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Effectiveness of PGI and PDO labels as a rural development policy

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Abstract

PDO and PGI labels are becoming increasingly important in the European market of food and quality products. The purpose of this paper is to analyse under what conditions these labels are successful in the market place, how they function and how they can help farmers to increase the social well being of rural areas. The discussion is presented in the context of the fresh meat product "Veal from Galicia". The main conclusion of this paper is that only those PGI or PDO products that carry on a premium generated by the presence of the label are able to fully achieve their rural development goals. Willingness to pay a premium for the label may be caused by both a desire for quality products and/ or a desire for support the local economy. Marketing strategies that may help PGI/PDO policies to increase the rural development and social well being of their communities include strict quality selection of the labelled products, promotion and awareness of their highest quality levels or brands, and a strong identification with the local economy.

Keywords : labelling, rural development

INTRODUCTION

In recent years, European consumers have tended to pay more attention to the attributes of foodstuff rather than price and quantity. Consumer's attitudes toward quality and desire for cultural identification have generated a growing demand for "value added" products and that carry a strong identification with a particular geographical region. This trend in consumers' preferences has led the European Union to introduce the Protected Designations of Origin (PDO) and Protected Geographical Identifications (PGI). A designation of origin is a region or a specific place that is used to describe an agricultural product or foodstuff. The quality or characteristics of the product are exclusively due to a particular geographical environment with its inherent natural and human factors. The production, processing and preparation of the product take place in the defined geographical area (for example, *Bordeaux*, *Rioja* and *Chianti* wines are PDO products). A geographical indication represents the name of a region, or a specific place that is used to describe an agricultural product or a foodstuff originated in that region. It also possesses a specific quality, reputation, or other characteristic that is attributable to that geographical origin. Its production and/or processing and/or preparation takes place in the defined geographical region. An example of a product that is categorised as a PGI is the object of our study, "Veal from Galicia", a fresh meat that is produced in Galicia, Spain.

The European Register of protected agricultural products has been updated many times to introduce more traditional products that meet the criteria established by the European Regulation. A large variety of regional products has obtained a PGI or PDO label, including cheeses, wines, olive oils and meats.

The PGO and PGI labels have been designed with the objective of maintaining typical European products and increasing the economic welfare in rural areas, protecting, at the same time, the domestic production from plagiarism in domestic and international trade. However, in spite of the rising importance of these products in the European market, not many studies have been done in order to evaluate whether these objectives are being met.

The intent of this article is to discuss under what conditions PDO/PGI labels can boost rural development and well being. We offer an example and additional clarifications based on the PGI label "Veal from Galicia". Veal from Galicia is one of the five fresh meats in Spain that has been recognised with a PGI or PDO label. According to some market surveys (Sigma-Dos, 1999) it is known by more than 50% of the shoppers, which makes it the most famous fresh meat in the Spanish market.

1. LABELLING AND CERTIFICATION ISSUES

There are many demand studies dealing with behavioural changes toward organic products, ecolabels and food safety labelling. Examples include van Ravenswaay and Blend (1999), Wessells (1999), Capps and Schimtz (1991) and Mathios (1998). In the U.S. there are different labelling programs which claim that they are promoting the rural development environment and nature conservation, such as the "Sustainable Summits" (sustainable mountain resource communities), "The Yampa Valley Beef Project", and "The Sustainable Forest Project". Many market researches have demonstrated that a change in labelling or information can change consumers or users behaviour and practices.

In this section, key elements for a successful PDO/PGI label are summarised. In addition to the promotion of the label, the quality of the product and the collective reputation are two of the basic pre-requirements to make a PGO/PGI product successful.

1.1. Quality of the product

Quality of the product and quality control are one of the keys of success of any labelling program. Certification agencies should develop rigorous quality controls in order to reduce the incentives of individual producers of cheating on quality. High quality controls will also serve the purpose of creating a good reputation for the label. Returning to the example "Veal from Galicia", the certification agency controls the identification of the animals, their feed and sanitary conditions from the moment that are born until the slaughterhouse. The animal feed is traditional and natural, and it is absolutely prohibited to treat the animals with products that speed their growth and development (such as hormones).

1.2. Strict Monitoring

In the case of the products labelled with a PDO/PGI, a consumer may not be able to recognise after their consumption all of the attributes that are claimed by the label such as local and traditional methods of produc-

tion, geographical areas with very particular characteristics. Therefore, such products are often a combination of an experience and credence good. Labelling policies can improve information about the experience attributes of food products. However, they are not that efficient in markets of credence goods. In these types of markets (which include the PGI or PDO products), a third-party reputable certification agent is required (Caswell, 1994). Recent literature developed in this field (McCluskey, 2000), points out the necessity of third party monitoring for the well functioning of these types of markets. Government monitoring of certification agencies is a basic tool that can be used to impose clear motivations to provide PDO/PGI high quality products.

1.3. Collective reputation

The success of a private label or brand name will depend on the reputation of the individual producer (Shapiro, 1983 and Allen 1984). In the case of PDO and PGI labels, one of the elements that will dictate its success is the collective reputation of the product. When the collective reputation of the product is high, then the label will be a powerful tool to signal quality. At the same time, the implementation of a label with high collective reputation will reduce the search costs associated with the consumer's choice. Borrowing from Caswell (1992) an effective label may transform a product from being an experience good to a search good.

Tirole (1996) modelled the idea of collective reputation as an aggregate of individual reputations. According to Tirole, if individual past behaviour is unknown, then the past behaviour of the member's group will condition or predict the future behaviour. This is strictly applicable to the PDO or PGI products, where individual producers are not known directly by the consumer. Therefore, consumers have to rely on the image of the co-operative or consortia that guarantees and promotes the particular label. The issue of collective reputation is relevant for both domestic and international markets. Recent studies in the field of reputation and agricultural products include Landon and Smith (1998) who showed that reputation is an important factor in the pricing of *Bordeaux* wines.

Additional issues that increase the effectiveness of the PGI/PDO labels as rural development policy are awareness of the label, local identification and identity preservation.

1.4. Awareness

Advertising campaigns or educational programs can stimulate consumer's understanding of the label. However, awareness is not as important as reputation of the product. For example, a consumer may be aware of the existence of a PGI wine, but this fact does not imply that the PGI wine is seen as an excellent quality product. In contrast with other type of labelling policies, such as organic certifications and eco-labels the historical reputation of the product is what strongly contributes to the success of PGI/PDO labels.

1.5. Local identification and preservation of identity

This is another important element that these labels can use in their own favour. European consumers tend to discriminate agricultural products from outside their borders, particularly, when those products compete on price with domestic production. This factor can help to promote the success of domestic PGI/PDO products, given that those products clearly "signal" the origin of the product, and a large part of the population is willing to buy local products. Another factor is the general sensitivity toward the preservation of the traditional agricultural system.

2. CONSUMER ACCEPTANCE AND CONFUSION ABOUT PGI / PDO LABELS

Recently, many labelling policies are proliferating as new market strategies. Currently, European consumers are being exposed to a larger amount of labels than in previous years. The EU is trying to pass laws related to genetically modified organisms (GMO) labelling, at the same time that they are expanding organic, eco-labels and PGI/PDO labels. This massive expansion of labels creates confusion between the consumers, rather than understanding of each particular label.

In a recent study about "Veal from Galicia" conducted by Bello, Gomez and Calvo (1997), 24,3% of the consumers "didn't know" whether the meat they bought had a PGI/PDO label. This implies that in spite of the advertising and awareness campaigns conducted by the certification agency "Veal from Galicia", lack of understanding or recognition about the label is still present. In the same study, consumers have also shown confusion about the quality of the two different types of meats from the same PGI "Veal from Galicia".

The basic differentiation between these two types of products, "Veal from Galicia" and "Veal from Galicia Supreme", is based on the age of the animal and feeding, being as its name indicates "Veal from Galicia Supreme", the best quality meat from this PGI.

Another difficulty in the marketing PGI/PDO labels is that consumers have little knowledge about the geographical origin of many agricultural products they buy. Many consumers are not aware of the origin of their grocery products, particularly in the case of fresh products without labelling. Usually, they identify the place where they live or buy those products as the production place. In the mentioned study about "Veal from Galicia", 100% of the consumers pointed out that the meat they were buying was grown in Galicia, when in the reality only approximately 30% of the meat sold in this region is also grown there. This misunderstanding is reducing sales on the PGI meat "Veal from Galicia", because for many consumers, the fresh meat they are buying is being produced in Galicia anyway.

3. ECONOMICS OF PGI/PDO LABELS IN THE MARKET PLACE

To illustrate necessary conditions for a PGI/PDO label to work, we will present a simple utility maximisation model. Even with this simplistic approach, the general conclusions are still policy relevant.

Following Van Ravenswaay and Blend (1999) and Wessells (1998), we assume that a consumer's utility function is derived from consuming PDO/PGI products (good *X*), substitute products without PDO/PGI labels (good *Y*) and all other goods (good *Z*). In addition, suppose that this consumer is sensitive toward the preservation of his/her cultural identity or background, where *P(X,Y)* represents the desire for cultural identification (consuming regional products from his/her region or others). We also assume that every time the consumer purchases a PDO/PGI product he/she is voting with his/her monetary income on favour of the preservation of the local economy and traditions. The utility function of this consumer can be represented as :

$$U(X,Y,Z,P(X,Y)).$$

In addition, suppose that :

dU/dX >0, dU/dY >0, dU/dZ>0, and *dU/dP >0.*

We can represent the utility maximisation problem that the consumer faces as :

$$\text{(1)} \quad \begin{aligned} & MaxU(X,Y,Z,P(X,Y)) \\ & s.t. p_x X + p_y Y + p_z Z = M \end{aligned}$$

We suppose that the utility is additively separable and quasi concave, and the total budget consists of the costs of purchasing the PGI/PDO labelled products, the non-labelled substitutes and the cost of the rest of the goods.

Taking the first order conditions for this optimisation problem :

$$\text{(2)} \quad \begin{aligned} & dU/dX + dU/dP * dP/dX - \lambda p_x = 0 \\ & dU/dY + dU/dP * dP/dY - \lambda p_y = 0 \\ & dU/dZ - \lambda p_z = 0, and \\ & M - p_x X - p_y Y - p_z Z = 0 \end{aligned}$$

The assumption that *dU/dX* and *dU/dY* are the same is strong, but the indirect effects of consuming goods X or *Y* on the cultural identification are different, since consuming product *Y* does not provide any positive effect on cultural identification or support of the local economy. Assuming separability, the utility of consuming good *X* is separable from the utility derived from the desire for cultural identification. This implies that the difference in prices of certified PGI/PDO labelled products and not PGI/PGO labelled product $(p_x - p_y)$ has to be equal to the difference in the marginal value of cultural identification when products *X* and *Y* are consumed.

Another way to understand this assumption is that firms cannot charge a premium higher than the willingness to pay for the certified product. Willingness to pay a premium for the label may be caused by both a desire for quality and desire to support the local economy, such as the "Buy Local" programs. However, this is a simplistic assumption because the premium that consumers are willing to pay for PGI/PDO products may not be a constant. Analysing the consumer's willingness to pay for the PGI label "Veal from Galicia", Loureiro and McCluskey (2000) found out that the presence of a label generates a high premium only in high quality meat cuts (except the highest extreme) while in cheap cuts (stew meats) the label does not generate any extra

premium. It is understandable that for expensive cuts consumers are willing to pay more for products that carry a PGI label, while for cheap cuts, the label does not play a significant role in the purchasing decision, and other factors such as the price of the meat and whether is on sale are far more important. Wessells (1999) pointed out that in the case of eco-labels for fish, some species carry on a higher premium than others. In the case of sustainable fisheries, consumers are willing to pay more for sustainable salmon than sustainable cod. This is because consumers are more concerned about the stock of salmon than the stock of cod.

Supposing that some PGI/PDO labels are not effective at stimulating high consumers' willingness to pay, or do not generate any extra premium for the label, what is the right marketing strategy to take ? Should they be withdrawn from the market place on the grounds that they may jeopardise the reputation of successful products ? Should they be still promoted and hope that in the future consumer will value those labels ? The answer depends on how important some of these products are for the local communities. If the certification agency acts as a profit-maximizer, the labelling and promotion costs should be oriented toward those products that carry on a higher premium for the label. In general, a strategy that may help the PGI/PDO labels is to promote the products with higher reputation levels and consumers' willingness to pay. For example, in the case of wine, a winery may be producing many types of wine with different quality levels, but they should focus their PGI/PDO label promotion only on the most recognised wines. In a dynamic context, promotion and awareness campaigns may help to increase the price premium for PGI/PDO labels.

Welfare implications of our non-constant willingness to pay hypothesis are quite interesting. If consumers are not willing to pay any extra premium for some PGI/PDO labelled products, then the labelling and certification costs are being wasted, unless producers get a premium for the labelled product. In general, if local farmers are not better off with the PGI/PDO labelling policy, then such a policy may not be justified because it is not contributing to the economic well being of the community nor to the cultural preservation of regional products. We believe that consumers' willingness to pay plays an important role assuring future PGI productions without much government subsidy and intervention.

CONCLUSIONS

Are PGI/PDO labels fulfilling the EU's rural development goals ? Are they stimulating the demand for domestic products and increasing farmers' welfare ? There is probably not a common answer to these questions. Every PGI/PDO label has a different value in the market place. Those with a high economic value have a high potential to fulfil their primary goals, and they should be protected and promoted. High premium of a label may be the result of desiring high quality products and/or desiring cultural identification. Others, with very little or no economic value, may not be able to increase farmers' welfare, and potentially, they even could damage other successful PGI/PDO labels, transmitting their "low value" image to successful regional products. High product quality selection, followed by strict monitoring and promotion seems to be a pre-requirement for any labelling policy to work, and in particular for PGI/PDO labels which transmit the image of high local quality products.

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