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Are clawbacks always efficient? Northern Vigor in Canada

By Natasha Power and J. Stephen Clark

Background

In discussions concerning product and marketing innovations, property right protection in the form of patents, trademarks, or copyrights has received much attention. These legally protected mechanisms are fundamental to the support of a competitive and innovative economy. The ability to trademark a product or copyright some form of intellectual property allows firms to build loyalty and is an important component of signaling quality. Lack of property protection allows some to free ride off the quality investments of others and risks leading to inefficient investments into product development.

The recent literature in trade has emphasized the use and application of “clawbacks,” especially as they relate to geographic areas and brand or product loyalty. One of the more famous trademarked terms related to a geographic area is “champagne,” which refers to a sparkling wine produced in the Champagne area of France. As such, no other sparkling wine can have unauthorized use of the word Champagne on its label. The ability to generate monopoly rents by applying such a term to other, hitherto unprotected products is referred to as a clawback. Clawbacks have an element of *ex-post* assignment of trademark status that is different from the *ex-ante* nature of other forms of property right protection, such as copyrights or patents.

To clawback a term means that a region, manufacturer, or producer that has a claim to a particular quality attribute can assign

property protection over that term so that it remains valuable and not subject to free riders. However, that may not always be the case, for a free riding firm may try to expropriate the property right by applying for legal protection of a term that hitherto had no legal protection. A Canadian example of this is the trademark protection of the term “northern vigor,” a term that has been commonly used to describe quality attributes of seed potatoes grown in northern climates. This seed is known for its excellent propagation properties and ability to flourish in less than ideal growing conditions. The term has been traditionally used to describe seed potatoes, but the phenomenon may also relate to other products, even animals.

The remainder of this brief explores some concepts surrounding property right protection in relation to agricultural foodstuffs. In particular, the concepts of geographical indicators and clawbacks will be discussed more fully in terms of the Canadian example of northern vigor in seed potatoes. The disadvantages associated with the use of clawbacks and its implications for agricultural markets in Canada will also be explored. Finally, the trademark application of the term northern vigor will be summarized to evaluate whether it has been market enhancing or market diminishing, thereby addressing the research question.

Information asymmetry

Consumers are increasingly concerned not only about how food is produced, but also about key attributes of food that are easily

recognizable and signify high quality standards. Agri-food product differentiation and brand promotion are mechanisms that allow consumers to base their purchasing decisions on characteristics such as quality, environmental standards, and health benefits. Such mechanisms also align the interests of both producer and consumer, thereby providing a solution to the problem of information asymmetry.

Asymmetric information occurs when producers know more, or have better information, about a product than consumers. Consumers are often unable to observe food products' quality characteristics, thus increasing the potential for market failure (Pick, 2003). To alleviate the problem of asymmetric information and ensure transparency, the supply chain can be controlled in a way that signals that the consumer's interests are being met, while still enforcing brand or product loyalty in the marketplace.

Patent protection and certification marks are legal mechanisms that can be used to identify and distinguish products from others in the marketplace and provide efficient information to consumers (Hughes, 2006). These concepts are fundamental to the support of a competitive and innovative environment. These forms of protection allow firms to build brand loyalty and provide an important component of signaling quality. Lack of such protection allows competing firms to free ride off the quality investments of others and would lead to inefficient investments into product development. In extreme cases, a market for "lemons" would develop and only low quality attributes would be reflected (e.g., the used car market). As it relates to agricultural products, geographical indicators (GI's) are increasingly being used to not only protect business and innovation interests, but also to protect credence attributes that cannot be identified even after a product is consumed (Young and Kerr, 2008). GI's are important for protecting the product's evocative value in the marketplace and for signaling inherent quality characteristics to the consumer, thus resolving information asymmetry.

Geographical indicators

The use of geographical indicators has become an important issue in international trade negotiations, especially concerning the trade of agricultural products. A GI is a legally protected mechanism used to identify a product by its geographical origin, signaling both its quality to and brand loyalty among consumers. Among the most well known commercial applications of GI's are those applied to spirits and wine, such as Bourbon and Champagne.

Geographical indicators signify to the consumer that the food product has unique and consistent qualities that are associated with their geographical origins (e.g., land, climate, or other quality characteristic related to a locality), and leverage the value associated with that particular geographic origin. GI's are afforded similar legal protection as trademarks that protect business interests, and discourage free riding off the quality investments of others and development of a market for lemons.

In a discussion on geographical indicators in national law, Hughes (2006) points out that a GI designates the place where the product was produced and that the locale is known to produce that item due to a known land/quality nexus (306). Hughes also notes that the larger the region, the less likely that production factors will be consistent or unique across that region. Therefore, every geographical indicator is a geographic identifier, but not vice versa. In Canada, these points are especially relevant to the discussion of northern vigor because of the ambiguity associated with the use of the descriptor "northern."

Clawbacks

The recent literature on trade has emphasized the notion of clawbacks, especially as they relate to geographical indicators. The term clawback refers to applying a trademark or some other form of property right protection by a country or region to a product for the purpose of creating brand loyalty or quality signaling of a hitherto unprotected term. Clawbacks have an element of *ex-post* assignment of property protection, unlike the *ex-ante* nature of patents. *Ex-ante* assignment of property right protection, such

as the use of trademarks, plays a crucial role in differentiating products in the marketplace and in the process of marketing product innovations (Mendonca, 2004). *Ex-post* application of a clawback can become problematic when a party asserts property right protection to a product name that has become generic in use or has already established loyalty and reputation among consumers.

Are clawbacks always efficient?

In international trade debates, there has been considerable attention given to the use of clawbacks and geographical indicators. The European Union has already registered many GI's, protecting the use of terms associated with such products as high quality dairy products and alcoholic beverages unique to various regions of Europe. The use of GI's is also considered a viable strategy to increase economic competitiveness and add value to the agricultural markets of various developing countries. Indeed, producers in developing countries could benefit from exclusivity of terms associated with their unique products (e.g., jasmine rice from India, Ethiopian coffee). In this case, *ex-post* assignment of property protection in the form of a clawback can assist in preserving the quality characteristics of a product and promote product or marketing innovation to encourage competitiveness in domestic or international markets.

The questionable use of clawbacks arises from the *ex-post* assignment of property protection to terms that are already general in use or already have established loyalty and reputation among consumers, especially in the cases where there is a market for lemons. In such a case, it is difficult to argue that an efficient market outcome has been achieved because the expropriation of the term by one entity has diminished the profitability of others. In such a context, clawbacks may provide incentive for the expropriation of previously used terms that already provide product value in the marketplace. This is a form of rent seeking by those who benefit from well-established geographic associations or product prestige in the marketplace.

Northern Vigor

Northern vigor is a term that has been traditionally used to describe the qualities and characteristics of seed potatoes grown in northern latitudes. Commercial seed potatoes grown in northern latitudes are recognized for desirable production qualities such as consistently higher yields and increased plant vigor. This is thought to be due to the fact that they perform well in less than ideal growing conditions where there is a relatively larger diurnal temperature difference than in southern growing regions.

There has been a dramatic shift in the areas where seed potatoes are grown in Canada. Prior to 1981, most of Canada's seed potato production was concentrated in the Maritime provinces. However, in the Prairie provinces from 1981 to 2001, the area used for production of seed potatoes expanded 90% in Manitoba, 251% in Alberta, and 405% in Saskatchewan. This westward shift in potato production is, in part, attributed to the proximity to U.S. markets, improvements in transportation infrastructure, and opportunities in western Canada's land base suitable for potato production (Statistics Canada, 1996).

At around the same time that potato production was shifting westward, researchers and other industry stakeholders were interested in determining the physiological basis of northern vigor in seed potatoes. In the mid 1980s, researchers at the University of Saskatchewan began a number of research trials to better understand the characteristics and qualities associated with the well-recognized superiority of seeds produced in northern latitudes. The results of the research suggest that northern vigor qualities are due to physiological changes in the seed tuber that affect growth and productivity. Among the factors affecting the physiological condition of the tuber are the climatic characteristics of the growing region in northerly locations (Agriculture and Agri-Food Canada, 2008).

Although the term northern vigor is most commonly applied to seed potatoes, the phenomenon may also relate to other products and even animals. More recently, the northern vigor potential has been evaluated in other agricultural products. In the mid-

1990s, researchers at the University of Saskatchewan began to investigate strawberry crowns, garlic, and medicinal and other aromatic crops for their northern vigor qualities. Of course, growing demand for alternative medicines and functional foods by health conscious consumers may mean substantial opportunity for the Canadian agriculture and agri-food industry.

Indeed, Nova Scotia strawberry producers have been exporting strawberry plants to the northern United States, Florida, and the rest of Canada due to the perceived quality of Nova Scotia rootstock material by the fruit growers in these areas. Of the 35 million plants grown by Nova Scotia certified nurseries, 85% end up in the abovementioned markets, providing a farm gate value of \$7 million to Nova Scotia producers. The question that arises is whether the benefits arising from a northern vigor trademark applied to strawberry plants produced in western Canada will diminish the profitability of eastern producers in the form of rent seeking. Will the perceived northern vigor and quality reputation of plants currently exported from eastern Canada be subject to free riders? Or do the geographical boundaries of northern vigor apply eastward and westward across Canada?

Currently, Northern Vigor is a trademark of the Saskatchewan Seed Potato Growers Association. The commonly accepted claim is that plants grown from Saskatchewan-produced seed are more vigorous and higher yielding than those grown in southerly locations. However, the designation of the term northern vigor is sufficiently ambiguous to the consumer, with little information to suggest that plants produced from seed grown in “northern” latitudes have superior qualities. As a term protected by trademark law, this designation is misleading because it fails to signify to the consumer the unique qualities associated with a particular geographic area or growing conditions. Rather, it acts as a geographic identifier, signaling only that the product has qualities unique to “northern” latitudes. The boundaries of what constitutes northern could contain heterogeneous growing conditions owing to differences in soil and climatic conditions across provinces and territories.

As the owner of the Northern Vigor trademark, the Saskatchewan Seed Potato Grower’s Association can commence with legal proceedings to prevent unauthorized use of the trademark. The question that arises is whether other firms, producers, or other industry stakeholders that have previously used the term northern vigor as a marketing tool can continue to do so. Clearly, if they cannot without payment to the trademark owner, then it is difficult to argue that an efficient market outcome has been achieved because the expropriation of the term by one firm has diminished the profitability of others. As a mechanism for marketing product innovations, it is unlikely that the objective function is to provide incentives to firms to simply expropriate the property right of previously used terms or initiate market failure due to information asymmetry.

Conclusions

This brief has explored some of the considerations concerning use of the term northern vigor to signify to the consumer the geographic qualities supposedly inherent in seed potatoes produced in Saskatchewan. We suggest that the use of this term may not resolve the problem of information asymmetry and may not adequately perform its function as an identifier of “northern” qualities in seed potatoes. Due to the long standing recognition of excellent properties in seed potatoes produced in most regions of Canada, especially Western Canada and the Maritime provinces, it is difficult to argue that an efficient market outcome has been achieved by the legal protection afforded to industry stakeholders in Saskatchewan. It remains to be seen whether the possibility for trademark extension of northern vigor to strawberries produced in Western Canada will have the same market diminishing effect on the strong export market of Nova Scotia strawberry rootstock material.

Although it is recognized that the term northern vigor is a trademark and not a geographical indicator, it is subject to similar arguments concerning the clawing back of such terms. Due to the ambiguity associated with what constitutes “northern” and the ability of most provinces in Canada to reproduce the quality characteristics associated with northern vigor, it is relevant to consider whether any attributes have been

preserved and whether the term accurately signals to the consumer a unique set of characteristics.

Furthermore, that the term northern vigor has been trademarked could result in demands for compensation from those who seek to market their product using this term, or at least exclude unauthorized use of this term by other market participants. It is unclear how such compensation or exclusivity enhances market efficiency when the term northern vigor is too vague to reflect a quality characteristic accurately and mitigate a problem of information asymmetry. If trademark protection does not accomplish net market efficiency, yet still results in compensation from those who seek to use the term, it may provide incentives to others to expropriate unallocated property rights. In such cases, it can result in attempts to generate monopoly rents rather than use forms of protection (e.g., trademarks, geographic indicators) meant to foster investments in product innovation.

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