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Enjoying a Good Port with a Clear Conscience: Geographic Indicators, Rent Seeking and Development

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The European Union is attempting to have the protection of geographic indicators strengthened in the WTO. There may be sufficient rents and other benefits available to justify this strategy in the negotiations. To achieve its rent-seeking goals, however, the European Union needs allies at the negotiations. It has been courting developing countries by touting the benefits of geographic indicators for their products. For most products originating in developing countries, the opportunities for rents will first have to be created, a resource-intensive and problematic activity. Further, even if rents can be created in the short run, the forces of competition are likely to erode them. Scarce resources might be better utilized on other development strategies that are more likely to yield sustainable development.

Keywords: developing countries, geographic indicators, incentives, rent seeking, sustainable development, WTO

> Using Cabernet Sauvignon grapes grown in the soils of Napa Valley vineyards, Winemaker Ed Shragia has created a vintage port of exceptional depth and concentration. Wood aging in oak barrels for eighteen months gives the wine a smooth, velvety texture.
>
> Label on 1999 Napa Valley Port,
> of Cabernet Sauvignon by
> Berringer Vineyards, St. Helens
> California

> GIs provide added value to our producers. French GI cheeses are sold at a premium of 2 euro. Italian "Toscano" oil is sold at a premium of 20% since it has been registered as a GI in 1998. Many of these products whose names are protected, are exported. 85% of French wine exports use GIs. 80% of EU exported spirits use GIs. GIs are the lifeline for 138000 farms in France and 300000 Italian employees.
>
> *Trade Issues*, EU Commission,
> 30 July 2003 http://europa.eu.int/
> comm/trade/issues/sectoral/
> intell_property/argu_en.htm

In the pre–Uruguay Round General Agreement on Tariffs and Trade (GATT 1947) the provisions on marks of origin constituted a relatively benign and rather innocuous aspect of trade law. The provisions were considered largely a convenient anachronism that provided some protection against the most egregious forms of misrepresentation. These provisions, like antidumping measures, represented one of the few areas where the GATT 1947, which was primarily designed to deal with the activities of governments, ventured into the regulation of the activities of private firms. After all, it is private firms that misrepresent the place of origin of their goods, not governments. While the impetus for putting a clause on marks of origin in a trade agreement seems lost in the "mists of time", it probably stems from the absence of international commercial law institutions as well as from their having been included in pre-GATT bilateral arrangements between countries.[1] Article IX.6 of the GATT 1947 states:

> The contracting parties shall co-operate with each other with a view to preventing the use of trade names in such manner as to misrepresent the true origin of a product, to the *detriment of such distinctive regional or geographical names of products* of the territory of a contracting party as are protected by its legislation. Each contracting party shall accord full and sympathetic consideration to such requests or representations as may be made by any other contracting party regarding the application of the

> undertaking set forth in the preceding sentence to names of products which have been communicated to it by the other contracting party.
>
> General Agreement on Tariffs and Trade 1947, http://www.wto.org/english/docs_e/legal_e/gatt47_01_e.htm#articleIX (emphasis added)

Article IX.6 has wording typical of the pre–World Trade Organization GATT with its consensus-based dispute system. It relied not on formal dispute settlement but rather on the willingness of member states to respond to moral suasion (Kerr, 2000). According to the *WTO Analytical Index – Guide to WTO Law and Practice* there has never been any jurisprudence associated with Article IX. It was not a subject that was of much interest to the member states.

Outside of trade agreements, a number of international agreements on intellectual property provided some protection for geographic indicators. These include the Paris Convention of 1883, the Madrid Agreement of 1891, the Stressa Convention of 1951 and the Lisbon Agreement of 1958. The World Intellectual Property Organization (WIPO) put forth a draft international treaty on geographic indicators. Without an effective dispute settlement system, however, the WIPO's efficacy was limited.[2]

The topic of geographic indicators was renegotiated during the Uruguay Round. While the original wording from the GATT 1947 reported above was carried forward without change into the GATT 1994, the protection of geographic indicators was also included within the new Agreement on Trade-Related Aspects of Intellectual Property (TRIPS). Geographic indicators are dealt with in three TRIPS articles. Article 22 – Protection of Geographic Indicators – defines geographic indicators as follows:

> 1. Geographical indications are, for the purposes of this Agreement, indications which identify a good as originating in the territory of a Member, or a region or locality in that territory, where a given quality, reputation or other characteristic of the good is essentially attributable to its geographical origin.

The remaining three clauses set out the obligations of members to legally discipline misrepresentations of the geographic origins of products in their domestic law.

Article 24 – International Negotiations; Exceptions – provides under exceptions a number of grandfathering clauses that have effectively allowed countries to pick and choose the geographic indicators they wish to protect. As a result, effective international protection for geographic indicators will be determined by future negotiations. The exceptions clauses state:

> 24. 4. Nothing in this Section shall require a Member to prevent continued and similar use of a particular geographical indication of another Member identifying wines or spirits in connection with goods or services by any of its nationals or domiciliaries who have used that geographical indication in a continuous manner with regard to the same or related goods or services in the territory of that Member either (*a*) for at least 10 years preceding 15 April 1994 or (*b*) in good faith preceding that date.
>
> 24. 5. Where a trademark has been applied for or registered in good faith, or where rights to a trademark have been acquired through use in good faith either:
>
> > (a) before the date of application of these provisions in that Member as defined in Part VI; or
> > (b) before the geographical indication is protected in its country of origin;
>
> measures adopted to implement this Section shall not prejudice eligibility for or the validity of the registration of a trademark, or the right to use a trademark, on the basis that such a trademark is identical with, or similar to, a geographical indication.
>
> 24. 6. Nothing in this Section shall require a Member to apply its provisions in respect of a geographical indication of any other Member with respect to goods or services for which the relevant indication is identical with the term customary in common language as the common name for such goods or services in the territory of that Member. Nothing in this Section shall require a Member to apply its provisions in respect of a geographical indication of any other Member with respect to products of the vine for which the relevant indication is identical with the customary name of a grape variety existing in the territory of that Member as of the date of entry into force of the WTO Agreement. (TRIPS, 1994)

Other clauses of Article 24 pertain to matters such as rules for geographic indicators that are no longer in use and statutes of limitation on bringing forward complaints. The exceptions are used to prevent terms such as “cheddar” and “port” from obtaining protection as geographic indicators after long periods of generic use.

Article 23 – Additional Protection for Geographical Indications for Wines and Spirits – has provisions that are more specific, for example, limiting practices such as referring to wines being in the “style of” Champagne, using homonyms that might mislead, such as “Rone” for “Rhone”, and the term “Burgundy” to describe wine even if the fact that it is being produced in New Zealand is fully revealed on the label. It also commits the member states to future negotiations:

> 23. 4. In order to facilitate the protection of geographical indications for wines, negotiations shall be undertaken in the Council for TRIPS concerning the establishment of a multilateral system of notification and

> registration of geographical indications for wines eligible for protection in those Members participating in the system.

This is the only TRIPS obligation to engage in negotiations to establish an international system for recognizing geographic indicators. Note, Article 23.4 applies only to wines and not to spirits.

In the Doha Ministerial Declaration that launched the Doha Development Round of negotiations there was a further commitment to negotiations to extend the system of internationally recognized geographic indicators to products other than wine. Section 18 of the Ministerial Declaration states:

> With a view to completing the work started in the Council for Trade-Related Aspects of Intellectual Property Rights (Council for TRIPS) on the implementation of Article 23.4, we agree to negotiate the establishment of a multilateral system of notification and registration of geographical indications for wines and spirits by the Fifth Session of the Ministerial Conference. We note that issues related to the extension of the protection of geographical indications provided for in Article 23 to products other than wines and spirits will be addressed in the Council for TRIPS pursuant to paragraph 12 of this declaration (WTO, 2001).

Hence, over the last 20 years the status of geographic indicators has moved from being a relatively obscure clause in the GATT 1947 to the forefront of WTO trade negotiations. It has been agreed that the degree of protection will be increased and its scope may be widened. The major proponent of the increased protection for geographic indicators has been the European Union, although Switzerland and some Central and Eastern European countries have also expressed support for the strengthening of the system. Some developing countries have also latterly become supporters of the EU position.

Frustrated with the slow pace of the negotiations in the TRIPS Committee, the EU has attempted to force the issue of geographic indicators (GIs) onto the agenda of the agriculture negotiations. In the 2004 Framework Agreement that was stitched together after the failed ministerial meeting in Cancún, the issue of geographic indicators being part of the agriculture negotiations was listed as being an area of interest, but one where no agreement could be attained. The EU has pushed hard since then to ensure that the issue remains in play at the agriculture negotiations. In August 2005 the EU made public a list of 41 geographic indicators for which it is seeking recognition as the exclusive domain of EU producers. This has been referred to as a “clawback” proposal because it represents a move to make many terms that are in widespread use internationally, exclusive (Grant, 2005). For example, the list includes terms such as Chablis, Sauternes, feta and Gorgonzola. Needless to say, the United States and a number of other countries are opposed to this approach.

The reasons the EU is pushing the issue of geographic indicators so forcefully are complex and extend beyond the transparent rent seeking involved. On the face of it, a geographic indicator confers a monopoly on the group of producers that are resident in the geographic area specified and engaged in the production of the good to which the indicator is applied. Monopolies can provide rents to those who have been endowed monopoly rights. In the case of the "clawback" designations sought by the EU, there may well be considerable rents that accrue in the short run as the favoured producers reap the benefits of many years (even centuries) of expenditures on marketing, reputation building and product refinement made by their forebears as well as the efforts of their current international competitors. If the clawback were to obtain international approval, it would take time for their former competitors to re-organize and come up with alternative marketing strategies – note there is nothing that prevents former users of the now restricted name from producing the same good that had commercial success in the market. They are only prevented from using the geographic indicator. Hence, there are likely to be some rents available from a successful clawback strategy but even these are likely to be transitory. The topic of monopoly rents will be returned to later in the discussion.

Even if the clawback rents are not sustainable, they may have considerable political value for the European Commission. The Commission faces internal and external – WTO – pressure to reform its Common Agricultural Policy (CAP) system of barriers to market access and subsidies. Protection for geographic indicators, on the other hand, appears to be something positive that the Commission can provide to offset the ongoing perception by agricultural producers that subsidies are being eroded. If one looks at the Doha Round negotiations on agriculture, or even more generally, it is hard to see much that represents a gain for the EU – it is all about concessions on agriculture with little reciprocity on services that could represent gains. Hence, a recognition of EU geographic indicators at the WTO could help the Commission's credibility among its agricultural constituents, and possibly within the broader society.

Having agricultural producers and rural industries feel good about the products they produce – superior to the cheeses, wines or olive oils produced by others – by giving them special, legally recognized designations is also not without political value.[3] In addition, there is an associated aspect of European cultural chauvinism that likes to demonstrate the superiority of things European. The EU has refused to recognize foreign, particularly American, geographic indicators. In a way, the EU's stance on geographic indicators is simply another manifestation of the differing views on trade in cultural goods and services that is also being played out at the WTO.

Beyond the rent seeking related to long-established geographic associations such as Madeira and Roquefort, large segments of the wine industry in a few of the EU's member states, particularly France, operate according to a classification system based on region of origin (e.g., Beaujolais, Bordeaux, Sainte-Emilion). In the global wine market, this geographic system is in direct competition with a largely "new world" (e.g., United States, Australia, New Zealand, Argentina, Chile, Canada) system based on the grape variety used in the production of the wine (i.e., Chardonnay, Riesling, Cabernet Sauvignon). The battle over what indicates wine quality is being vigorously contested and there are large and valuable markets at stake. It is a battle over the shaping of consumer perceptions of quality and taste. Beyond any market benefit that may arise from preventing those outside the area of geographic indication from "falsely" labeling their product, the psychological effect of having an internationally sanctioned appellation may have considerable commercial value. The fostering of geographic indicators, one suspects, is also a way for the EU, and particularly the national governments of its member states, to transfer some resources to producers under the guise of market promotion initiatives. It is a way for national governments to show support for their producers without engaging in competitive "top-ups" of CAP subsidy programs.

For all these reasons, the rent seeking associated with well established geographic names by the EU is understandable and part of the inevitable wrangling that will arise from regulatory asymmetry, particularly across the Atlantic.[4]

The EU, however, has been largely isolated in its attempts to have its position on geographic indicators accepted at the WTO. As a result, it has been seeking allies among other members of the WTO. In particular, it has latterly begun to "beat the development drum" by fostering the impression that the EU is actually pursuing recognition of geographic indicators to assist the development prospects of member states. For example, according to the Commission:

> India, Pakistan, Sri Lanka, Thailand, Kenya, Jamaica and other developing countries have demanded better GI protection. They are worried about multinationals patenting and selling "Basmati" rice, "Ceylon" tea, "Blue Mountain" coffee, "Jasmine" rice. The EU is helping them ripping [*sic*] the benefits of the TRIPs Agreement and fully supports their demands (EU Commission, 2003).

Of course, this is a good tactic during the Doha Development Round negotiations. Some developing countries with existing grievances over products such as Basmati rice[5] have begun to support the EU position. Further, geographic indicators are likely something that NGOs and other civil society groups that support initiatives in developing countries can become enthusiastic about given the emphasis on local production, traditional production methods and community values that are often bundled with geographic indicators. If these civil society groups take up the call, the EU will reap the benefit of their considerable lobbying abilities and the influence that they have with many developing-country governments. More allies among developing countries may well follow.

While this may be a good tactic in negotiations, it is cynical manipulation of developing countries at worst and naïve meddling in the affairs of poor countries at best. This is because, while there may well be short-term rents available from the long-established geographic indicators of the EU, the case for similar rents accruing to producers in developing countries is weak. Hence, this approach may lead to developing countries wasting their limited resources chasing an illusive dream. In short, protection of geographic indicators is something developed countries have the luxury to (likely) waste their resources on, but it is probably not something that should be encouraged in developing countries.

Look at the major argument for tying a marketing strategy to geographic indicators. It is that a price premium, and hence increased profits for producers in the geographic area, can be obtained from consumers. This means consumers must be convinced that products originating in the particular geographic area have special attributes that consumers should value over competing products produced by others. This is not a costless process. In all but a few cases, most products of developing countries do not have the cachet of Champagne or Scotch and will require a considerable marketing campaign to convince consumers they should pay a premium. These marketing expenditures will, of course, have to be deducted from the premium that is received by producers when calculating the profitability of a marketing strategy based on geographic indicators.

It has been long known that the efficacy of marketing campaigns for products such as Washington apples or Florida grapefruit is notoriously difficult to prove (Wolf, 1944).[6] Studies using the most up to date econometric methodology suggest that, at best, returns to such marketing campaigns are transitory and require constant reinforcement (Cardwell, 2005). Thus, developing-country producers are likely being encouraged to lock themselves into major long-term commitments of marketing resources with no assurance that positive rewards will be reaped from those expenditures. Expenditures to build a brand not tied to a geographic area may prove a better investment.

It is also difficult to discern the true premium that is tied to a geographic indicator. This is because most products are marketed with a bundle of cues for consumers that attempt to signify quality. Consider whiskey made in Scotland. The geographic indicator is Scotch. On any label found on a bottle of Scotch there will also be the company brand (e.g., Glenlivet), a production method (e.g., single malt, blended), a sub-geographic indicator (e.g., highland, island, lowland) and possibly a particular input (natural peat–filtered water). All of these may contribute to the premium, and some, like the company brand, may be heavily promoted. How much of the premium can be attributed to the Scotch appellation?[7] Similar bundling of marketing cues can be found for almost any product with well-known geographic indicators – olive oil, cheese, wine, port, ham. Thus, it is not possible to attribute all of an observable premium to a geographic indicator.

Further, what is important is not the premium, but rather the net contribution to profit that the geographic indicator provides. In addition to the marketing costs associated with promoting the geographic indicator, there may be additional production costs associated with more traditional production processes – which are often tied to the geographic indicators – or costs associated with ensuring the existence of the quality attributes consumers associate with the geographic indicator. These extra costs will have to be subtracted from the premium to determine the net contribution of the geographic indicator to profits. Hence, it is misleading to use raw information on premiums – such as is found in the second quotation, from the European Commission, that begins this article – as evidence of the benefits that producers will receive from recognition of geographic indicators.[8]

Beyond the complex questions surrounding the returns developing countries might expect from efforts to establish their geographic indicators in the minds of consumers, there are other dynamic questions relating to the sustainability of any profit premiums that do arise from those efforts. Markets are not static. Success will lead to actions by competitors and within the geographic region – actions that will erode profits.

The first challenge will be to defend the geographic indicator from counterfeit production in foreign markets. Even if foreign governments are made responsible for enforcement, holders of the rights to the geographic indicator will have to expend resources monitoring foreign producers and bringing any violations to the attention of foreign governments. Defense may also require the preparation of a formal legal case for presentation in foreign courts or quasi-judicial mechanisms that may be put in place to handle complaints about counterfeit products. These activities will require considerable resources from the producers benefiting from the existence of the geographic indicator.

If the geographic indicator is successful in creating profits, it will not go unnoticed by potential legitimate competitors. Currently, this is why port is produced in Australia, South Africa, the United States and a host of other countries. This competition is what "destroys" the value of the geographic indicator. Of course, removing this competition is what the EU clawback provision is meant to accomplish, and in the short run will yield rents. Right now, competitors outside Madeira or Parma don't have to be proactive in capturing any rent available because they can simply label their products Madeira or Parma ham. In the wake of the granting of international protection for geographic indicators, if the use of the geographic indicator does yield profits, it will spur a reaction by competitors. As suggested above, there is nothing preventing them from replicating the product, only from labeling it as having originated in the geographic region. Thus, if there are actual product attributes valued by consumers, they can be duplicated;[9] they will only have to be marketed in a different way. There is ample evidence that competitors are likely to be up to the challenge if pushed to find alternative marketing cues. For example, South African port and grappa producers will have to react to a clause in their country's recent trade agreement with the EU to stop marketing their products as port and grappa. They are already formulating their strategic responses:

> An example of a way to be compliant with the agreement is demonstrated by Giorgio Dalla Cia who is simply eliminating the word "grappa" from his label which normally reads, "Dalla Cia Grappa" above the letter "G".
>
> Some port producers have also gone down this route, with JP Bredell introducing "Cape Vintage" in 1995 with no reference to the word "port". Their "Late Bottled Vintage" came onto the market in 1996, years before the change from the term "port" would be enforced. But, as Bredell's marketing representative Donald Keys points out, it's better to get in early with change, than wait for change to be enforced.
>
> While the Port Producers' Association is still battling to come up with an acceptable name, the South African port producer Villeria has released its latest bottle of "port" as "Fired Earth 2000 Bottled Late" fortified red wine. (Tralac, 2004)

The Canadian vintner Sumac Ridge is marketing a "port style wine" called "pipe" with some success in an attempt to create a new association in consumers' minds. Over time, such marketing efforts are likely to erode any premium that can be gained from a geographic indication.[10] There is no way that a blunt instrument such as a WTO agreement can be used to control efforts of firms to inform consumers that their new products are close substitutes for products associated with geographic indicators. Even if some of these marketing efforts fail, as long as potential profits are available, entrants with new "substitute-creating" strategies can be expected. Producer groups in developing countries will be faced with sophisticated marketers in developed countries. Geographic indicators, particularly ones with which consumers have only a recent association, are likely to be an easy target for marketing specialists from developed countries.

There are also dynamic forces that will be set in motion within the territory covered by the geographic indicator. If there are profits arising from the successful establishment of a geographic indicator, then an incentive to enter the industry within the geographic area will be created. This extra production will put downward pressure on price, eventually leading to the elimination of any profits arising from the existence of the geographic indicator.[11] As a result, any benefits to producers in the territory to which the geographic indicator applies are not likely to be sustainable. Hence, the appropriateness of adopting geographic indicators as a development strategy should be closely scrutinized.

The link between geographic indicators and sustainable development is tenuous at best. Developing countries should give careful consideration to the implications of involving themselves with the rent-seeking activities of the European Union. While there are likely some short-term rents available from clawing back some geographic indicators with a long history of positive association with quality in the minds of consumers, developing countries have few such products with strong consumer attachments based on geographic association. Creating new consumer associations with geographic areas is likely to be expensive and the benefits not sustainable. Resources will likely be better spent on other facets of development that are more likely to yield sustainable outcomes.

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Endnotes

1. See Leddy, John M., Oral History Interview (1973). Mr. Leddy was one of the U.S. negotiators of the GATT 1947.
2. These limitations became the spur for including intellectual property as part of the new international trade system negotiated in the Uruguay Round of GATT negotiations. See Kerr (2003) for a discussion of the reasons for including the protection of intellectual property in trade agreements.
3. Even if the feta cheese produced in a Danish factory is indistinguishable from (or even superior to) one produced in a more traditional industry in Greece.
4. The trade-related aspects of regulatory asymmetry show up in a number of areas: biotechnology, food safety, environment. See Isaac (2002) for a discussion of transatlantic regulatory asymmetry. For a comparison of the U.S. and EU approaches to geographic indicators see Moore (2003).
5. See Kerr, Hobbs and Yampoin (1999) for a discussion of developing-country grievances regarding Basmati rice and similar products. For a broader discussion of intellectual property rights and traditional knowledge see Isaac and Kerr (2004).
6. Wolf (1944) also makes the point that this lack of transparency in discerning the efficacy of a marketing campaign is often to the benefit of those paid to conduct the campaigns, to the detriment of producers.
7. Certainly, given sufficient data it might be possible to sort out the approximate contribution of an appellation *ex post* but it would not be possible prior to a product being marketed. One other bit of evidence that suggests that geographic indicators may not have a lot of value is the fact that no major cheese producer has located in Cheddar, England. While there is a small cheese factory in Cheddar serving the local tourist trade arising from nearby Cheddar Gorge, no one has attempted to capitalize on what might be the cachet of cheese originating from Cheddar (J. A. Hobbs, personal communication).
8. That is, "French GI cheeses are sold at a premium of 2 euro. Italian 'Toscano' oil is sold at a premium of 20% since it has been registered as a GI in 1998" (EU Commission, 2003).
9. If there are particular production skills or industry secrets that must be duplicated by competitors then it is these that should be protected directly rather than using an indirect geographic indicator.
10. The steepness of demand curves is determined by the closeness of the available substitutes. As consumers become aware of new substitutes, the demand curve for the products associated with the geographic indicator will have a less steep slope thus altering the profit-maximizing premium.

11. If there are resource limitations in the geographic area that act as a barrier to entry then, over time, entry will drive up the cost of relatively fixed factors of production until profits are competed away. This will lead to a transfer of benefit to the owners of the relatively fixed factors but producers will no longer benefit from the geographic indicator. The same result can be expected if the government puts in place barriers to entry within the geographic area. See Gaisford and Kerr (2001) for a discussion of "capitalization" of benefits.

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