economists and sociologists have sought first of all to explain the overall trends in wine consumption. The parameters explaining demand may be of a strictly economic nature: the prices of wines and of substitute drinks (other drinks, whether alcoholic or not), the incomes of consumers, levels of taxation or advertising expenditure. They also make use of a large number of demographic and sociological indicators covering the characteristics of the populations being studied and their consumption habits. For this reason, the studies that have been undertaken are extremely numerous and have the advantage of not being limited to one particular country or type of wine. We can therefore look at analyses carried out in the traditional Mediterranean producer and consumer countries (France, Italy, Spain), in countries in northern Europe (United Kingdom, Germany, Benelux, Scandinavia), in North America (United States, Canada) and in Oceania (Australia, New Zealand) and Asia (China, Japan). We should also note a large number of more specific studies concerning demand for red wine, white wine, quality wine, *Appellations d'origine* or table wine.

We find in Bazoche, Giraud-Héraud and Surry (2005) a first comparative analysis of most of the studies carried out on price- and income-elasticities for the demand for wine (with one hundred publications collected so far). The first result shown up by this meta-analysis (econometric analysis of econometric studies) is the very strong distinction that may exist between the structure of consumption in Latin and Euro-Mediterranean countries in comparison with Anglo-Saxon countries. Also, it seems to be confirmed that the types of wines and the marking of their specific character plays an important role in the behaviour of consumers. These authors also show the influence of the origin of the wines on the level of elasticities.

A finer analysis of consumption, and therefore of the different markets, then makes it possible to justify (or reject) a certain number of accepted ideas on the revival of the traditional systems of *Appellation d'origine* in relation to the strategies of industrial brands. We can note:

i) Sociological studies making it possible to characterise consumers and their purchasing behaviour according to their individual characteristics (nationality, age, sex, socio-economic category, etc.) and the place of consumption (country, consumption at home, away from home, purchase at supermarket, specialist wine outlet, etc.).

ii) Econometric studies studying the purchase decisions of consumers and the willingness to pay. This is essentially a question of connecting the (objective and subjective) characteristics of the products on offer and the reaction of the consumer in relation to the decision to purchase a particular wine.

These two types of analysis start from the assumption that it is not so much the total volume of quantities consumed at the world level as the change of modes of consumption which constitutes the central point in a complete understanding of the economy of the sector.

At the sociological level, it is a question of explaining the development of the consumption behaviour of new generations, and the place and frequency of consumption in relation to the different wines. It is then important to understand as far as possible the behaviour of consumers in relation to the information transmitted to them by the labelling of the products, and whether this information shows them precise characteristics, typical features, certain or expected quality, and offers something which cannot necessarily be measured.

If we take the example of France, domestic consumption represents half of domestic production. But it is important to note that 2/3 of the wines are consumed at home and 1/3 outside the home. For home consumption, the French purchase wine largely in hypermarkets and supermarkets, which represent, according to the TNS panel of consumers, 60% of purchases of still wines for households.

In this context, INRA and ONIVINS have set up an observatory of wine consumption. This survey has run since 1980, is repeated regularly every five years, and is particularly rich in terms of the collected data. It allows us in to show how we have been seeing, since 1995, a recovery in the interest Study carried out by Ykems for the CNIV – original version in French

in quality wine in France, with, however, a proportion of declared non-consumers standing today at 38%.

To differentiate the categories of consumers, the criteria used has been the declared frequency of wine consumption:

- 'Every day or nearly every day': regular consumers
- 'Up to twice a week, or less than that': occasional consumers
- 'Never': non-consumers.

Even if this development seems to have slowed down since 2005, we see a powerful movement of a population from "regular consumers" to "occasional consumers".

In the case of Italy and the other Mediterranean countries, the non-consumption of wine translates into an increased consumption of beer and, there too, wine is little by little moving into the sphere of occasional consumption. The consumer then prefers quality to quantity. It is therefore chiefly table wines which register the fall in consumption.

Overall, and this is something that is also confirmed by many surveys, the consumption of the Mediterranean countries has developed over time towards occasional consumption outside the home of wines of the highest quality, as most often indicated by *Appellations d'origine*.

However, the socio-economic studies of type i) above are in reality very restricted in number. Although relevant for an explanation of the observed economic data, they are very expensive and difficult to undertake and therefore only concern a very limited number of countries (so that the INRA-ONIVINS study was the object of a decision for an expanded version by the OIV, which never in fact came about). This is why it is necessary to turn to the attached econometric studies to measure the demand from consumers for *appellations d'origine* on the basis of the available statistics.

Limiting ourselves to more specific studies (the consumption of a particular type of wine), the econometric studies on the purchasing decisions of consumers put a particular stress on measuring willingness to pay. This means explaining the observed sale prices and defining the important variables which influence these prices: the objective quality of the wines, their reputation - linked to an official sign of quality or provenance (VQPRD), their private reputation (fame of a brand or *domaine*, medals, classifications, etc.), the system of labelling and publicity, etc.. These studies principally use hedonist price methods. They are more numerous than the sociological surveys and are the subject of many scientific publications.

Hedonist price analysis and experimental economics

The hedonist price method is today the econometric method most often used to study the quality-price relationship of products. This method consists of carrying out a price regression on the characteristics of the products and may then provide a measurement of consumers' preparedness to pay. One then defines an implicit price for the characteristic by the differential of the price in relation to this characteristic (i.e, the value accorded by consumers to one supplementary unit of the characteristic). One is then led to distinguish the objective characteristics of the wine which are printed on the labels (*Appellation d'origine*, year, classification, etc.) from the sensory characteristics so as to discover the value that consumers implicitly attribute to these two types of characteristics. In application to the wines of Bordeaux and Burgundy, Combris *et al.* (1997, 2000), show that it is the objective characteristics which have most effect on price differences, and not the sensory characteristics (see also Nerlove (1995) and Gergaud (1998) for a study on the data from Champagne). Landon and Smith (1998) also show how it is necessary in this type of analysis to distinguish the individual reputation of a wine from the collective reputation to explain the fixing of a price on the market (this collective reputation being in the circumstances the reputation of the *Appellation d'origine* to which the wine belongs). By concentrating on the case of the Bordeaux *grand cru* wines, Jones and Storchmann (2001) supply an evaluation of the prices of the wines by establishing the relation which might subsist between the factors influencing quality and those influencing price.

All these studies show that consumers of wine are as much consumers of wine, in the sensory meaning of the term, as they are consumers of labels. This result is not in itself surprising and may be explained by a strong attachment to a brand or to an origin which the consumer evaluates positively, all other things being equal.

Study carried out by Ykems for the CNIV – original version in French

Are the *Appellations d'origine* supported by the wishes of consumers?

The reply to this question is complex, on account of the diversity of the objective parameters which affect the choices of consumers. The results obtained by Loureiro and McCluskey (2002) show, however, that the interactions between the geographical indications and other signals of quality improve the enhanced value of the products on the markets. There remains only the distinction between the collective brand that an appellation represents and the private brand: a distinction which is essential, but nevertheless difficult to make.

We find, however, in Schamel (2000), and Schamel and Anderson (2001), a whole series of arguments which tend to show that the region of origin of a wine brings an enhanced value which is not negligible, and is independent of the AOC system. From a more general point of view, we find in Bilkey and Nes (1982), Peterson and Jolibert, 1995, and Verlegh and Steenkamp (1999) complete reviews of the socio-economic literature, seeking to show that the influence of a country of origin on enhancing the value of a product is both significant and important. It also appears that globally, the brand is an element of information which is evaluated as less important than the region of origin (Alvensleben and Schrader, 1998, Tustin and Locksi, 2001), notably in the sector of wines where brands have little reputation (Atkinson, 199, Thode and Maskusa, 1998).

Also, by looking at the perceptions which consumers have of regional products, Tregear, Kutznesof and Moxey (1998) show that consumers associate the geographical origin to a specific product and that this association is most often linked to attachment to a heritage and to historical savoir-faire, something the technical specifications of the AOCs take account of (pedological aspects, respect of the rules for production, etc.).

In the end, it seems well established that the *appellations d'origine* may have a market value greater than the sensory characteristics of a wine and at least equal to that of a private brand. From this starting point, we see that there is a real publicity value in the notion of an *Appellation d'origine*, which is not well appreciated today by consumers: half of them make no real differentiation between an *Appellation d'origine* and a wine with GI, such as a *vin de pays*, and price does not constitute a sufficient indicator of differentiation (cf. figure 9), the *vins de pays* marked with a grape variety in particular being offered in price ranges similar to those for AOC wines.

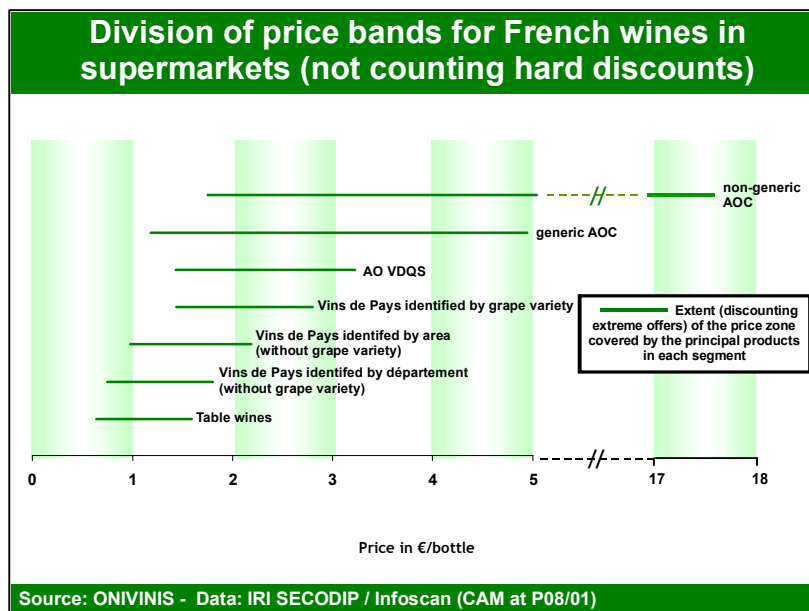


Figure 9 – price ranges for different types of wines in supermarkets

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Annex 3 - Collective reputation and regulation

Wine is one of the sectors for which the European regulations have authorised, under certain conditions, the utilisation of mechanisms to regulate supply. A first level of regulation relies on conditions for production linked to the notion of *Appellation*. Thus, the existence of a maximum authorised yield and an obligatory area of production, the control of the grape varieties used, and respect of certain non-intensive production practices contribute to a limitation of the capacity for first marketing and to the setting up of barriers to entry for producers (a producer who does not respect these production criteria being *de facto* excluded from the market of the AO in question). A second level of regulation concerns the collective procedures for compulsory storage (as in the case of retention) and the collective financing aimed to encourage the withdrawal of products (aid to distillation). These proposals for intervention involve producers' unions and sectoral organisations, the State then intervening afterwards, after a check by national organisations, to give force of law to these measures – in France the INAO for the technical specifications of the *Appellations d'origine* and the authorised yields, the General Directorate for Competition, Consumption and Repression of Fraud for the blocking and motivational finance for the withdrawal of products.

The legitimacy of collective interventions by groups of producers or interprofessional organisations when it comes to control of supply has already been the subject of many debates. Very often, the interventions are judged negatively because they might form part of an implicit or explicit attempt at price control, and in general mitigate against free competition. Nevertheless the professionals of the AO production and more generally of the collective quality marks, confronted by recurrent difficulties of co-ordination, frequently wish they could have tools for collective control and regulation of supply (see for example Raynaud and Valceschini, 1999, Bovet and Chappuis, 2001).

Even if so far the regulations define the authorised margins of action, it is still important to analyse their foundations, on the one hand because such practices may once again be subject to controversies at the European and international levels; and on the other hand, because the intensification of world competition leads the professionals of the AOs for wine to expand the mechanisms for regulation of supply (Giraud-Héraud, Soler and Tanguy, 2002), thus exposing themselves to attacks from producers or sellers who judge these limitations to be hindrances to their own commercial development; and finally, because the formulations used at present, in particular in the framework of the wine CMO, remain a little ambiguous.

The position according to which the agreements and joint practices must be compatible with the EU regulations was recognised in Title IV of the last CMO. The balance between the application of the general rules of the competition policy and the recognition of the legitimacy of regulation of supply is in fact found through the formulation of a restriction to the market regulation mechanisms. Thus, the member States, through the sectoral organisations, may lay down marketing rules to regulate supply on first marketing, provided that such rules relate to the retention and/or gradual release of produce, to the exclusion of any other concerted practice such as: (i) price fixing, price fixing, even for guidance or by way of recommendation, (ii) rendering unavailable an excessive proportion of the vintage that would normally be available and, in general, any abnormal operation to curtail supply (article 41 of Title IV). In other words, the blocking of quantities constitutes a tool for regulating the supply, which, like the maximum yield imposed on the AO, is judged legitimate when applied up to a certain level, but illegitimate beyond that.

The question is then to find out to what extent these mechanisms for regulation are necessary for the construction of the AO and for the maintenance of its reputation in the long term. We show below why the effects of *free-riding*, which are harmful to the appellation, may be avoided by this type of regulation, and why a regulation of the supply may be in the interest of consumers.

The teachings of the theory of reputation

Since the seminal article of Akerlof "The Market for Lemons: Quality Uncertainty and the Market Mechanism" (Akerlof, 1970), economists are increasingly aware of the importance of information for competition and market structures.

By setting out the example of the market for second hand cars (the *lemons* of the title), Akerlof characterised "goods of experience" by the fact that the characteristics of the products, and therefore their value from the point of view of the consumers, could not be precisely determined at the moment

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of purchase. The problem which then arises for a goods of experience market is that the producers may improve their profit by affirming that the product is of a higher quality than is really the case. Aware of this, prudent consumers are not ready to pay a high price for a product of unknown quality, and at the same time producers are not motivated to offer high quality products. Such a process thus leads to a collapse of the high quality market due to a "Gresham's law" effect, according to which the bad products chase out the good ones (absence both of supply and of demand for this type of products). The reason is that consumers cannot learn about the quality of a product (for example through repeated purchases), and consequently the producers have no motive to supply anything but the minimum required to authorise them to put their products on the market.

In the context originally analysed by Akerlof, the quality of the products is given and does not depend on the actions of the producers. That is a case of "adverse selection" where an exogenous supply is diversified in quality. If, on the contrary, producers can make strategic choices about the quality of their products, we can find ourselves in a situation of "moral hazard" (Shapiro, 1982) and it may be necessary to intervene in the information structure of the market to encourage a pressure in favour of quality. Indeed, if a high quality product appears to be profitable for producers and demanded by consumers, the sale of this product may be rendered possible by the improvement of information about the characteristics of this product and through labelling. Thus it becomes possible to understand the requirement of reserving the notice of origin which gives the reputation of products solely to products satisfying the technical specifications of the requirements and controls which guarantee the appellation, while avoiding all ambiguity in the identification of other products which could lead to confusion.

Schmalensee (1978) and Smallwood and Conlisk (1979) have considered the effects of learning in consumer choice by supposing that quality is positively correlated with the probability of repeating purchases. This approach makes it possible to explain the natural discipline of producers to sell products of good quality. We therefore find in Riordan (1986) a whole series of arguments making it possible to encourage the sale of products of experience, through the improvement of signals and the repetition of purchases. Nevertheless, as is underlined in Shapiro (1982), this approach is not based on the analysis of directly rational behaviour by consumers (how could they base their decisions to make or repeat a purchase on the prices attached to products whose quality is initially unknown?).

To respond to the criticisms of Shapiro, other authors (Klein and Leffler 1981, Shapiro, 1982; Bull, 1987; Malcomson and MacLeod, 1998; Hölmstrom, 1999) have adopted an approach of looking at reputation as based on the hopes of consumers in relation to quality. The principal argument is that the possibility of improving a reputation may be an effective method of motivating the sellers to offer high quality products. However, the condition of success for a good reputation is that firms offering good quality should have a real profit higher than the sum of short term profits which they could have obtained by cheating consumers.

Thus, Shapiro (1982) analyses reputation in terms of hoped-for quality and shows that a simple delay in improving reputation as a reward for high quality production may prejudice the market. It is also understood that disturbances to the supply/demand equilibrium for a category of products which affect the income of firms engaged in trajectories of constructing a reputation also damage their motivation to attempt high quality production.

To understand the stakes in building and maintaining a public signal of quality, we then require a theory of collective reputation.

Collective reputation

There are relatively few economic studies on collective reputation. For Tirole (1996) the agents forming part of a collectivity (for example, the employees of an enterprise, or the producers in an AO area), share a reputation based on the average quality produced by this collectivity. This author then shows how the new members of this organisation may suffer from the laxity of their seniors, collective reputation depending on individual reputations and vice-versa.

For Tirole, the past behaviour of individual agents is not known to consumers. The only thing that counts is the 'average' perceived past behaviour of the group, which the consumers use to predict the future behaviour of the agents. On this basis, Loureiro and McCluskey (2000) draw a parallel with the *appellations d'origine* to show how the success of an *Appellation d'origine* may be the logical consequence of controlling a previously existing collective reputation. Consequently, the setting up of an AO which has a good starting reputation will make it possible to reduce the social cost to Study carried out by Ykems for the CNIV – original version in French

consumers of acquiring information about quality. On the other hand, using a collective signal for products with an insufficient initial reputation will not be an effective marketing strategy; and at the same time, those firms producing an exceptional quality will reap no benefit from the collective brand.

Winfree and McCluskey (2005) approach collective reputation as a dynamic problem of managing resources: reputation is assimilated to a common resource, belonging to the group and from which private strategies are derived. Consequently, if we accept the principle of Karp (1992), a lack of restrictions to access to the resource will lead to rapid extraction of that resource (i.e. the producers will profit from the reputation as quickly as they can without making investments or efforts to maintain this reputation). In these conditions, Winfree and McCluskey show that in the absence of effective systems of traceability, collective reputation may only be maintained if the agents concerned are sufficiently few in number.

If the perceived average price has an effect on the perception of quality of a consumer of products marked with a notice of origin, something which tends to be corroborated in the case of wine by various studies (see annex 2), any disturbance linked to inappropriate levels of production capacity in relation to markets which affects market prices will reduce collective reputation and also in future destroy the hope of reaping a reward for quality.

More generally, various arguments have been mobilised in the literature to justify regulation in the context of defence of a collective reputation.

Regulation and collective reputation

Starting from an analysis of the costs of certification, Albano and Lizzeri (2001) show how a 'cartelisation' of firms may make it possible to improve the quality of certification, encourage collective reputation and motivate firms to invest. We also find in Marette *et al.* (2003) the same type of arguments, where sharing the costs of certification may produce the result that monopolistic behaviour is preferable from a social point of view to competition among producers. Auriol and Schilizzi, 2003 then discuss the comparative effectiveness of different modes of financing of the fixed costs of certification: contributions in proportion to the quantities sold, or public grants. Bourgeon and Coestier (2006) have also shown how public grants to control quality by groupings of producers may be justified, in spite of the a priori negative effect of monopoly power of one professional organisation on a specified market. Their analysis shows in particular the necessity of making a clear separation between quality control (and fixing the level of this) and the control of the market (from the point of view of prices and quantities). This second aspect may very well, in the public interest, be left to the discretion of private organisations of producers as long as the quality control is managed publicly.

Independently of the question of the costs of certification (promotion, control), a factor often justifying the regulation of an *Appellation d'origine* by implicit or explicit control of the quantities put on sale is the link which may exist between the reputation of a product and the level of production. When this link is found (as in the case of certain agricultural products where the ex-ante control of production may make it possible, all other things being equal, to improve the objective quality of the products), it is possible to justify the existence of a monopoly which will naturally act in the interest of consumers (Giraud-Héraud *et al.*, 2003).

In a general model of collective reputation where each agent chooses his own quantity and level of quality (therefore without their necessarily being an inverse relation between quantity and quality), the market price then being a function of the average of the qualities obtained by each agent and of the overall quantity produced, we may show that two market organisations may be socially optimal: a monopoly imposing a level of quality and the total quantity put on the market, or even a simple constraint setting a minimal level of quality, each remaining free to choose his own levels of quantity and quality. Competition will only be preferable if the regulator is capable of imposing a sufficiently high minimal level of quality. The regulation of quantity for the AO, seen here as a restriction of the supply, will be justified as long as the only authority capable of obtaining the socially optimal quality from each individual producer is an organisation grouping together all the operators enjoying a collective reputation.

Conclusion

It is clear that setting up procedures to regulate supply may in practice have other objectives than those linked to collective reputation: in particular a better adjustment of supply to demand, the logic of which is strictly limited to controlling quantities. Any decision to restrict supply then poses an immediate problem from the point of view of a policy for competition. Since it is imposed on all the producers of the appellation, it may appear as a distortion of the competition between producers (some may consider that it is a brake on their commercial development), this regardless of the percentage of harvest that is blocked. On the other hand, if we include the link, indicated above, between setting up procedures to regulate supply and the question of reputation, we understand better the basis of the response given by the CMO of 1999. In this framework, in fact, the idea that the control of supply may not effect an excessive percentage of the harvest may be interpreted as follows:

- Controlling the yield of an appellation and setting a mechanism for creating reserves of volumes constitute two tools seeking to limit the volumes produced, either for reasons of quality (because of an inverse relation between quantity and quality, and because of variations in production), or to avoid disturbances rendering ineffective the individual quality strategies which contribute to the maintenance of collective reputation

- Controlling the yield of an appellation and setting a mechanism for creating reserves of quantities contribute in a legitimate manner to the common good when they translate as a limitation of volumes up to a threshold beyond which the gains linked to controlling quality and maintaining reputation are higher than the negative effects linked to the co-ordination of producers; these are illegitimate when the regulation of the supply is situated beyond this threshold.

In this framework of hypotheses, it becomes possible to demonstrate the conditions which formally guarantee the correct foundation of a decentralised regulation of supply. It is also possible to show that the effectiveness of the regulation can only benefit from an expansion of the tools for intervention as long as the objectives being pursued remain coherent with the economic justification in article 41 of the CMO of 1999.

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Annex 4 –Vertical relations and range strategy

By relying on known results from the economic literature, we show under what conditions vertical separation between production (undertaken by the vineyard) and marketing and sales (undertaken by the wine sellers) is compatible with the efforts of marketing and promotion for *Appellation d'origine* (AO) wines. We set out within this framework the interest of regulation by the inter-professional bodies.

1. The need to develop commercial brands

The requirements in terms of regularity of products and the ability to react to orders from distribution networks impose a grouping of the supply, and for consumers, the favoured solution is to add simple signals to the notice of origin. The creation of brands, and their development in a competitive environment, has become necessary today for the following reasons:

- Brands leaning on appellations are what consumers demand. The Marketing literature explains the attachment to brands, this being linked to the quality of the signal and the regularity of acquisitions. In many studies, the accent is put on the demand from consumers for a continuous supply in a context of repeated purchases.
- A minimal volume of production is economically necessary to guarantee the continuous supply to the market, in particular in an environment where there is a significant development of supermarket distribution (with an increase of rates of rotation of products).

With more than 60% of the whole food and drink market, the power of supermarket distribution has important implications for wholesale markets, in relation to balancing the power relations between the upstream and downstream parts of the market. Many studies have shown that distribution brands have played a major role in inverting the power balance in favour of the distributors and to the detriment of producers and manufacturers, including their national brands. Mills (1995) has thus shown how distribution brands improve the performance of the distributor (i) by diverting sales which had previously been made under national brands in the direction of distribution brands supplied at a lower, intermediary price and (ii) by increasing the profit margins compared with national brands.

In the wine sector, these distribution brands have gained great importance because 25% of the wines sold in France, and nearly 50% of the wines sold in Great Britain, are sold according to this type of strategy. However, distribution brands do not necessarily act in the interest of the AO, because the effort made guarantees marketing of the product at a particular shop and not through a general (national and international) marketing network.

All these reasons mean that the development of wholesale brands, and their link with the development of multinational companies (Coelho and Rastoin (2004), Green, Rodrigues Zuniga, and Seabra Pinto, 2006) is an obligatory development for the long term profitability of regional AOs.

Nevertheless, this development requires significant expenditures on marketing structures, merchandising efforts and investments in publicity. On this point, the reputation of AOs should be able to act as an economic springboard for the brand: the brand will benefit from the mutualised investments undertaken to promote the AO, the brand indicating a capacity to buy from a region whose production is demanded by consumers while offering guarantees of quality and regularity. In a vineyard without an original reputation (for example, the vineyards of the New World or those providing European table wines), brands can only be built up on the basis of contracts for supply (Rousset, 2005). Inversely, in a famous vineyard (such as the European regional appellations), contracts are very difficult to maintain because of the breaks in supply linked to the alternative development of systems of direct marketing (Giraud-Héraud, Soler, Tanguy, 1999, 2001). The question of the maintaining wine sellers' motivation to invest is then the key question of the economic development of AOs.

2. The problem of "Hold-ups" in supply contracts

The question of effective investments in the framework of relations between enterprises has been developed many times in the economic literature. Whether it is a question of the vertical relations between producers of raw materials and processing enterprises, or between producers and marketing enterprises (wholesalers, supermarkets, etc.), their commercial relations only rarely take account of the whole set of efforts that different partners may make to improve the enhanced value of the products on the various markets. The processing enterprises and the distribution enterprises may thus be led to under-invest in innovation or marketing efforts, simply because the relationship with suppliers is not stable and supplies can not be guaranteed, whether from the quality, quantity or price point of view.

To characterise this phenomenon, called "hold-up", economists use notions of specific assets and incomplete contract.

An asset is said to be "specific" to a given use if it loses its value if it is used for another purpose. The specific character of an asset involves economic dependency for its owner, and if he is not protected by a perfectly enforceable contract, he may fear *ex-ante* that part of the value of his asset will be expropriated *ex-post*. He will then prefer not to invest.

Contracts, even when it is materially possible to implement them, which is not always the case, may make it possible to remove a certain number of risks in the inter-enterprise relations. However, they can only very rarely include all the market contingencies (Gonzales *et al*, 2003) and the various opportunities related to this or that innovation, or to the needs for greater investment in emerging markets, for sufficient efforts in marketing, etc. This is why the economic literature usually speaks of "incomplete contracts", to analyse the harmful effects of a lack of commitment to the various contributions that an enterprise may expect from its partners. The contracts are said to be "incomplete" because they cannot foresee all possible cases, contain all the details, or be perfectly clear for all third parties.

For an overview of the literature bearing on hold-ups and incomplete contracts, we may consult Schmitz (2001). The original contribution of Holmstrom (1982) notably makes it possible to explain the emergence of these phenomena in the framework of production by teams (clubs, organisations of producers, etc.). In particular, if investments are not contractable, and the members of a team share the surplus created by common production, Holmstrom shows how difficult it is to envisage that all members of a team will receive their total share of investments. Williamson (1985) and Klein (1988) have then suggested that the integration of units of production should improve organisation in such cases. The consequence of this phenomenon is therefore that vertical integration would most often be preferred to the market in the case of transactions implying specific assets.

Nevertheless, simple mechanisms may exist making it possible to organise effective investments. For example, Aghion, Dewatripont and Rey (1994) have shown that the problem of under-investment can be solved if it is possible to set up schemes for re-negotiation. Noldeke and Schmidt (1995) have also shown how simple optional contracts may make it possible to resolve the problem of hold-ups. Finally, De Fraja (1999) shows that the introduction of a sequence in the investments and of *ex ante* planning of the re-negotiation of the initial contract after the risks are revealed may also make it possible to return to an optimal situation. To apply this work to the question of the choice of investments in a context of vertical separation (vineyard / trade), see Gaucher, Soler and Tanguy (2002).

These solutions may if appropriate be used when the context of power relations between producers and distributors favours them. However, to demonstrate their effectiveness, most authors rely on an asymmetrical distribution of negotiating power between the enterprises, with one of them hypothetically able to impose a contract-type on the other enterprises.

Usually, we may ascertain that the repeated character of the economic interactions makes it possible to explain why, in the absence of vertical integration, investments are not necessarily sub-optimal and that vertical relations may be regulated by simple contracts which do not require special mechanisms for re-negotiation. The fact that suppliers do not have guarantees of sales from one period to another may in fact permit this effectiveness.

This type of argument generally arises when investments are made repeatedly (as for example for regular marketing efforts), so that in consequence the effects of reputation make it possible to maintain the effectiveness of the relation (Hälonen, 2002 and Baker *et al*, 2002). If, on the other hand, the investment is relatively heavy, but only rarely needs to be made in the course of the relations

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between the enterprises involved, contract exclusivity may become necessary to protect the investment of a marketing enterprise (Klein, 1988).

3. Necessity to regulate the spot market for regional AOs

The parties to a transaction generally have to make a choice between an investment with a special character and an investment with a general character.

As long as the contracts are executed as foreseen, the first type of investment will often make it possible to reduce costs. But such investments are also risky, since specialised assets may not be redeployed without loss of productive value in case of interruption or premature termination of the contracts. Thus, the threat of 'hold-ups' that we have just discussed is one of the reasons for the organisation of transactions within the chain (as well as the specialised literature cited above, we may consult the more basic studies of Klein, Crawford and Alciac (1978) and Grossman and Hart (1986) on the subject).

We note that:

- a. The opening of new markets for the product of an AO which he neither owns nor enjoys a monopoly over exposes the wholesaler to competition with other suppliers of the same AO, the producers themselves, grouped in co-operatives capable of assuring the same functions of *blending* and logistical optimisation in a competitive manner, while benefiting from the existing reputation of the appellation.
- b. In the absence of this competition (only sellers maintain competence for marketing), if the producers are grouped together and capable of exercising some power over the market, they may be able to demand an increase in remuneration for their raw material (AO), in parallel with the development of the markets for the AO, which will again expose the seller to the possibility of not obtaining the expected remuneration for the part of his investments in marketing which may not be recovered.

Several schemes for vertical organisation and for differentiation of products nonetheless make it possible to avoid the disincentive to invest. This is the case especially if the seller has a commercial area and a range of products making him indispensable for access to networks seeking to minimise the costs of supply; this will also be the case if the seller manages to differentiate his AO-Brand product from the classical AO product (cf the great brands of Champagne).

When the assets deployed in the transactions are moderately specific, hybrid forms of non-standard contracts may appear. Adaptation is then realised jointly by the two partners, through explicit mechanisms to determine their choices, or simply relying on mutual confidence (Ménard, 2004).

In the case of the wine sector, the stabilisation of prices by a regular adjustment of supply to demand can then avoid opportunist behaviour (in the harmful sense of the term) in the AO markets. The regulation of the intermediary market thus becomes the simplest method of developing distribution brands.

Vertical separation is not an obstacle in itself for investment in the marketing of AOs, and the dynamics of mutual strengthening of private brands and of the reputation of the appellations have been confirmed (cf. Champagne, Porto). They seem in fact indispensable to guarantee a regularity of supply and to allow brands to create contracts with technical specifications which differentiate their products from the minimum criteria required in the framework of the AO. In the framework of a simplified segmentation of the supply and an effective regulation of the regional AOs, ambitious strategies for development of the regional trade (passing via a concentration of the sector) can thus come about and find external sources of funding (see Saulpic and Tanguy, 2004).

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Annex 5 – Main systems of regulation used or tested in French vineyards

The regulatory measures employed so far are of 3 types:

- Regulatory measures for production via the reduction of planted areas and/or the reduction of yields, these measures being mostly supplemented by financial aid from the sectoral bodies complementing national and/or European support funding,
- Measures to reduce the surplus volumes by distillation, also accompanied by financial aid to motivate wine-growers to use this rapid solution,
- Regulatory measures for stocks thanks to the setting up of good-quality reserves whose management may be organised not only to resolve the problems of surpluses but also to avoid creating too many reserve stocks, and to create a motivation to maintain quality.

The practice of grubbing up has above all been seen in the vineyards of Bordeaux and Languedoc. Thus, since the wine year 1999-2000, grubbing up has increased by about 75%, going from 785 ha for 1999-2000 for the group Bordeaux Red + Bordeaux Supérieur + Côtes to 1351 ha for 2005-2006 with an average of 1900 ha grubbed up per year over the whole area. Although at first these campaigns of grubbing up were more aimed at vineyards for the production of white wines, they have been redesigned since 2003-2004 to concentrate on the *appellations* having the largest surplus volumes in stock (Bordeaux Red in particular).

Grants for grubbing up are instituted to encourage definitive exit from the sector. So in the Beaujolais area, aid for 2006 and 2007 amounts to 6000 €/grubbed-up ha from the European Union, to which is added 2000 €/ha from the State, the sectoral body undertaking to pay a complementary amount of 1700 €/ha.

In order to reduce production, apart from the reduction of planted areas, **the reduction of yields** is also used. Faced with the reduction of yields sold, a readjustment of fixed yields has taken place throughout the vineyards of France: the case of the Bordeaux Red appellation is an illustration of this, with yields which have gone from 60 hl/ha in 2001-2002 to 50 hl/ha in 2005-2006; or in the case of the regional appellation *Côtes du Rhône*, from 53.8 hl/ha in 2000-2001 to 40.7 hl/ha in 2005-2006. In spite of these reductions, the recorded yield remains higher than the yield sold, which explains the creation of more surplus stock each year.

But these measures, taken too late, have not made it possible to avoid the accumulation of stocks for several years. This is why more drastic measures, seeking to destroy the surplus production through crisis distillations, have been taken since 2000-2001 in certain growing areas.

Distillation is voluntary, and therefore practised according to the free will of the growers, but at the same time encouraged by European, national and inter-professional grants. On 7 June 2006, the European Union decided to finance distillation up to 1.914 €/degree of alcohol/hl for table wines and 3 €/degree of alcohol/hl distilled for quality wines, with a ceiling of 5000 Euros/grower and under the condition of a minimum of 450 hl distilled per grower (the last condition applying only to the distillation of table wines). This European supply being less than the demand that the French State had presented to the European Union, the French Government has undertaken to supply supplementary aid to growers, making it possible to increase the total aid (EU + France) to 2.90 €/degree of alcohol/hl distilled for table wines and to 3.35 €/Degree of alcohol/hl distilled. If the total amount of aid is attractive for table wines, it remains insufficient for quality wines, which is why some sectoral organisations have also participated in support for distillation.

Thus, for certain appellations, the amount of cumulative aid has almost reached the rate for wholesale price (for Bordeaux Red it stands at 730 €/ton distilled). In 2005-2006, distillation was the end of the road for 185,056 hl for the Bordeaux area (124,000 hl of which was for the Bordeaux Red appellation), 130,000 hl for the Beaujolais area, and 22,000 hl for the Côtes de Provence. For 2006-2007, distillation will reach 368,048 hl for the Bordeaux wine area, 181,031 hl for the valley of the Rhône, 162,031 hl for Languedoc-Roussillon, and 123,640 hl for Beaujolais.

Distillation has only had mitigated success since the delays for payment of grants that have been awarded are much longer than those for the execution of contracts. Certain producers therefore prefer to release their wines on to the market at low prices rather than practising distillation and then waiting for the support payments to be made.

Some sectoral bodies have therefore created relay credits. The Interprofession calls on a bank to supply liquidity to operators at the time of distillation, which makes it possible to cover the payment of grants. The operators then reimburse the amount of this loan to the Interprofession which made it, plus interest. The Interprofessions of Bordeaux and the Côtes de Provence, which are profoundly affected by stock surpluses, have taken this decision.

However, if the distillation measures make it possible to destroy part of the existing overstocks, they are not appropriate for smoothing out discrepancies between supply and demand. In other words, the destruction of surpluses is only a last resort in the face of an established crisis which it would have been preferable to avoid with better regulation of the adjustment of production to market conditions.

Creation of reserves / Retention and release mechanisms

Regulatory measures for stocks based on setting up reserves associated with management of individual or collective blocking and unblocking of these reserves have been attempted by several inter-professional bodies. In case of a high quality harvest, these creations of reserves make it possible to remove a share of the volume from sale so as to be able to use them later on in case of shortage. They are in certain cases matched with measures of ISV type (Individual Substitutable Volume) enabling producers to replace part of the volume without unblocking by wines produced over the authorised yield level, with the aim of increasing the average quality of the reserve stock.

Beyond these quality aspects, **these approaches aim to smooth out as far as possible the fluctuations of production, and also the tensions which might appear during the first marketing: the reserve is then assimilated to a regulatory stock. For example, the systematic utilisation of this mechanism in Champagne has made it possible to limit imbalances between supply and demand (figure 1) and at the same time to reduce tensions in the grape market (in case of a small harvest as in 2003) but also in the market for “vins clairs”¹⁵, where a lack of supply of grapes to the wholesale trade can generate significant price increases.** Thus, in 2004, despite sufficient production to cover the needs of the sector (14,000 kg/ha authorised with an initial blocking of 1200 kg), the trade was not able to cover its needs for supply from the grape market and had to turn to the secondary market for “vins clairs”. Estimates made before the opening of the latter set the demand at 150 000 hl for a supply of 50 000 hl. The Interprofession of Champagne therefore unblocked 1000 kg/ha and delayed the opening of the market for “vins clairs”, which made it possible to avoid a price explosion.

¹⁵ First stage of wine making in Champagne

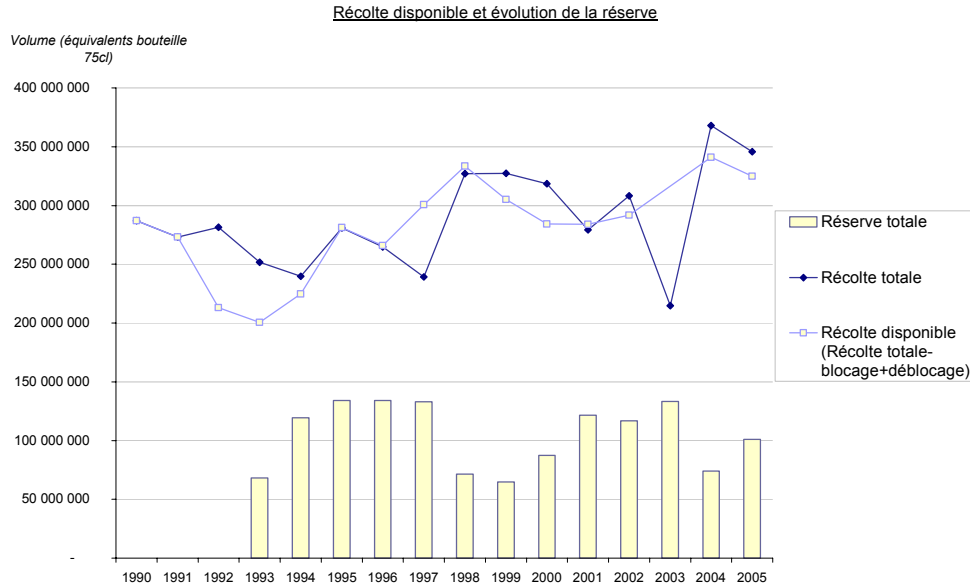


Figure 1 – Smoothing of the available harvest by using the reserve – Champagne Appellation

However, other attempts to set up collective quality reserves in a systematic fashion have often met with failure, due to the small volumes concerned (in Bordeaux for example) and to the systematic release of volumes in the year following the blocking. Since the trade comes to anticipate this release, the volumes removed from the market continue to weigh on the prices¹⁶ (which presumably demonstrates the ineffectiveness of the mechanism of creating reserves).

Certain approaches, however, rely on this same mechanism of regulation but accompanied by finance for operators to motivate them not to unblock reserves. Thus, the Côtes du Rhône appellation experimented in 2005 with a plan to control supply which was organised as follows:

- The inter-professional body contracts a loan to finance the wine put into reserve by the producers in the scheme up to an amount of 80€/hl (when the rate was YYY €/hl) and also covers repayment of interest.
- Withdrawal of 200 000 hl from the market, blocked until there is a decision to release it from the inter-profesional body, conditional on the rise of the market price
- During the release, if the market price has risen, the producers reimburse the amount initially advanced by the inter-professional body (otherwise, the inter-professional body takes charge of the discrepancy)

¹⁶ Even if the authorisation certificates are only issued at the time of release

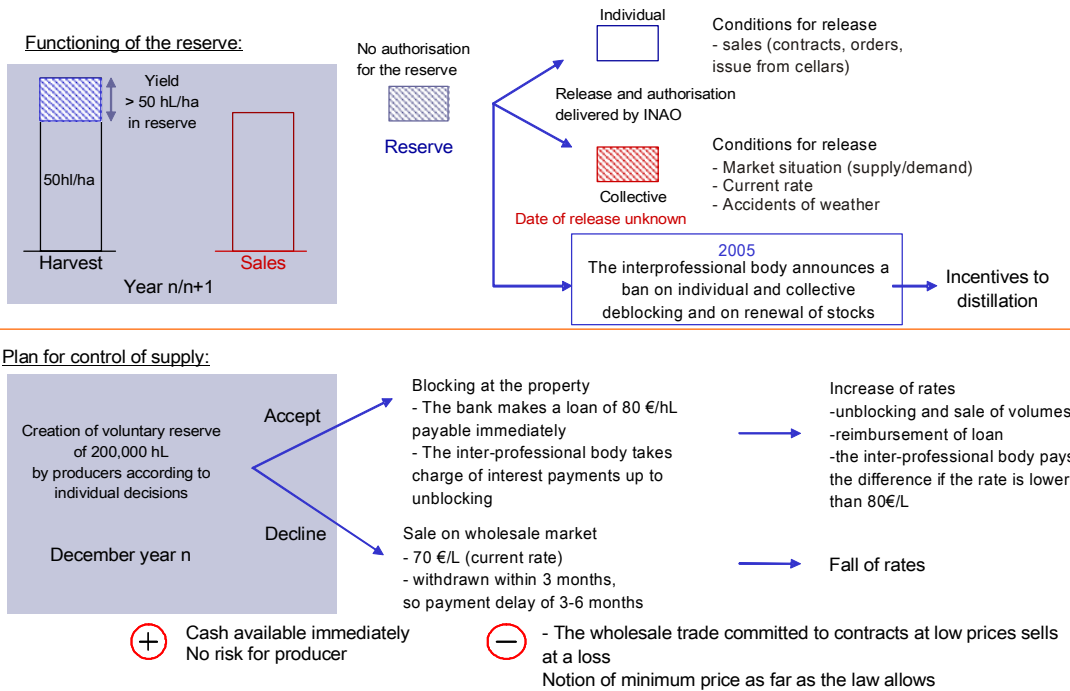


Figure 2 – Regulation through creation of reserves in Côtes du Rhône

In the end, collective management of a reserve is difficult to maintain. Thus, as with direct financial incentives, it has been very complicated to set up in Côtes du Rhône and is still far from systematic. In particular, the uniform application of the measure generates inequalities linked to the heterogeneity of individual situations and in the end, operators demand more available volume, even if they can only sell it at a low price, essentially for reasons of cash-flow. Strong political tensions within the sector create a pressure for too rapid unblocking, with cancels the impact of all blocking.

This is why we see today an orientation towards planning for the individualisation of the practices of creating reserves (individualisation of blocking or individualisation of de-blocking). For example, the blocking may be *individualised* in the framework of an established maximum yield which is valid for all operators; the sectoral organisation grants the right of creating a reserve on condition that the operator does not go beyond an authorised maximum reserve stock. This is the case for example with the mechanism of ICV (individual compensatory volume) tried, exceptionally, in Chablis (constitution of a reserve of a maximum of 30hl/ha, up to a limit of 10hl/ha/year, and releasable individually as long as the ICV for the stated yield does not exceed the basic yield. (see figure 3). Champagne is also following this path so as to develop its own reserve system, for the time being associating collective blocking and individual de-blocking (see figure 4).

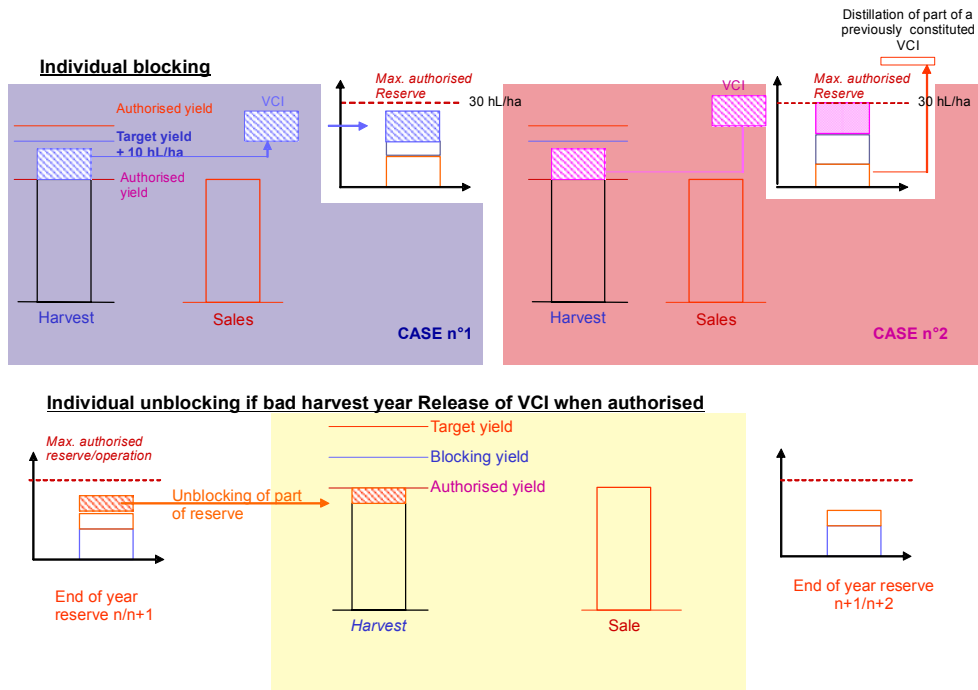


Figure 3 – Individualisation of blocking and un-blocking: the case of the ICV in Chablis

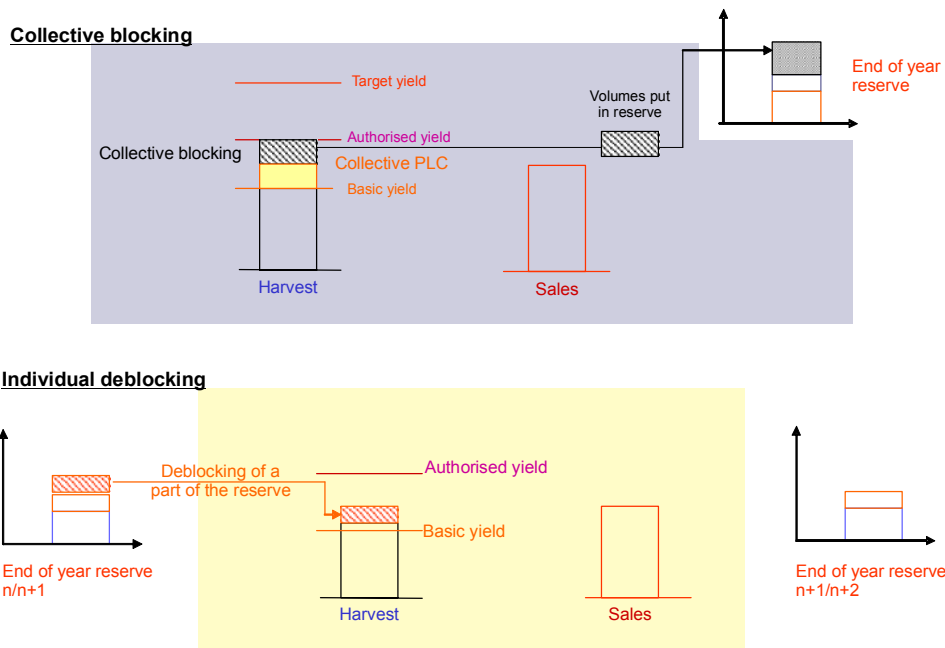


Figure 4 – Collective blocking and individual de-blocking – The case of Champagne

Individualisation of yield decisions

Taking account of the difficulties linked to the collective regulation of production, and the impossibility of maintaining systems to create reserves without a priori adjusting supply to demand, our current reflections are orientated towards integrating individual economic reflections into yield decisions. A proposal moving in this direction has therefore been formulated by the Interprofession of Bordeaux (see figure 5).

So far the Interprofession of Bordeaux has managed the blockings and de-blockings of reserves in a collective manner by means of a collective PLC (“plafond limite de classement” ie

Study carried out by Ykems for the CNIV – original version in French

maximal classification ceiling, characterising the volumes produced beyond the authorised yield but having a right to use the appellation) defined each year, when decisions are taken about the yields per appellation to be defined for the following wine year.

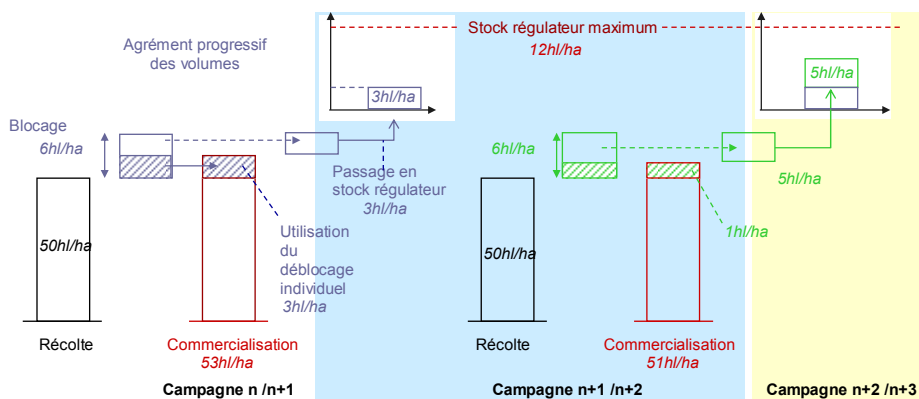
So as to individualise these management rules, the proposal that has been formulated associates the definition of a basic yield to an individual PLC. The volumes between the basic yield (50hl/ha for example) and the PLC would only be authorised during the year if the volumes sold exceed 50hl/ha (the conditions for approval being linked to sales).

In the course of the following year, the residual volumes would be reassigned as regulatory stocks if sales do not reach the level fixed by the basic yield and the PLC. A new basic yield and PLC would then be defined while deploying a mechanism similar to that for the preceding year. As long as the regulatory stock thus constituted reaches a limit which is to be defined, the volumes being placed in reserve may replace those of previous years as long as the latter are then destroyed.

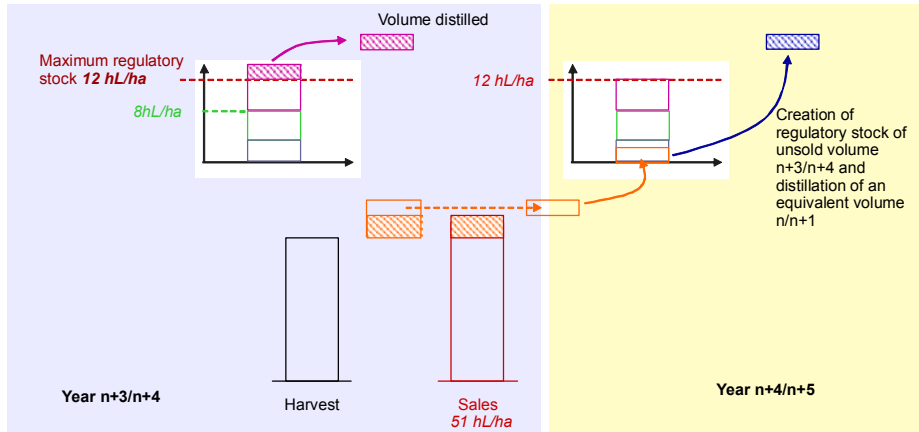
The de-blocking would be decided by the inter-professional body in case of risks to production or sales. Originally collective, it could be individualised according to the possibilities of the sectoral organisation to mobilise people to manage the files for demands for individual releases and to oversee marketing for each operator throughout the year.



- Campagne n / n+1 : Rendement de base + blocage ; les volumes entre le rendement de base et le volume bloqué ne seront agréés durant la campagne que si les volumes commercialisés dépassent 50hl/ha
- Campagne n+1 / n+2
 - Basculement des volumes résiduels en stock régulateur si la commercialisation n'atteint pas le niveau rendement de base + blocage
 - Redéfinition d'un rendement de base + blocage et mécanisme similaire à la campagne n/n+1



- The regulatory stock is limited to x hL/ha; when this platform is reached, the volumes going into reserve may replace those of previous years as long as those volumes above the ceiling are destroyed.
- Unblocking: this is decided by the inter-professional body in case of variations in production or sales. A priori collective, it may be individualized.



Finally, the desire for increased individualisation of regulatory measures, either by the creation of reserves or by ‘economic’ management of yields is a good illustration of how difficult it is for the authorities in charge of regulation to apprehend the diversity of individual situations. However, at the practical level, setting up such systems is meeting great difficulties today: the complexity of the information systems, with economic information available too late, splintering of decision-making structures, etc. Advancing along this route therefore supposes a complete renewal of the organisation of the sector and of the associated available management tools.