

Wine Market Regulations in a Small World



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Davis



Henrich Brunke*, Rolf A.E. Mueller*,
Daniel A. Sumner**

Main points

1. Regulations on wine and grape production methods differ between Old World and New World wine regions and lead to clashes
2. More trade and more closely linked markets imply that old regulations may no longer be suitable
3. Old world regulations are slow to adapt and may impede the competitiveness of Old World wine producers
4. Restrictions on production methods used by imports may cause trade clashes

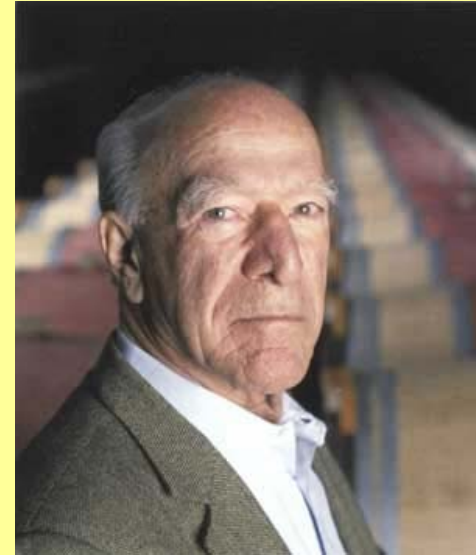
Quotes

- **" ... the Australian wine industry has established a competitive position based on a 'culture of innovation' rather than 'tradition'."**
(Aus Govt 1995, p.112)
- **"One of the strengths of the Australian wine grape and wine industry is the development and use of new processes and technology."**
(Aus Govt., 1995, p. 111)
- **Why is Australia's wine industry so successful?
"Because we do not have your regulations!"**
Simon Thistlewood, Winemaker, Bimbadgen

What have these two men got to do with each other?



Malcolm McLean
1913 - 2001



Robert Mondavi
1913 -



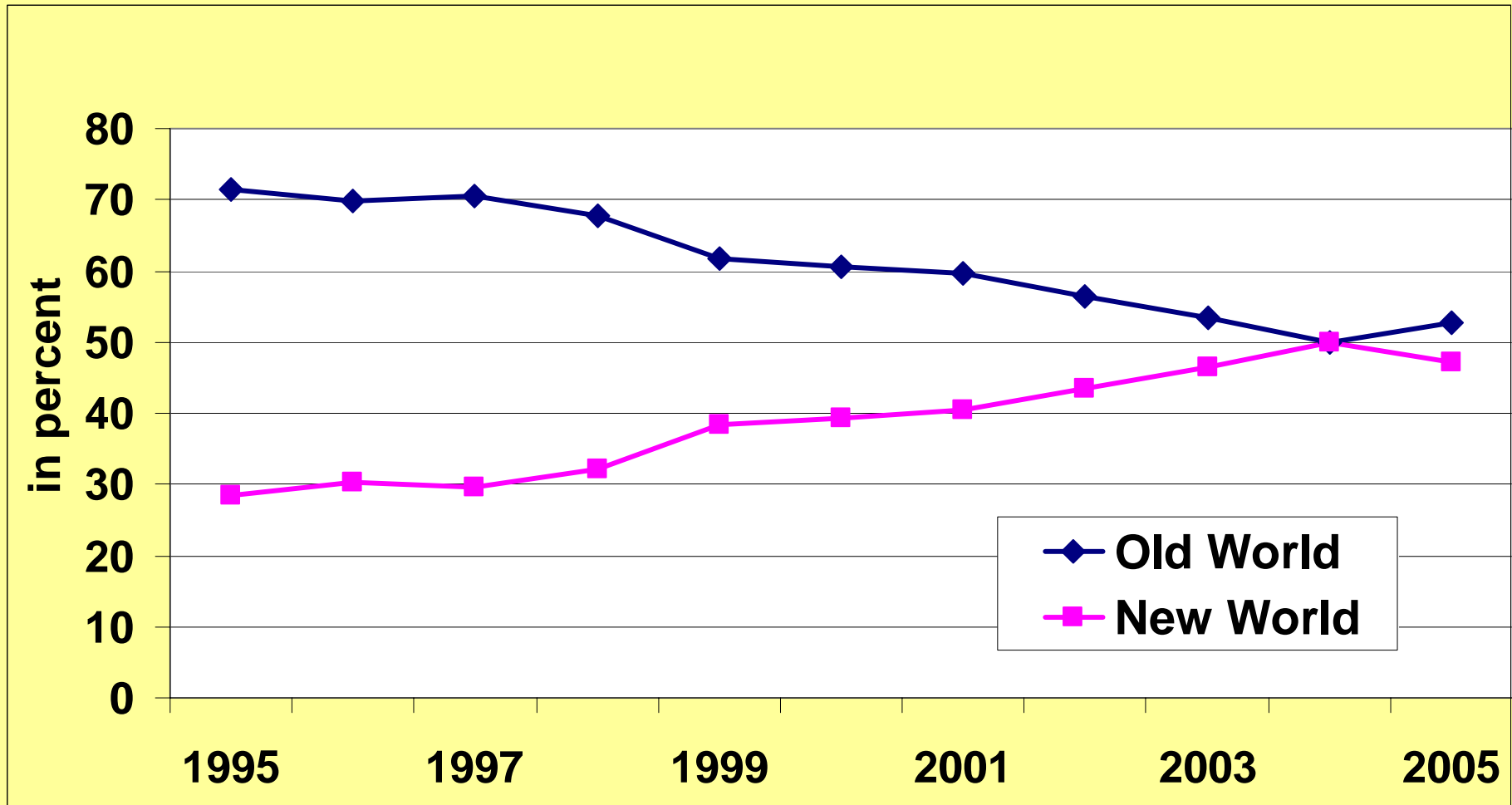
Globalization of Wine Market

- Trade agreements leading to reduction in trade barriers
- Bilateral wine-specific agreements
- Falling transportation costs
 - ~ 0.10 €/bottle from Melbourne to Hamburg
- Increased access to information on wine through new technologies
- Exchange rates

Development of World Wine Markets, 1976-today

- World wide production decreased 16 percent and consumption by about 17 percent
- New World has increased production, while Old World production has fallen sharply
- New World consumption has increased in most countries, while Old World consumption has fallen
- World trade has nearly doubled, and New World shares in exports have increased

Exports as share of world exports (excl. intra-EU trade), 1995-2005



Source: Wittwer and Rothfield

From Globalization to Regulation

- More competition, mainly in US, UK, emerging Asian and lesser extent German import markets
- In France, for example, with consumption decreasing, exports becoming more important
- Regulations maybe affecting the competitiveness

→ **What are these regulations?**

Overview of wine grape growing regulations in four countries

Regulation	France	Germany	Australia	USA
Limits on area planted	Yes	Yes	No	No
Max. number of plants/ha	Yes	No	No	No
Max. wine marketing	Yes	Yes	No	No
Limitations on varieties planted	Yes	Yes	No	No
Limits on irrigation	Yes ⁽¹⁾	No	No	No

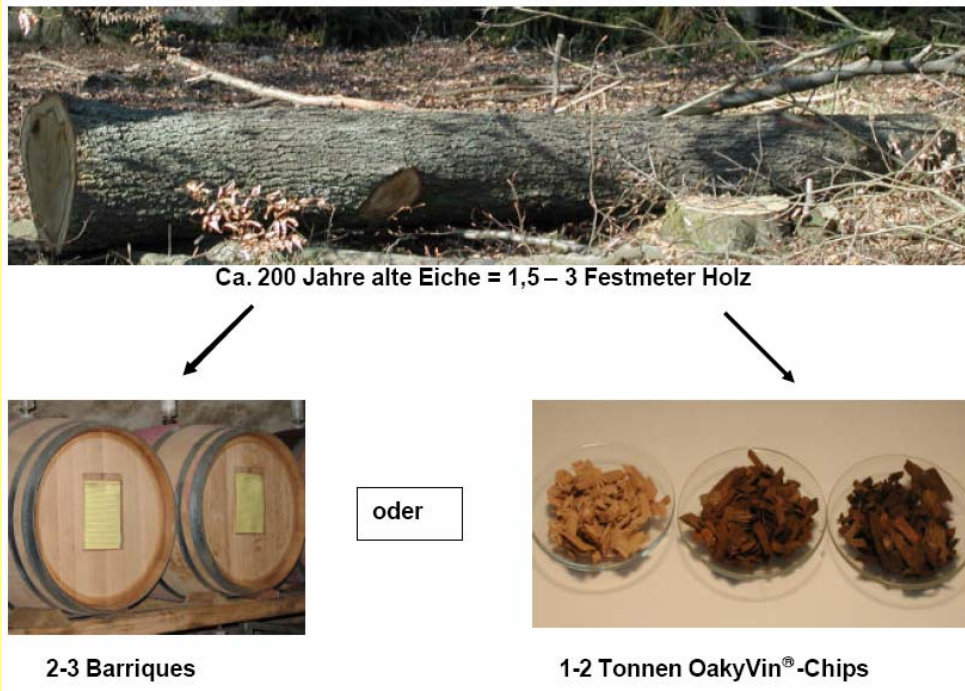
(1): as of 2007, irrigation in France became legal during three months in the summer.

Winemaking regulations in 4 countries

Additives and Techniques Restricted	France	Germany	Australia	USA
adding yeast, malolactic bacteria	No	No	No	No
adding concentrated grape must	Yes*	Yes*	No	No
adding sugar to increase alcohol; "chaptalization"	Yes/No*	Yes/No*	Yes	No*
acidification	Yes/No*	Yes/No*	No	No
deacidification	Yes/No*	Yes/No*	No	No
adding water	Yes*	Yes*	No*	No*
use of oak chips and staves	No	No	No	No

*: restricted except under specified conditions or in the EU depending on the geographic location. Sugar, f.e. is allowed in northern, but not in southern Europe. Adding sugar allowed in US not CA

Barrels versus oak chips

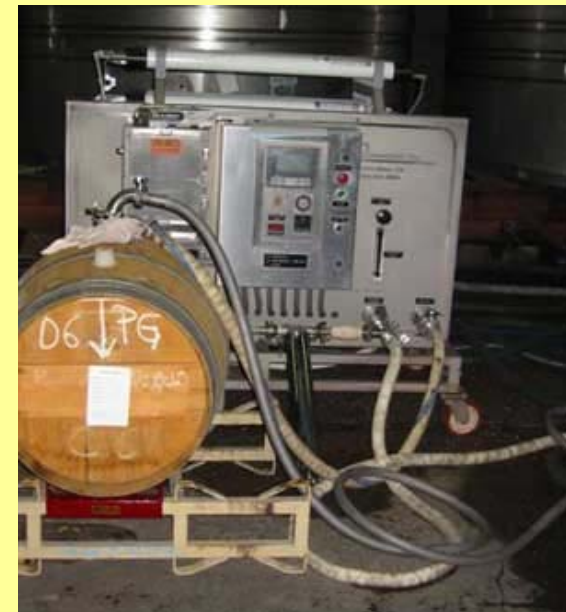
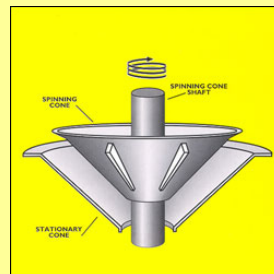
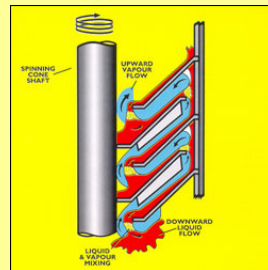


Staves

- Cost of a 225 l barrique barrel: ~ \$ 800 per barrel
- Loosing value quickly: after about 5 years no more use
- production of oaked wine: $3 \cdot 225 = 675$ l
- additional cost per liter of oaked wine: ~ 1.10 \$/l
- additional cost of oaked wine using chips: 2-3 ¢/l
- **difference in taste: not detected by most buyers**

Winemaking regs in 4 countries, cont.

Technological Processes restricted	France	Germany	Australia	USA
Reverse osmosis	Yes	Yes	No	No
Spinning cone column	Yes	Yes	No	No



Policy Responses

- **2006 EU-US wine accord**
 - oenological methods (oak chips)
 - geographic indications (GIs)
 - low alcohol wines (< 7%; e.g. ice wine from Germany)
- **2007 negotiations for a new EU-AUS wine agreement**
 - mainly labeling and GIs
- **2007 Proposal for EU CMO Reform**
 - discontinue intervention measures, i.e. distillation subsidies
 - subsidies for grubbing up of vines until 2013 (?) (new plantings)
 - prohibition of chaptalization (adding sugar to increase alcohol) (~ the end for German red wine?)
 - labeling (variety without origin)

Economic Rationales for Wine Regulations

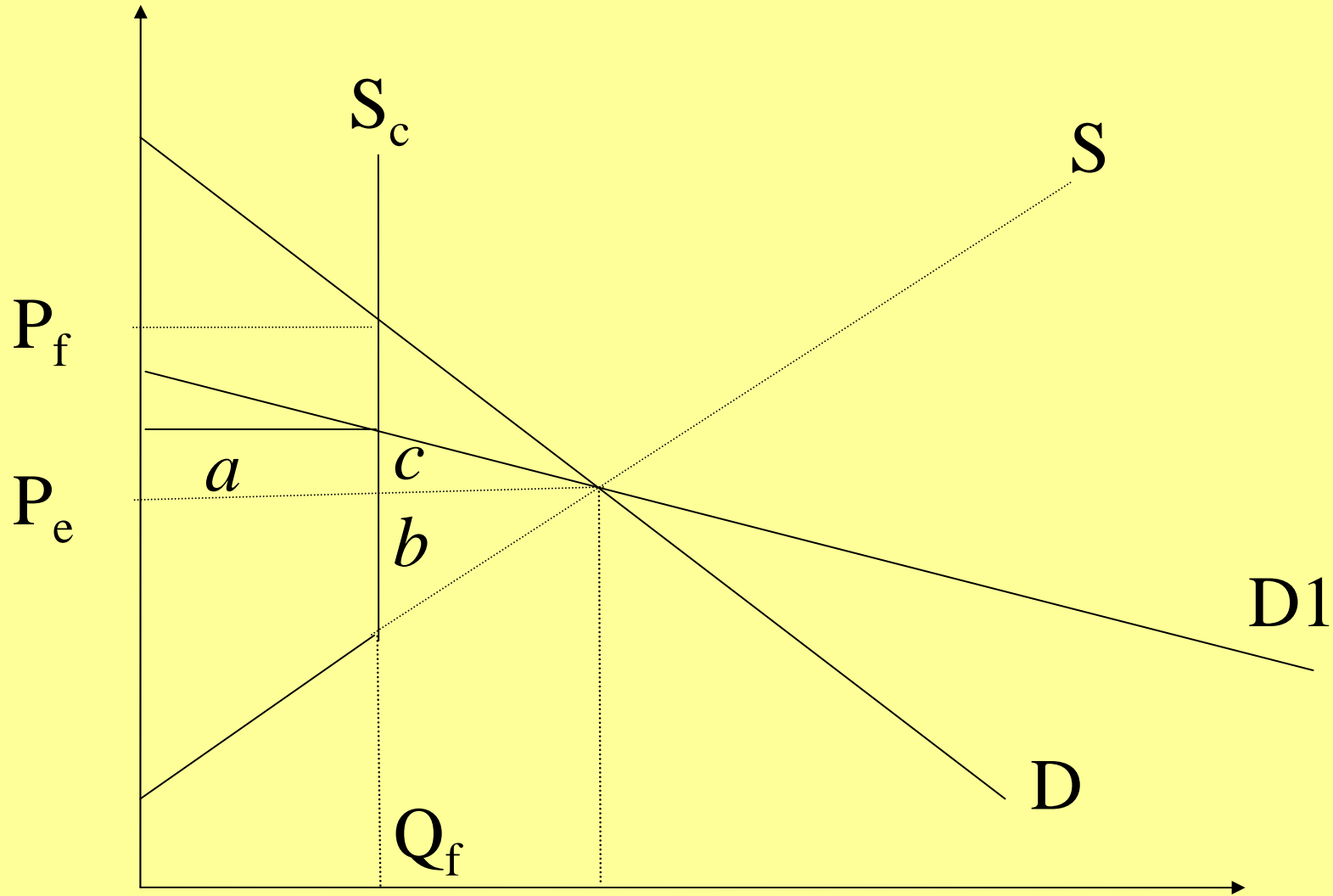
1. Provide consumers with consistent, uniform and traditional product
2. Restrict output to raise price
3. Differentiate the local wine from wine produced in other regions
4. Favor traditional producers over local innovators

→ Regulations may have important impacts on producers, consumers and competitors.

1. Provide consumers with consistent, uniform and traditional product

- Raise demand through stable quality, which allows region to claim appropriate price
- For example, variety or reverse osmosis restrictions may assure consumers a traditional product
- Demand shifts out and may be less elastic
- Consumers may benefit if the rules comport with their tastes

2. Restrict output to raise price

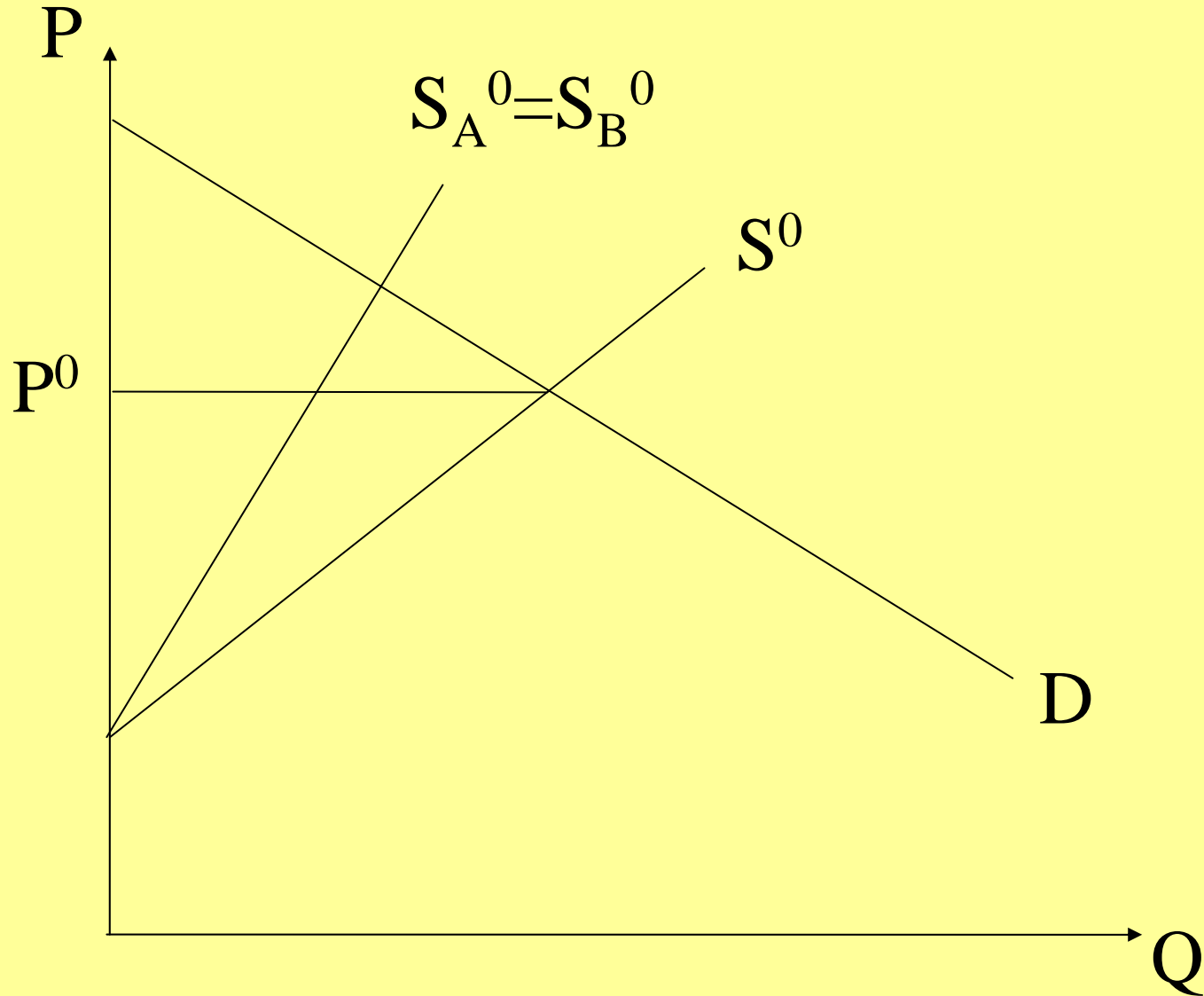


- With globalization demand within a regulated region may become more elastic and cartel rents decline

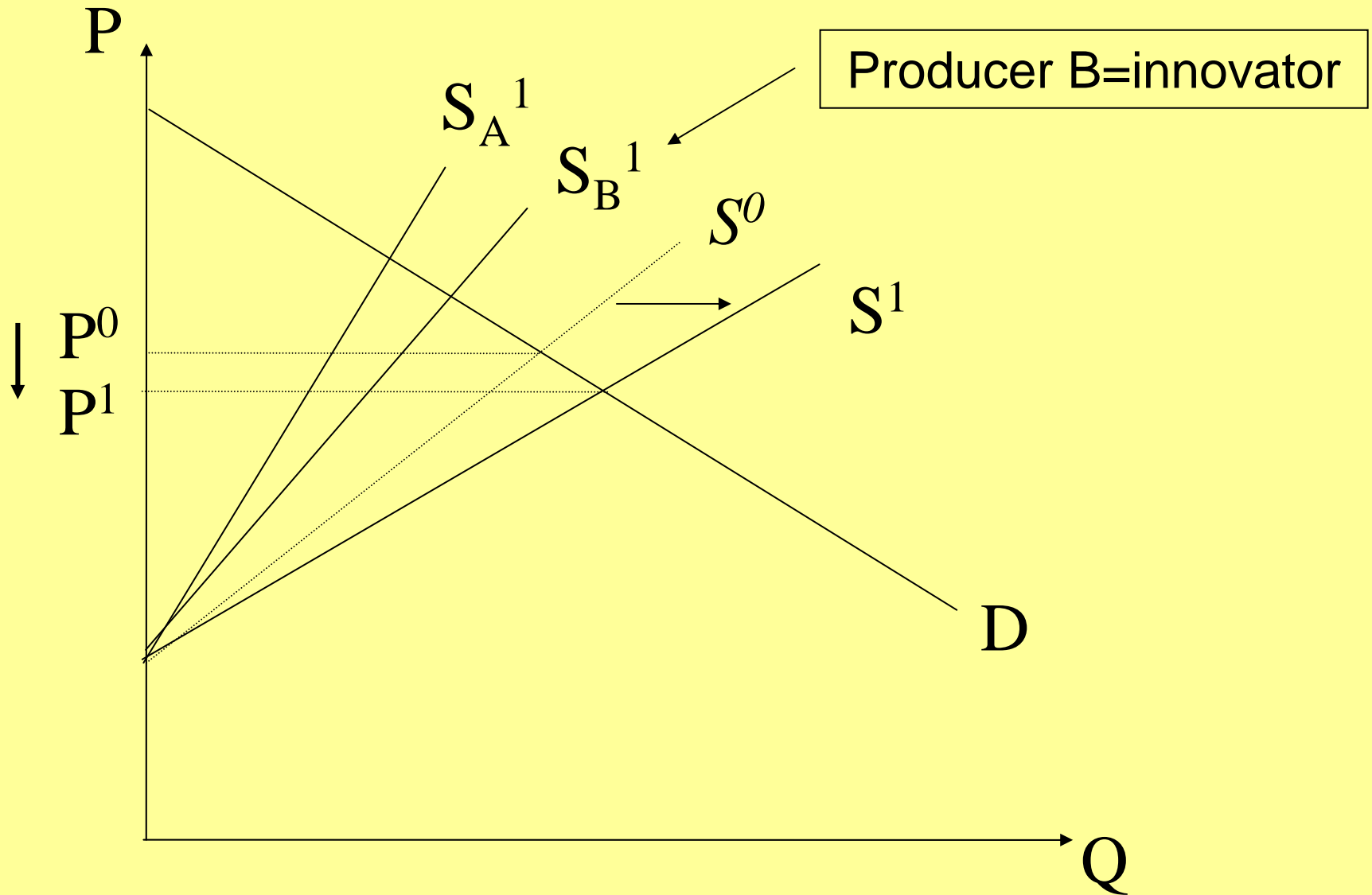
3. Differentiate the local wine from wine produced in other regions

- This aims at having a specific demand for a domestically produced product and
- to make the consumer value the local or regional product
- Increase cartel rents by causing demand to be more inelastic
- Similar to picture in (2) but now demand elasticity is create by regulatory strategy
- Less effective when consumer do not recognize the regulation as creating a distinctive product
- Ex: “Oak is oak” and consumers may not value a barrel over chips

4. Favor traditional producers over local innovators



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Impacts of regs on different actors

	Old World				New World
Example regs in Old World	Trad. Prod.	Innov. Prod.	Trad. Cons.	Innov. Cons.	Producer
Restriction of Spinning Cone	+	-	+	-	+
Restriction on Yield	+	-	+/-	-	+

On-going research

- Understanding better what drives specific regulations
- How has the increased competition affected the impacts of regulations and regulation change?
- Identify the costs of regulation on different groups of producers and consumers and hence the total welfare impacts