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Economic Policy Conclusions

Beer is made by men, and wine by God.
—Sentence attributed to Martin Luther (1483–1546)

Over the last few decades the global wine market has experienced enormous upheavals both on the demand and the supply side. Two convergence processes have been affecting the absolute quantity of alcohol consumed and the type of preferred beverages while the market has experienced the aggressive entry of the so-called "New World" countries. These two phenomena have been a serious challenge to Mediterranean Europe, a traditional producer and consumer of wine, but have been a great opportunity for New World countries.

Markets are becoming more integrated—which increases the variety of products available—and quality has been steadily growing, together with buyers' skills. Consumers are benefiting from this situation, but the point of view of producers is more problematic. The fall in consumption in Mediterranean Europe has generated a structural oversupply of wine in the world, which has been continuing for decades. The economic strategy of firms from New World countries relies on the adoption of technologies aimed at producing standardized products of good quality and on the large economies of scale, which allow for lower prices. Instead, firms from Old World countries invest in the promotion of tradition and terroir to differentiate themselves and avoid price wars that would erode profit margins. Further, since domestic consumptions of wine have been falling for decades, "exporting" has become a necessary condition for Mediterranean countries.

Government policies are very different as well. Europe has been heavily influenced by the French dirigisme, and the EU Common Agricultural Policy has regulated almost every aspect of wine production, distribution, and sale. Most importantly, the EU has tried to eliminate the world oversupply of wine by providing a number of incentives whose effects have been controversial. The United States, instead, adopted the three-tier system after the repeal of Prohibition in 1933, where the producer has to sell to the distributor, who has to sell to the retailer, who can finally sell to the buyer. However, every state or even every county can decide how to regulate the distribution and sale of alcohol so that nowadays there are thousands of laws in the United States and several barriers to direct-to-consumers sales and shipments (see Riekhof and Sykuta, 2005, for more details). These impediments give considerable bargaining power to distributors and represent a serious obstacle to (especially small) producers as this distribution channel has been shown to positively affect firm growth and gross profit margins (see Newton, Gilinsky, and Jordan, 2015, for a study on US wineries).

In such a difficult environment, surviving this "wine war" depends on six key variables.

1. *Quality of products.*
   In recent decades there has been a constant increase in the quality of wine produced in every part of the world and a parallel increase in the expectations of consumers who have become very well informed and ever more demanding. Therefore, producing shoddy wines is no longer sustainable. The consortia for the protection of appellations must work constantly to improve production specifications without giving in to the temptation to lower minimum quality standards to achieve short-term benefits. At the same time the adoption of best-practice and innovative cultivation techniques needs to be encouraged through research and development, and it should not be deprecated but rather fully endorsed, although excesses and adulterations should be avoided. The role of universities and winemakers' and agronomists' associations is fundamental, and they must also receive strong and adequate public support.

2. *Changes to the tax system.*
   Alcoholic beverages are subject to two types of taxation: excise duties on alcohol content and ad valorem tax. Taxes on alcohol content favor an increase in quality because, based on the assumption that the best products are more expensive, their relative weight decreases for higher-range goods. Taxes ad valorem do not change the relative prices between products of different qualities. Therefore, if we intend to raise the quality of products, then the tax burden should be moved from value-added taxes to excise taxes, leaving the total tax burden unchanged.

3. *Marketing and a clear wine classification system.*
   Perceived quality is, however, more important than actual quality (Cardebat, 2017, p. 44) since it directly influences purchase choices and consumers' willingness to pay. Marketing campaigns are essential to impose the company brand and influence sales, but they remain the prerogative of large groups that are just a small minority in the Old World. For this reason, well-managed EC appellations and funds provided by the European Union for protection consortia to promote

wine abroad become important instruments of industrial policy. The same holds true for the funds provided by the Market Access Program of the US Department of Agriculture for marketing, promotion, and research.

The appellation system, if regulated intelligently, can mitigate the information asymmetries between producer and consumer so that small businesses, without the necessary financial resources to build a solid individual reputation, are able to benefit from the reputation of a prestigious collective brand at a low cost. Over the years, the Appellation d'Origine Contrôlée (AOC) and Denominazione di Origine Controllata (DOC) systems have been criticized because of the excessive number of appellations (Colman, 2008, pp. 60–62),[1] which sometimes even have similar names and overlap geographically in countries like Italy.[2] Yet other criticisms report a weak correlation between hierarchical categories (e.g., Denominazione di Origine Controllata e Garantita [DOCG], DOC, IGT) and product quality as well as a growing share of wines classified as excellent, a term that risks losing all significance. Appellations that have a small number of producers should therefore be eliminated unless they are "pearls in the national winescape."

In addition, a system should be devised that can, on the one hand, stop an ever-increasing number of wines from being classified as excellent and, on the other, avoid having membership in the top segment being a poor reflection of the real hierarchy of quality, thus perpetuating the status quo forever, rather like an aristocratic title. Downgrading, therefore, should not be a theoretical and remote possibility but rather a concrete one and as frequent as relegation in soccer/football leagues. It would allow other wines to level up and prevent overcrowding and the emptying of the information content on the label once a cry of *todos cabelleros* ("everyone's a winner") has been made. The choice of who decides which appellations are upgraded and downgraded is, obviously, complex from both a technical and a political point of view.

4. *Competition and support to small wineries*.
Market concentration usually increases when there is no booming consumer demand or radical product innovations, and this has been the case in the wine sector (see Thornton, 2013, p. 289). The problem is that large companies and conglomerates exert their market power at the expense of consumers and reduce product differentiation. In addition to preventing abuse of a dominant position, public support—especially in terms of services and promotion—can be crucial for the survival of small firms and are often those producing some of the best and nonstandardized wines.

Further, in the United States the problem of growing market concentration involves not only wine producers but also distributors. Here it is necessary to end the three-tier system that generates higher prices to consumers and discourages the purchase of quality wines. In addition, distributors tend to favor large companies and corporations because they are able to offer a diversified portfolio of products at competitive prices and are well known, and therefore logistic and marketing costs are minimized. However, this is detrimental to small, emerging, quality firms, especially since most states discourage—through costly administrative tasks—the direct-to-consumer sales of alcohol. Without having the chance to fully rely either on distributors or on direct sales, small producers have a hard life, and this is bad for both competition and qualitative excellence.

5. *Economies of scale and competitive prices.*
The high-end wines that can be sold at high prices represent a small part of global wine production (Thornton, 2013, p. 218). Wines of general consumption are generally from the medium or low levels and are aimed at a clientele who are very sensitive to the quality/price relationship or even just price. Price largely reflects the structure of average production costs, which in turn are an inverse function of economies of scale: large companies have greater bargaining power in the purchase of production factors and can achieve better organizational efficiency leading to lower average costs.

The average size of European companies is much smaller than New World companies (see Thornton, 2013, p. 289). This guarantees, on the one hand, a great variety in production, but on the other hand it involves a competitive disadvantage on the cost side and sometimes even for quality since the adoption of some machinery and special wine-making techniques can be too burdensome for small businesses. Therefore, there is a need for consolidation in many countries (Colman, 2008, p. 108).

From this point of view cooperatives play a fundamental role in compacting production potential spread over hundreds or thousands of firms with vineyards that are too small to survive in the market. Their task is to engage in the constant improvement of quality, identifying internal management rules that can minimize the risk of opportunistic behavior by members. But public authorities should promote a process of aggregation among smaller private companies through appropriate tax incentives to make them competitive and capable of surviving.

In most US states direct-to-consumer sales are either forbidden or discouraged. However, they increase competition and reduce prices (Ellig and Wiseman, 2007) and therefore can increase the demand for quality wine and the firms' investments to achieve excellence.

6. *Promotion of the wine culture among consumers.*
The imbalance between demand and supply of wine in the countries of Mediterranean Europe is caused not by the growth of production—which has been declining for decades—but by the collapse of domestic consumption. The answer

of the EC legislators has consisted in a succession of policies aimed at "bureaucratically" restoring equilibrium and favoring restrictions on production while encouraging exports to non-European countries. These attempts have proven to be useless for the most part because they have often generated the opposite effect to that desired. Above all, production could not be restricted in non-European countries, and consumption, the other side of the coin, has been completely ignored. With an almost stationary population and a 50–70 percent decline in per capita consumption in the countries of Mediterranean Europe in less than half century, the authorities have tried to act only on the supply side.

Instead, a national wine education plan actively involving sommelier associations could bring young people closer to this drink. While keeping in strict accordance with the protection of public health with the aim of not increasing total consumption of alcohol, the objective would be to encourage consumers' willingness to pay. It would also hope to reverse the process of substituting wine with beer and spirits that has been taking place for years in many countries. Wine is often perceived as a complex product, especially by consumers with a low level of wine education (Thornton, 2013, p. 237), so this type of training could succeed in influencing their preferences. Indeed, in his experiment with Canadian students Sagala (2013) showed that attending a wine appreciation course increased their monthly wine budget and promoted wine consumption in a socially responsible manner. It is very strange and totally unacceptable that beer is becoming "trendier" than wine in countries such as Italy and Spain that have an ancient wine-making tradition.

Courses introducing wine should be given at the beginning of adulthood and include lessons on health protection given by specialized medical personnel that illustrate the benefits of moderate consumption and warn about damage from abuse. Tasting knowingly—and not swigging—alcohol must be the model of consumption for young people from the time of their coming of age because bad habits drag on through life with very serious and irreparable consequences for health. Awareness campaigns such as "Wine in Moderation" are not only ineffective from the point of view of the results achieved but also conceptually wrong. Limiting the slogan to wine alone, in fact, puts this drink in a bad light when it actually plays a very marginal role in the phenomenon of juvenile binge drinking and road deaths. It would, therefore, be more appropriate to change the slogan to "Alcohol in Moderation" and divert resources toward training programs set up in the way mentioned above.

Courses about approaching wine held by sommelier associations should also be supported abroad by cultural institutes to increase the reputation of national wines, to enhance the loyalty of buyers, and to further the export of quality wines. All these measures should be accompanied by the promotion of "wine roads," with adequate economic incentives for the renovation of wineries by famous architects. Wine should be considered as a cultural good producing a number of positive externalities—especially in the tourism sector where it is likely to attract people with higher levels of income and education, thereby promoting economic development (Towse, 2010, pp. 530–533). Indeed, food and wine tourism has an enormous potential but is only minimally exploited, and for this reason it should be supported with public grants (Marks, 2015, pp. 186–187, 193). It is also essential to develop a serious public transport policy (subways, buses, taxis) to allow people to leave their cars at home in the evening.[3]

Richness of vineyard heritage.
New World countries are very competitive on the cost side and often also on the quality side, but as they do not have native vines, they are forced to plant international varieties that have been successfully cultivated in all the other continents. Therefore, they are not distinctive, unlike the countries of the Old World that have hundreds of native vines in addition to those adopted internationally. Some New World countries are trying to create new "native" grapes artificially (McKee, 2016), but it is difficult to say whether they will be good and whether they will be easy to sell internationally.

The richness of the vineyard heritage is a strong point when it comes to a sophisticated and curious clientele, but it can be an obstacle for less experienced buyers who find themselves faced with a jungle of vines and appellations that they have never heard of. Argentina is the perfect example of a country which has built its success on just a few international vines. Indeed, many consumers immediately associate it with Malbec, a French vine that has found its ideal terroir overseas. In general, vineyards in the New World are largely dominated by about ten varieties.

For this reason, this debated point was mentioned but not numbered as a seventh key variable. Even though many observers consider it as a potentially strategic variable, there is no evidence that it positively affects sales and prices. Actually, the anecdotal evidence collected among wine producers and oenologists suggests that promoting niche grape varieties is difficult because people do not know them. Further, once tasted, these vines are barely remembered. Thus, the much-vaunted importance of the immense vineyard heritage of the Old World deserves to be further investigated.

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By: Stefano Castriota

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