European Union Trade Protectionism, The Transatlantic Trade and Investment Pact and their Implications for the Competitiveness of Global Wine Markets

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I. Introduction

In light of the forthcoming Transatlantic Trade and Investment Pact and bilateral efforts on the part of the EU and US to foster freer, fairer trade, producers in both the EU and US stand to see some significant changes in the regulations that apply to them should TTIP be completed by mid-2016. It is hoped that TTIP will create jobs through the expansion of trade and investment opportunities, create new rules for trade and investment between the EU and US, and form an even stronger bond between two of the world’s largest economies (US Trade Representative, 2013). Over two years into the negotiation process, agriculture remains a stumbling block to mutual agreement, and within agriculture, the liberalisation of the wine trade between the EU and the US remains a key issue between the world’s two biggest producers and exporters, especially as wine is among the most valuable products traded between the two.1 US winemakers have long complained about tariffs and nontariff barriers to entry in the EU, and made requests to the European Commission and to the WTO that they be dropped; EU producers, meanwhile, have called for yet-stronger protections for their geographical indications (GIs), namely for Champagne.2 Though the Doha round, which promised to look at EU protectionist measures, was largely scrapped by 2012, TTIP presents another opportunity for the EU to revise its agricultural policy and so promote freer trade between the United States and the EU.

To understand the potential implications of TTIP for the global wine market, I endeavour to answer the following questions:

(i) How successfully has the EU’s agricultural policy protected and promoted the business of European wine producers, and to what degree has its agricultural policy harmed US winemakers? Along these lines, how large is the net benefit of EU agricultural regulations to global free trade?

(ii) What effect, if any, will TTIP have on EU agricultural protectionism and the wine industry?

(iii) What initiatives should the European Union, and specifically the European Commission, take to foster an objective of fairer, freer trade?

To answer these questions, I begin by reviewing the current policies—the Common Agricultural Policy, the Common Market Organisation and its reforms, and TTIP—and key players to better understand the trade environment for EU and US wine producers. With the help of theory and current empirical research I then try to predict the effect that TTIP may have on the profits and sales volumes of both EU and US producers. My endeavours yield the following conclusion: while nontariff barriers are of greatest concern to both the EU and the US, they are far too numerous—and indeed, present in the US wine market just as they are present in the EU wine market—for the elimination of one or even a few nontariff barriers to cause a substantial-enough increase in welfare. In the interest of effectiveness, the most crucial focal point for TTIP is the elimination of tariffs,

1 The importance of these issues is especially pronounced given the value of these trade areas’ wine markets. EU wine market exports are valued at over €8.6B, while US wine market is valued at approximately $1.5B, with $474M in exports going to the EU (Robinson, 2015; Wineinstitute.org, 2014; Brostrom and Brostrom, 2009). Rickard et al also note that wine comprised roughly 20% of US agricultural imports from the EU in 2012, while wine was the EU’s fourth largest agricultural import from the US (Rickard et al, 2014).

which will open the EU and US wine markets to fairer, freer trade, increase producers’ sales volumes and profit potential, and increase consumer welfare through better access to high quality, affordable wine.

II. EU Agricultural Protections:

The CAP, CMO, TTIP, and the Current State of Affairs

Since the adoption of the Common Agricultural Policy in 1962, European agricultural policy has remained distinctly protectionist. Because agriculture is no longer Europe’s dominant economic activity, from the start, the CAP was intended to expand production, foster food security, and stabilise prices in agricultural markets, in an effort to ensure that the Single Market could sustain itself and its people (Markovic and Markovic, 2014). The body responsible for the execution of the CAP, the European Agricultural Guarantee and Guidance Fund (EAGGF), has had the largest impact via its guarantee system, as its guidance system has largely failed. Under the guarantee system, the EAGGF establishes a target price for each product—which is intended to help producers cover costs and gain some level of profit—as well as an intervention price 7-10% below the target price at which the Commission will intervene by buying agricultural surpluses to bring the price up to the guaranteed price (Griffiths and Wall, 2012). To protect EU producers from low-priced imports, the Commission imposes tariffs on agricultural imports from foreign producers, such that \( P_{\text{import}} = P_{\text{intervention}} = P_{\text{target}} - C_{\text{transport}} \). To protect producers from high external tariffs, the Commission pays out export subsidies to ensure that producers are receiving at least the intervention price—the minimum price a producer would receive at home (Griffiths and Wall, 2012). It is under this same logic that the EU has elected to pay over €522M to promote European wine exports, with €280.5M in subsidies allocated to France, €334M allocated to Italy, and €333M allocated to Spain each year until 2017 (Robinson, 2015). As a result of the high prices it has mandated, the CAP has benefitted domestic producers and harmed domestic consumers and foreign producers, all the while promoting inefficient, high-cost land use by small-scale farmers.

Since the introduction of the CAP, the European Parliament, Council, and Commission have made several joint efforts to reform the EU’s agricultural policies, especially with regard to the wine industry. The major initiatives have included a move away from price supports to direct subsidies for producers, the establishment of a single Common Market Organisation (CMO) in 2007, and a step away from major tools of intervention (Ragonnaud, 2015). Prior to the establishment of this single CMO, in 1999, a reform undertaken by the Parliament, Council, and Commission helped pay for the restructuring of many vineyards, improving producers’ ability to compete on the global market and produce high-quality wine, and improving consumer welfare in the process (European Commission: Initiative for Agriculture and Rural Development, 2015). The 2008 and 2013 CMO reforms emphasised the promotion of European wines via export subsidies and investment in marketing\(^3\) and the further restructuring of vineyards, costing the European Commission €675M (Meloni and Swinnen, 2012). According to Meloni and Swinnen (2012), during this period, the European Commission also strengthened the quality control regulations it introduced in 1962, helping

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\(^3\)A good example of this is the EU-subsidised effort the Rhone region of France has made to promote their wines in the US. Wine producers have recruited French and American wine-lovers to travel to wine shops and conduct seminars across the United States, with the express purpose of teaching American consumers about their Appellation Origine Protégée (AOP) and maximising sales.
to mitigate the damage caused by imperfect information on quality on the part of consumers, thus improving consumer welfare.

These reforms have increased the efficiency of and decreased some of the costs of European wine production, and have increased consumer welfare with improvements in quality, yet they have introduced a great deal of distortion into the wine market and failed to eliminate many measures taken to protect the European wine industry, leading to a continued disadvantage for foreign wine producers. The European Commission’s 2008 Wine Reform, for example, eliminated some of the export refunds that aided European producers in maintaining their strong positions in the US market, but kept in place a €32-per-hectolitre Common Customs Tariff on sparkling and other imported wines, barred US wine producers from receiving zero-duty concessions, and maintained extremely strict Geographical Indication regulations\(^4\) (COGEA, S.r.l., 2014). These protectionist measures, with import restrictions and other regulations, have led the US Trade Representative to file several complaints with the World Trade Organisation about the EU’s unfair trade practices; the EU has also filed a few complaints against the US, citing state regulations that restrict the retail availability of certain types of wine, leading to higher prices for European wines in many states and decreased profit potential (Directorate-General for External Policies, European Parliament, 2015; Rickard et al, 2014).\(^5\) The trade partners have also maintained nontariff barriers, such as planting regulations, requirements that all labels detail their appellations and winemaking processes, and tariffs that vary for bulk and bottled wine.

Several efforts have been made to mitigate these concerns, but in light of the permanent hiatus declared on the Doha Round of Trade Talks in December 2008,\(^6\) the EU and the US have had to redouble their efforts to foster a fairer, freer trade relationship. The result has been the Transatlantic Trade and Investment Pact, which is intended to eliminate or reduce several barriers to trade, including tariffs and other nontariff barriers. Specifically, TTIP aims to improve and increase market access, improve regulatory cooperation, and develop more effective trade rules (Rickard et al, 2014). In light of the number of measures taken to protect agricultural markets, the reduction in barriers to trade called for by TTIP has the potential to expand wine trade between the EU and the US, making wine more affordable, of generally higher quality, and easier to obtain (on the part of consumers) and sell (on the part of producers). While it is not clear whether the elimination of these barriers will come more from the tariff side or the nontariff side (though tariffs will likely be the first barriers cut, simply out of the case of doing so), the elimination of these barriers to trade are expected to promote saving by EU and US companies and lower the cost of imports and

\(^4\) Geographic Indications (GIs) are among the most important quality-control regulations placed on wine. In order to bear the name “Chianti Classico DOCG”, a wine needs to be produced from 80% Sangiovese grapes plus 20% native varietals such as Canaiolo (or a foreign grape, like Cabernet Sauvignon) in one of only nine villages near Chianti. A similar rule has been made for Champagne, and has been upheld by the European Commission’s Directorate-General on Agriculture. The GI regulations do protect small wine-producing regions and the producers within them, but they make it tremendously difficult for external producers to enter the regional market.

\(^5\) It should be noted that the US is unusual in the relative lack of protections provided to its winemakers. According to Brostrom and Brostrom (2009), the US lacks a national export market promotion and subsidy program for the wine industry, but the US Department of Agriculture does assist exporters and funds the Wine Institute California Wine Export Program, which helps educate foreign buyers about and promotes the California wine industry.

\(^6\) The insurmountable issues that stalled the Doha Round included: (i) the continued need to eliminate red tape at EU and US borders, (ii) the US’s desire for the EU to reduce tariffs and limit the number of lower-tariff-exempt products, and (iii) the inability of reform and rising commodity prices alone to eliminate trade-distorting subsidies (Donnan, 2015).
exports, thus increasing sales, and expanding the demand for labour in the wine market as well as the demand for US-EU traded wine.

III. Theoretical Implications: Protected Trade vs. Free Trade

The EU and the US have used a number of strategies to protect the wine trade, the most visible of which is the ad valorem tariff. Using a log-log regression of wine prices to quantity demanded across wine-consuming countries, James Fogarty estimates that the own-price elasticity for wine is -0.24, highlighting fairly inelastic demand for wine in keeping with largely inelastic demand (and supply) in agricultural markets (Fogarty, 2008). In keeping with Fogarty’s findings, we assume a fairly inelastic demand in Fig. 1.

Initially, assume a certain type of Pinot Noir is priced at $P_{\text{DOM}}$, and assume that Europeans demand $Q_d$, but the European market supplies only $Q_s$; hence, Europeans import $Q_d-Q_s$ of Pinot Noir from California to satisfy their demand. In response to complaints from French winemakers, suppose the European Commission imposes a tariff, $T$, on all future imports of California Pinot Noir. As a result, domestic producers capture some of the domestic consumer surplus as producer surplus (shown in yellow), the government collects revenues (shown in maroon), and there is a substantial amount of deadweight loss (shown in silver). For exporters in the US, this clearly poses a barrier to entry that becomes more significant the larger the tariff. For marginal cases in which a winemaker’s expected profits are large enough to warrant exporting without large tariffs, but not large enough to pay the tariffs and still properly serve the market, tariffs can prove insurmountable and prevent a winemaker from exporting to the European market.

The EU and US have also enacted several behind-the-border barriers to trade, including subsidies to domestic producers to increase their ability to compete on a global scale, as illustrated in Fig. 2.

With the introduction of a production-based subsidy, domestic producers can expand production, increasing the domestic supply of wine, while decreasing price to bring it more in line with the world price.

With the introduction of an export subsidy, as in Fig. 3, the situation is a bit different. In the below graph, the blue line represents the quantity of imports and exports in each country. When the EU pays its winemakers an export subsidy, this causes an increase in the domestic price of wine (to $P_{\text{DOM}}^\text{EX}$) and a decrease in the price of EU wine in other countries (to $P_{\text{IM}}$). Consumer Surplus increases in the importing country by the space $E+F+G$ and decreases in the EU by the space $a+b$ (as a result of higher prices; $b$ is a negative distortion on consumption). Producer surplus decreases in the importing country by the space $E+F$ (due to increased competition), and increases in the EU by the

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7 $P_{\text{DOM}}$ is the domestic price, $P_w$ is the world price.
space $a+b+c$ (due to access to new markets and a greater potential for profit; $d$ is a negative distortion on production). Government revenue in the importing country will not change, but will decrease by $b+c+d+f+g+h$ in the EU. National welfare in the importing country will increase by the space $G$, while EU national welfare decreases by the space $b+d+f+g+h$; global welfare decreases by $F+H+b+d$.

When taken together, tariffs and subsidies have clear, negative effects on producers in importing countries, and often have negative effects on consumers in the exporting country as a result of an increase in prices and mixed effects on consumers in the importing country, who have access to some cheaper foreign wines, the stock of which is limited by producers’ ability to navigate these barriers to trade.

**IV. The Current Empirical Evidence on Wine Market Protectionism**

*Literature Review*

Rickard et al (2014) simulate a 50% reduction in import tariffs and 50% reduction of domestic supports given to EU and US wine markets. They derive the tariff effects from published rates\(^8\), while they create a model from which they derive the effects of domestic supports. Their model examines the effects of reductions in tariffs and domestic supports (such as the aforementioned retail restrictions on the sale of European wine in Eastern US states) on price, trade and welfare, and from it, they find that a 50% reduction in EU and US tariffs increases consumer welfare in Europe but decreases consumer welfare in the US (due to higher prices for West-Coast wines). They also find that a 50% reduction in the domestic regulations that restrict the retail of European wine in the Eastern US creates an $85M increase in consumer surplus in the Eastern US, with a $92M net increase in consumer surplus globally (Rickard *et al*, 2014, p. 14). Thus there is a greater net benefit to welfare when US domestic regulations are removed than when domestic regulations are removed in the EU; this is strongest for premium wines. Rickard and his colleagues speculate that a reduction in domestic regulations is far more important than a reduction in tariffs, given that tariffs are relatively low for bottled wine and are more important for bulk wine. The reduction of EU domestic regulations that control wine grape supply and US regulations that restrict retail availability in the Eastern US would, they predict, have much larger welfare effects. For this reason, they conclude that the top priority in TTIP must be the elimination of nontariff barriers; though tariffs are much easier to negotiate, the welfare gains to consumers and producers from the reduction of nontariff trade barriers are much larger (Rickard *et al*, 2014, p. 16). Rickard *et al*’s model is rather ingenious in that it takes into account an insufficiently examined barrier to trade within the US: restrictions on the retail of US or EU wines in certain regions. However, to improve this study, it might be useful to look at some other nontariff barriers to trade, such as Geographical Indications and labelling requirements that, for example, have prevented the Chateau Ste. Michelle Wine Company from exporting its wines to the EU (due to its use of the word “Chateau”).

Deconinck and Swinnen (2014) come close to the necessary analysis, as they look at how the size of geographical indications (GIs) relates to quality and affects consumer and producer welfare. They note three current debates about GIs, the most important of which is the impact of GIs on international trade. Within this debate, some countries believe GIs are good solutions to asymmetric information issues, while others believe GIs protect producers from well-established regions from competition by entrants from new

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\(^8\) According to Rickard *et al* (2014), ad valorem tariffs for non-premium bulk wine fall within the 12.7-17.8% range, while tariffs for bottled wine are in the 1.3-8.9% range (p. 3).
regions—a “war on terroir” of sorts (Deconinck and Swinnen, 2014; Josling, 2006). Deconinck and Swinnen focus on the welfare effects of a change in a GI area for domestic and foreign producers as well as consumers, and construct a model that takes into account a producer’s distance from the centre of a wine-producing region; they assume the quality of a wine varies negatively with distance. They assume a GI region of area x provides producer surplus of $\Pi'(x) = p - c - (F/x)$ for insiders at distance $i$, and no producer surplus to outsiders (Deconinck and Swinnen, 2014, p. 9). If we assume US wine producers are considered outsiders, it follows that US wine producers will not benefit as Geographical indications are expanded and strengthened. However, as GIs are expanded, winemakers now within that region will receive a net benefit (from a cost-sharing effect, minus a decrease in prices) despite having to pay a small up-front cost; winemakers outside of that country and outside of that region still receive no benefit and may lose from stronger regional protections. Applying the model to international trade, the assumption that the GI region (such as Champagne) has international market power enables producers to extract rents from foreign consumers, adversely affecting domestic consumers. This study provides an excellent starting point, as it creates a rigorous model of the welfare effects of Geographical Indications. For a future study, it might be helpful to adapt this model to illustrate the exact welfare effects of the strengthening of Geographical Indications in one country on producers and consumers in another.

This research illustrates a need for a two-part approach to the reduction of barriers to trade, as well as the difficulty of effectively removing these barriers. Although tariffs are the easiest to eliminate, and can be eliminated with simple legislation, the removal of nontariff barriers would require negotiations between each EU member nation and each US state—which in the case of France, Italy, and California, could be quite difficult indeed.

V. Conclusion

My examination of theory and research indicates that TTIP does stand to have a large impact on EU-US trade as well as on wine markets. Despite the inefficient expenditure they involved, the EU’s earlier agricultural protections have played an important role in insulating EU wine producers, and have provided a good incubator for the development of new vineyards. However, the EU’s tariffs, export subsidies, and other nontariff barriers have presented a large challenge to US wine producers, preventing small-scale producers from being able to export their wines to the EU market. EU consumers are also adversely affected by a narrowing of the selection of wines available, as well as by the higher prices which result from the EU’s production subsidies. As TTIP promises to cut or eliminate tariffs and eliminate at least some nontariff barriers, it may adversely affect winemakers in its removal of some protections, but it will further open the EU market to US producers and the US market to EU producers, enabling producers in both areas to exploit economies of scale and potentially obtain larger profits. It will also substantially benefit consumers in providing them a wider variety of choice at a wider range of choice, and will decrease the strain put on the Commission and the US Government to enact protective legislation and subsidise production that may be inefficient. Taking these possibilities into account, the net benefit to wine producers of TTIP will far exceed the net benefit of previous EU-US wine market and trade regulations. In addition, theory and empirical research indicate that the reduction of (and potential elimination in) tariffs promised by TTIP is not only the most feasible means of improving trade dynamics between the EU and US, but also a very effective means of increasing both consumer and producer welfare. While the elimination of nontariff barriers might have a larger effect on welfare in the long run, it would come at significant cost to
governments and local producers, as doing so would require negotiations at the state and national level. Thus, TTIP, through its elimination of tariffs and the conversation on an elimination of nontariff barriers that it begins, promises to provide substantial benefits to EU and US wine producers and consumers.
Bibliography


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