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California Wine and the EU Wine Policy Reform

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Wine relations between the European Union (EU) and the United States tend to be uneasy. It took 20 years of tedious negotiations before the two finally reached a trade agreement for wine in October 2005. The United States agreed not to use certain terms, such as "Burgundy" and "Chianti," which some EU countries—France and Italy in particular—thought were their own. In return, the EU would allow the import of U.S. wines that were produced using oenological methods that were not, or not yet, allowed in the EU.

The expected calm in wine relations between the United States and the EU at the conclusion of these protracted negotiations did not occur. Instead, in Germany, a campaign flared up against U.S. wines, in particular wines from California sold in German supermarkets. Wines from California were characterized in popular magazines as "Coca-Cola" wines, "artificial" wines and "Frankenstein" wines that had very little in common with the "pure" and technologically "innocent" wines grown on German soil and nurtured by German wine makers into "bottled honesty."

Nothing substantial came of the defamation campaign and the wine agreement was signed in March 2006. The spat in Germany over the acceptability of wine that was produced with the help of modern oenological techniques may have been a rear-guard action of conservative wine romantics. Current developments in EU wine market policies suggest that the EU is trying to come to terms with the new realities of world wine markets, where the EU is seen as a region that produces wines that often do not meet the tastes of wine drinkers at home or abroad. In order to catch up with its new-world competitors, such as California, the EU Commission agreed in December 2007 on a profound reform of its common wine market policy. The reform aims to increase the competitiveness of EU wine producers worldwide, by lifting some of the burdensome regulations that have plagued the EU industry. This brief summarizes the changes in the EU regulations under the new reform and highlights their potential impacts on the California wine industry.

A brief review of the wine industry and market in the European Union

The EU now comprises 27 countries with a population of about 500 million stretching from the Baltic to the Adriatic. About 2.4 million wine producers in the EU produced nearly 4.5 billion gallons of wine on about 8.9 million acres in 2005 (based on the data from the EU-25 which does not include new wine producing members Bulgaria and Romania). In the same period, California had about 4,600 wine grape growers, about 2,300 wineries and produced 650 million

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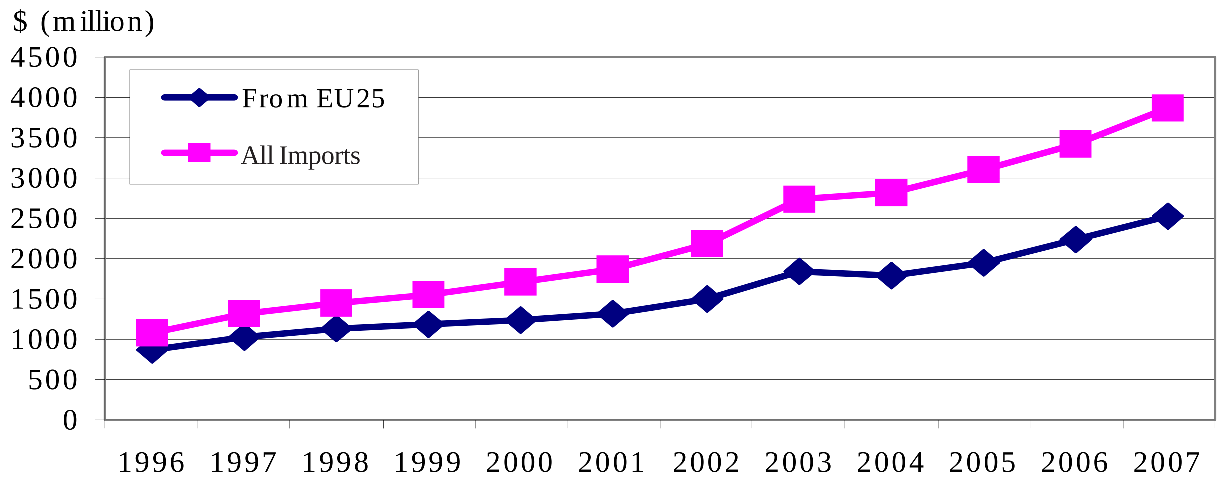
Figure 1: Value of U.S. Wine Imports, Totals and Shipments from EU25, 1996-2007

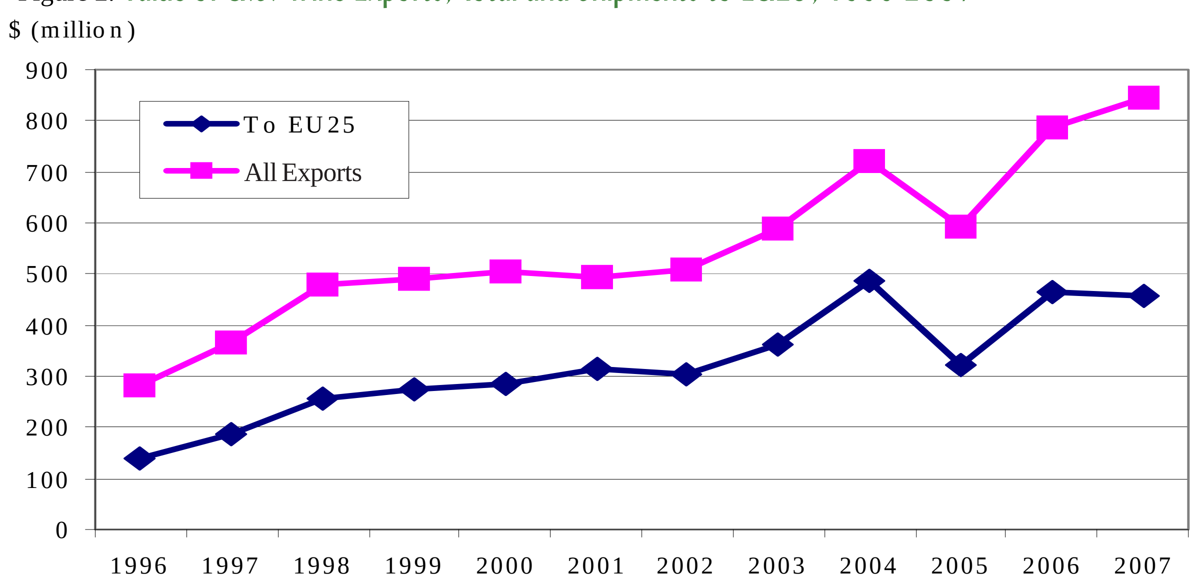


Source: U.S. Customs Service (http://dataweb.usitc.gov)

gallons on about 470 thousand acres. Thus, California produces about 14 percent as much wine as the EU on about five percent of the area. The EU is a major exporter to the United States, shipping about $2.5 billion worth of wine to the U.S. market in 2007 (Figure 1). During the same period, the EU was California's most important export destination with wine shipments totaling $450 million or about 16 percent of EU wine shipments to the United States (Figure 2). In recent decades, EU wine consumption has been falling steadily (Figure 3), although sales of higher-priced wines are increasing. Imports, many from California and Australia, have grown dramatically, while exports have increased slowly.

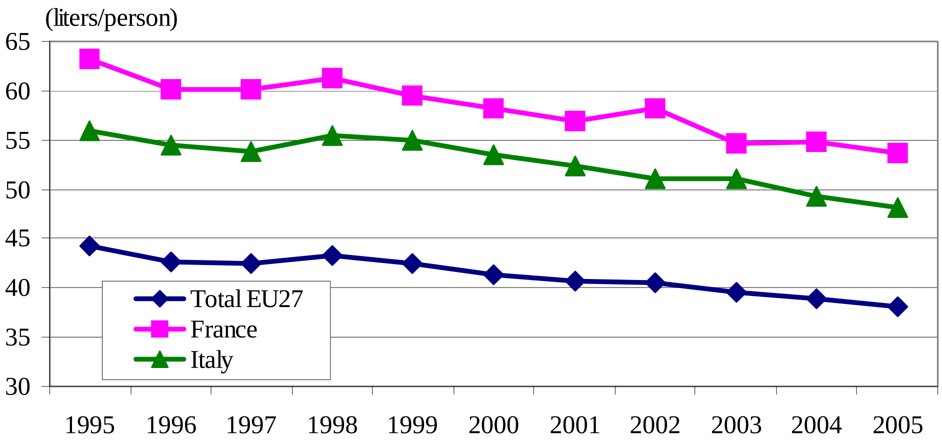
The EU has been plagued by drastic overproduction and, based on current trends and without taking into account the wine reform, excess wine production (and therefore government storage and disposal), will reach 15 percent of annual production by 2010/11 (EU Commission 2007). To dispose of the surplus,

Figure 2. Value of U.S. Wine Exports, Total and Shipments to EU25, 1996-2007



Source: U.S. Customs Service (http://dataweb.usitc.gov)

Figure 3. Per Capita Wine Consumption, EU27, France and Italy, 1995-2005



Source: Wittwer and Rothfield (2006)

distillation program were from France, Italy and Spain. The reform will begin to phase out the distillation programs over four years, starting in 2009, depending on particular member states.

When the program is removed, these wines will probably end up on the market. This will depress prices for low-quality wine until the policy of removing vines kicks in and reduces the supply of low-quality wines.

the EU has spent about 500 million euros every year for various market intervention measures, of which the "crisis distillation" of wine into alcohol for industrial use is the most important.

The new wine policy reform and implications for California

The state of EU wine markets has encouraged the EU Commission to initiate a reform of its wine market policy. The rest of this paper discusses important measures of the reform and their impact on California wine producers. The following issues are featured:

1. End of distillation support
2. Removing vines (the grubbing up scheme)
3. Chaptalization (adding sugar)
4. Labeling
5. Elimination of planting rights and re-allocation of funds saved.

End of distillation program

The EU will no longer use its market intervention measures, which has the potential to have impacts on California wine producers. In recent years, these EU market interventions consisted mainly of subsidies for the distillation of wines and the storage of wines and the alcohol distilled from surplus wine. About 15 percent of EU wine production entered such schemes in recent years (Table 1). Most of the wines that entered the

In recent years, distillation measures have mainly been used for lower-quality wines which have suffered the most under the gradual decline in consumption that has been observed over the last 50 years in France and other large wine consuming countries. Some bulk wines exported from California to the EU market or to third country markets may face tougher competition from these cheaper European wines. However, as lower-quality wines become cheaper, some consumers that had consumed higher-priced wines may shift from higher to lower-quality wines. The decrease of prices in the lower-quality category may thus pull down prices of higher quality wines, depending on the degree of substitution across wines of various qualities. It is unlikely that this effect will be large and significant negative impacts on California producers from the elimination of the distillation program in the EU are unlikely.

Grubbing up scheme

Parallel to the elimination of the distillation scheme, the EU also encourages wine producers to remove (grub up) vineyards producing low-quality wines. The reform offers the grubbing up scheme for 3 years only. Participating wine growers are compensated through payments,

Table 1. European (and French and Spanish) wine production and share of totals disposed through distillation intervention, 2003-2006 (in million gallons)

	2003/04	2004/05	2005/06	2006/07	Average
EU Total					
Wine production	4,216	4,894	4,360	4,460	4,483
For distillation	439	595	716	652	601
Share (percent)	10.4	12.2	16.4	14.6	13.4
France					
Wine production	1,220	1,510	1,351	1,358	1,360
For distillation	78	131	165	173	137
Share (percent)	6.4	8.7	12.2	12.7	10.0
Spain					
Wine production	1,101	1,136	934	997	1,042
For distillation	244	274	279	232	257
Share (percent)	22.1	24.1	29.9	23.3	24.8

Source: EU Statistics (http://ec.europa.eu/agriculture/markets/wine/facts/index_en.htmp)

which are designed to encourage early participation.

This program is intended to attract the least efficient producers or those who fail to find a market for their product, such as producers in France, Spain and Italy that now benefit from the crisis distillation policy. Note that the overall area torn out as a consequence of the reform may be greater than the area receiving the subsidy from the grubbing up scheme, as producers may choose to tear out wines without compensation if alternative crops offer higher returns. Because producers of cheaper wines are likely to lose from other aspects of the reform, some additional market-motivated grubbing up is expected. The grubbing up subsidy is meant to counterbalance the cancellation of the distillation program and to limit the supply increase of low quality wine. For California producers it means that the small impact of the elimination of the distillation program will be further reduced. If the grubbing up scheme were larger than the supply increase from the end to distillation, total EU wine supply would decrease. In that case, California wine makers might even benefit from the reform. However, given the planned scope of the scheme, this scenario is not likely.

Elimination of planting limitations and funds for restructuring, promotion, etc.

Two more elements of the new reform have the potential to put some pressure on California producers in the medium or long term. First, the reform phases out area restrictions. Up to now, EU wine area has been strictly controlled through planting rights. By 2015, the planting rights will be abolished (EU member nations may extend this until 2018). Successful producers are likely to expand their area under production and are likely to be those that are poised to compete most effectively with California.

Secondly, more funds will be made available to member states for measures that range from vineyard restructuring, modernization of the supply chain and the promotion of EU wines in the domestic or export market. The medium to long-term impacts on California wine producers might be noticeable because certain European wines could be able to strengthen their competitive position in the domestic and export market.

Chaptalization

The initial reform proposal aimed at the banning of the use of sugar to raise alcohol in wine (chaptalization). This practice was permitted for low-alcohol wines, including Germany's lower end of "bottled honesty" wines. Banning sugar turned into one of the most controversial elements of the proposal, as many wine makers, particularly from the northern countries of the EU, opposed it vigorously. Germany, the biggest wine producer in the northern half of the EU, as well as Austria and France, were the most outspoken critics, because adding sugar to increase the alcohol content of the lower quality wines has been a century-old tradition in those regions. A ban on chaptalization would have been particularly damaging for Germany's rapidly growing red wine production. Nearly 38 percent of all German wines were red wines in 2006, according to the German Wine Institute.

In Germany, chaptalization can now be used to add a maximum of 3.5 percent alcohol to a wine. This limit will be lowered to 3 percent under the reform. Under a ban, California producers would have benefited from an EU prohibition of sugar because German consumers have developed a taste for red wine in the last decade and California has no need for chaptalization. California exports to Germany and other European markets would have had an opportunity to replace some of the lower-quality wines that would be undrinkable without sugar added.

Labeling

The EU wine reform also simplifies the labeling laws for EU wines. For wines that do not have a geographic indication, EU winemakers can now state the vintage and the variety on the label. This change aims to allow EU wine makers to compete with California and other "new world" wines that put the variety and the vintage on the label.

Reformed European labels means that California producers may face increased competition from European wines, which will now supply consumers with the varietal and vintage information to which they have become accustomed. It is unclear, however, how many European wines will be affected by this measure, as most EU wines are produced under a geographic indication and those wines are unaffected by the reform.

Summary and concluding remarks

We have identified how the new reform of the European policy for wine will affect producers in California and the rest of the United States. We find that California wine producers and exporters will notice only moderate impacts form the EU wine policy reform. Most measures of the reform will affect those segments of the EU industry that are not directly competing with California wines. California wines face slightly more competition in the lower quality wine segment and more EU money will be spent on promoting EU wines. California wine producers need not be alarmed but attention to further developments is warranted.

For more on the new EU wine policy go to: http://ec.europa.eu/agriculture/capreform/wine/index_en.htm