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Can Foreign Producers Benefit from Geographical Indications under the New European Regulation?

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This article discusses some economic issues linked to the 2006 European regulation regarding geographical indications. Economic implications of this regulation for foreign producers are investigated. The article examines whether or not the development of a geographical indication is a profitable strategy for foreign producers. The discussion here concludes that geographical indications may allow such producers access to a high-quality segment of the market, but efficient quality management is a necessary condition for reaching such a segment.

Keywords: geographical indications, regulation, quality

Introduction

Geographical indications (GIs) are designations voluntarily adopted by agricultural producers; the state provides property-rights protection for GIs, laws against false descriptions of characteristics, and sometimes quality-monitoring assistance. GIs are used as signals to consumers of quality or other attributes based on the geographic origins of food products. GIs are available to any producer within the specified region of origin. GIs raise issues of access to domestic markets for foreign producers who want to compete in the GI niche.

Disagreements over the European Union's system for regulating GIs led the United States to file a complaint with the World Trade Organization against the European Union regulation in 1999. In 2005, the WTO released the panel report regarding the European GI system. The panel's conclusions and recommendations led the European Union to revise its rules governing how international GIs are treated (WTO, 2005). The regulation now allows recognition of foreign GIs by the EU GI system and access to the EU market with the European GI logo for foreign producers.

This article focuses mainly on economic impacts, as other articles in this special issue will detail the legal aspects of GIs. In particular, this article abstracts from many issues being addressed within the Doha Round, such as issues regarding the creation of a multilateral register of wines and spirits (see Kerr, 2006, and Vincent, 2007). Moreover, this article is not an exhaustive presentation of all economic impacts (see complete reviews by Fink and Maskus, 2005, and Josling, 2006).

The discussion here details how recent WTO and EU decisions may affect the use of GIs by foreign producers. The first part presents the recent decisions announced in 2005 and 2006 and discusses whether or not these decisions pave the way for access to the high-quality segment for products originating in developing countries. The second part seeks to answer the following question: Is the development of a GI a profitable strategy for foreign producers? The discussion is based on microeconomic argumentation.

The WTO Decision and the European Regulation

The European Union provides specific legislation for the registration, certification, and protection of GIs for agricultural products and foodstuffs via the EC Regulation No. 2081/92. GIs are classified as either Protected Designations of Origin (PDOs) or Protected Geographical Indications (PGIs) at the European level (European Commission, 1992).

PDO is "the term used to describe foodstuffs which are produced, processed and prepared in a given geographical area using recognized know-how" (European

Commission, 2006). The designation *PGI* means "the geographical link must occur in at least one of the stages of production, processing or preparation. Furthermore, the product can benefit from a good reputation" (European Commission, 2006). The European regulation sets up a link between the origin of the product and one or several characteristics that can be identified by consumers. These characteristics include high-quality dimensions, since reputation matters in the PGI definition.

Controversies between the European Union and the United States over protection of GIs led the WTO Dispute Settlement Body to establish a panel to determine whether EC Regulation No. 2081/92, regulating GIs, violated the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) of the WTO (Babcock and Clemens, 2004). The U.S. challenge of the EU regulation was based on the following points: (1) discrimination against foreign products with respect to geographical indication protection and (2) failure to protect foreign trademarks. These failures violated the WTO principle of national treatment, which requires members to provide at least equal treatment to domestic and foreign producers regarding intellectual property rights. In 1999, the United States contended that Regulation 2081/92 did not "provide sufficient protection to pre-existing trademarks that are similar or identical to a geographical indication" and was inconsistent with the European Union's obligations under the TRIPS Agreement (WTO, 2006). In 2003, the United States filed an additional request for consultations concerning the protection of trademarks and GIs for agricultural products and foodstuffs, contending that Regulation 2081/92 impeded foreign producers from accessing the European GIs. The U.S. position with respect to its domestic market is that its trademark laws (in the form of certification marks) adequately protect U.S. and non-U.S. GIs alike, and that there is no further need for special property-rights protection for GIs. A WTO dispute settlement panel was formed in October 2003.

In April 2005, the WTO panel ruled that EC Regulation 2081/92 was inconsistent with the TRIPS Agreement and the General Agreement on Tariffs and Trade (the GATT) in several respects (WTO, 2005). In particular, the panel determined that EU regulations were inconsistent "with respect to the equivalence and reciprocity conditions, as applicable to the availability of protection for GIs" and that the European Union could not deny GI protection to third-country products from countries whose GI protection systems were not equivalent to the EU system (WTO, 2005). In other words, foreign producers should be guaranteed the same access that EU producers have to the EU system for protecting GIs.

Guaranteed access is a contentious question, because producers from non-EU countries with different approaches regarding the link between GI and quality wish to

register GIs under the EU system to receive the benefits of the PDO/PGI seals that are known by some EU consumers (Loisel and Couvreur, 2001).

The panel also determined that the EU regulation failed to protect pre-existing trademarks from confusing uses of GIs and that the European Union could not require third-country government participation in the processes of verification and transmission of applications, verification and transmission of objections, and inspection structures and declarations (WTO, 2005). Given that these inconsistencies "nullified or impaired benefits accruing to the United States", the panel recommended that Regulation No. 2081/92 be brought into conformity with the TRIPS Agreement and the GATT.

In response to the WTO panel decision, the European Union published Council Regulation (EC) No. 510/2006 on March 20, 2006 (European Commission, 2006). The new regulation, which came into force on March 31, 2006, more clearly defines EU systems for recognition and registration of third-country GIs, allows individuals and groups to apply for registration of a third-country GI in the European Union without participation of the third-country government, and provides greater protection for pre-existing trademarks. Article 2.1 of Regulation 510/2006 requires that the agricultural product or foodstuff for which application for a GI is being made "possesses a specific quality, reputation, or other characteristics attributable to that geographical origin" (European Commission, 2006).

The new regulation satisfies most U.S. concerns about registration of third-country food products and moves toward mutual recognition. With enactment of EC Regulation 510/2006, a foreign producer now has a chance of registering a PDO or PGI in the European Union. Once an application has been filed, the commission has up to 12 months to scrutinize it. If the commission determines that the conditions of the regulation have been met, the application is published in the *Official Journal of the European Union,* and interested parties have 6 months in which to file an objection (see additional details about the regulation in Marette et al., 2008).

The full story of the impact of this regulation on registrations has yet to emerge. To protect the common reputation of the PDO/PGI system, the commission may be tempted to reject applications from some foreign producers who apply for European GIs despite the absence of a precise link between quality and origin. On the other hand, the fact that the PDO/PGI system has registered more than 700 GIs (excluding wines and spirits) in the European Union suggests that this system is prone to accept foreign GIs. Even though Colombian coffee was recently accepted as a European PGI, it is hard to predict from this instance the chances that other groups of producers from third countries will be accepted, since producers of Colombian coffee were already

organized for promoting quality and the product was recognized in Europe by many consumers before the PGI application. Further, it is not clear how many GI applications foreign producers will make under this regulation.

Even though the United States was the primary complainant for the WTO panel report of March 2005, it seems likely that the opportunity to apply for a PGI/PDO under the EU system will be used mainly by non-U.S. farmers, as U.S. certification marks as GIs are not used a lot in the United States (see table 1 in Marette et al., 2008). The new European regulation is mainly an opportunity for producers from developing countries that have experienced difficulties entering western markets and protecting property rights. European consumers may be interested in new GIs that signal food products with specific tastes. This is the case for cocoa or coffee, for which consumers' willingness to pay may be high and for which origin matters because of tastes specific to countries from South America or Africa (for instance, the Ethiopian coffees named Sidamo, Harar, and Yirgacheffe).

Regulation 510/2006 conforms to the WTO panel decision that producers from third countries be allowed to register a PDO/PGI. Regulation by the European Commission should allow uniform implementation of the regulation, thereby allowing the same protection and potential benefits to third-party PDOs/PGIs as those allowed to GI products from member states.

Economic Discussion

The new regulation allows the EU regulatory system to recognize and protect foreign GIs and allows foreign producers to apply directly for registration of GI products in the European Union. The regulation holds the promise of national treatment for non-EU producers. These changes represent clear progress in terms of market integration but raise a number of issues that are addressed briefly in this section which focuses on economic arguments (see also Bramley and Kirsten, 2007). The key issue is whether or not foreign producers, in particular producers from developing countries, will apply for PDOs/PGIs in order to promote the quality of their products.

In a situation of quality uncertainty, GIs provide value when they protect the common reputation of farmers who strive to promote the quality of their products or a given characteristic, including specific processes of production (Bureau et al., 1998). GIs aim at increasing profits by attracting interested consumers who are willing to pay a premium for products of a specific area. The acceptance conferred by a European GI may help foreign farmers to benefit, through use of the European PDO/PGI logos, from access to a high-quality segment of the market. Do the development of a GI and

the process of application to the EU system bring enough benefit to farmers to make these activities worth their while?

The export strategies of third-country producers may lead to new applications to the EU system of GIs governed by regulation 510/2006. Producers from third countries will hope to benefit from the higher willingness to pay that is a characteristic of some EU consumers. Empirical evidence supports the notions that some consumers are interested in obtaining more information about the conditions of production from different countries and that increased international trade leads to a higher consumer sensitivity regarding the origins of products. The empirical literature suggests that a significant effect on prices or consumers' willingness to pay exists, even if the price premium may be relatively low and clearly depends on each specific GI (see McCluskey and Loureiro, 2003, for a review).

As McCluskey and Loureiro mention, "The major generalization we can draw from [the] group of empirical studies on consumer response to food labeling is that the consumer must perceive high eating quality in order for the food product to command a premium. This was particularly important for socially responsible and origin-based products" (2003, p. 101). This finding means that good quality is essential to obtaining a premium with a GI.

Quality management mainly relies on sunk-cost spending, for example, certification and/or high-skill workers. Application and verification costs may limit access to the GI system of the EU for some groups of small farmers because of these large sunk costs. If quality and information are produced at a sunk cost, a firm—by selecting a relatively high level of quality—can potentially drive competitors with lower-quality products out of a market (Shaked and Sutton, 1987). As sunk costs are not passed on to consumers via prices, elimination of potential rivals is possible. As a result, concentration at the producer level increases. Marette and Crespi (2003), Marette et al. (1999), and Lence et al. (2007) showed that sunk costs linked to quality management for farmers' organizations explain the concentration and the necessity of supply control among farmers inside a GI.

The data presented below suggest that market concentration exists for the "successful" GIs, that is, the GIs with a significant market share. Table 1 shows that the first ten Italian PDOs and PGIs accounted in 2004 for 82 percent of total (domestic and foreign) sales (value calculated at retail level) of Italian PDOs and PGIs. (At the end of 2004 there were over 140 Italian PDOs and PGIs.) Note that the first three PDOs/PGIs alone account for 56 percent of total sales.

Table 1 Sales and Market Shares of the Top Ten Italian PDOs/PGIs

	2004 sales (million euros)	2004 market share (percentage)
Prosciutto di Parma	1776	23
Parmigiano Reggiano	1499	19
Grana Padano	1154	14
Prosciutto di San Daniele	481	6
Gorgonzola	378	4
Pecorino Romano	328	4
Bresaola della Valtellina	315	4
Mozzarella di Bufala Campana	278	3
Speck dell'Alto Adige	219	2
Mortadella di Bologna	204	2
Total		82

Source: ISMEA (2006).

This table raises the point that consumers recognize Prosciutto di Parma, Parmigiano Reggiano and Grana Padano as specific brands with established reputations rather than as products signaled via the GI system. These products benefit from a significant price premium compared to the basic products. The quality reputation of these three products is the essential condition for having large market shares.

The link between quality management and the recognized GIs is not specific to Italy. The practice of "coupling" PGI/PDO to quality systems is also frequently used in France, where the Label Rouge is mainly given to products with GIs. The Label Rouge (LR) system benefits from a quality reputation mainly in the case of poultry. In 2004, the average price for a Label Rouge chicken was €6.06/kg versus €2.48/kg for the cheapest chicken on the shelf (Label Rouge, 2007). The reputation of Label Rouge dominates the reputations of other systems for signaling quality.

Table 1 shows that market shares matter. Food items marked with prominent locations are comparable to branded products, whereas a rather unknown EU label may not influence consumers' choices at all. In the case of a well-known GI, producers may benefit from the European regulation because of the protection against misuse by competitors, the quality assurance scheme, and the possibility of supply control (see Lence et al., 2008).

Table 1 suggests that the concentration effect mentioned above seems to operate inside the GI system. A few GIs dominate the market and are able to partially extract consumers' willingness to pay for products from a specific origin, while other GIs have tiny market shares with no influence on consumers' choices. Clearly from table 1, the 130 remaining Italian PDOs/PGIs, with 18 percent of total sales shared among

them, are "scattered" in terms of economic impact and reputation. For some of them, the link between the geographic origin and the specific quality may be elusive. It is difficult for small GIs or new entrants from third countries that benefit from the new EU regulation to establish their reputations.

The foregoing point is linked to the sensitive issue of the plethora of GIs in Europe; accompanying this plethora is the risk that consumers will be confused and find it difficult to identify high-quality products. Except for the "famous" GIs, such as the ones appearing in table 1, label proliferation is the main flaw of the GI system. Marette et al. (2008) count approximately 700 geographical indications (excluding wines and spirits) currently registered in the European Union. Peri and Gaeta (1999) count more than 400 official appellations in the wine sector in Italy, 450 appellations in France, and 1,397 in the wine sector in Europe overall.

This label proliferation creates confusion for consumers. Indeed, Loisel and Couvreur (2001) show that even in France such signals of quality are not clear to many consumers. For example, the recognition of quality labels by French consumers is only 43 percent for Label Rouge (a high-quality seal for poultry), 18 percent for l'Agriculture Biologique (organic food), and only 12 percent for Appellations d'Origine Contrôlée (the French GI). One major problem is simply the legibility and clarity of a label, especially one showing some official seal. Although Label Rouge is a well-established label, which suggests that reputation matters, the fact that less than half of French consumers recognize it is suggestive of the problems inherent in any label and GIs in particular.

The previous examples suggest that the effectiveness of GIs as signals of quality may be lowered because of GI proliferation. Under these circumstances, producers who cannot or choose not to enter a protected GI system can always turn to the classical trademark system, which protects foreign brands in the European Union and many other countries. In such a context of GI proliferation, quality management is crucial to establishing a reputation and getting high prices. Given the proliferation of GIs, there is a risk that some may give rise to unsubstantiated claims that do not help consumers clarify their opinions on characteristics of food products. These "poor" GIs may tarnish the credibility of "serious" GIs that employ rigorous certification processes in order to maintain quality.

The European Union considers the GI system to be an effective method of protecting quality in agricultural products and has enacted policies to support the use of GIs. As shown in the previous section, the new regulation 510/2006 allows the EU regulatory system to recognize and protect foreign GIs and allows foreign producers to apply directly for registration of GI products in the European Union. Geographical

indications may help producers enter the PDO/PGI segment of the market, but only a few products are likely to benefit from large market shares because of an established reputation (see table 1). An alternative option could be to develop private brands, where efficient quality management is a necessary condition for reaching high-quality segments in order to obtain decent incomes.

Farmers from developing countries may be interested in using PGIs/PDOs to enter the EU high-quality market. One interesting option for farmers in developing countries would be to "couple" the PGIs/PDOs with private brands or other labels such as fair trade labels, which are supposed to favour decent incomes for "poor" farmers. Recently, labels associated with fair trade and fair working conditions in developing countries have gained prominence, although producers' market share in Western countries is relatively limited (between 2 percent and 4 percent for different products and locations; see Krier, 2006). By "coupling" PGIs/PDOs with private brands or other labels, farmers may collectively capture a share of the willingness to pay exhibited by European consumers interested in the origins of products, allowing producers to set the high prices necessary to cover certification costs. The PGI/PDO provides protection against misuse and a quality assurance scheme, both of which are precious for small farmers using fair trade labels.

Based on the previous discussion, it is a thorny question whether or not the new European regulation is appropriate to help small farmer's cooperatives to set up quality assurance schemes as a basis for exporting high-quality products into the EU. On the positive side, a GI increases profits by attracting interested consumers who are willing to pay a premium for products from a specific area. The European GI system may help farmers determine an efficient system for managing quality. On the negative side, GI proliferation hobbles the chances of having a well-known GI that will influence consumers' decisions. In such a context, covering the sunk costs of certification and advertising may be impossible for small cooperatives because of a likely lack of consumers' recognition, which in turn leads to the absence of price premium. It is likely that the negative aspects outweigh the positive aspects. However, additional empirical/econometric studies are necessary, measuring both positive and negative aspects linked to GI adoption.

Conclusion

The WTO panel decision and the new EU regulation represent significant progress in the WTO negotiations, because they move GI protection toward mutual

recognition of GI registration systems among countries. The WTO panel decision demonstrates that the WTO process is compatible with EU efforts to differentiate and label quality in agricultural products and foodstuffs.

Empirical evidence demonstrates that labels on goods often convey information that affects consumers' purchasing decisions. GIs may help allow foreign producers access to a high-quality segment of the European market, but efficient quality management is a necessary condition for reaching such a segment and increasing profits.

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