REFORM OF THE COMMON ORGANISATION OF THE MARKET IN WINE
Policy Department for Structural and Cohesion Policy

AGRICULTURE AND RURAL DEVELOPMENT

REFORM OF THE COMMON ORGANISATION OF THE MARKET IN WINE

STUDY


PE 369.020 EN
This study has been commissioned by the Committee on Agriculture and Rural Development of the European Parliament.

It has been published in the following languages:
- Original: FR.
- Translation: EN.

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Manuscript completed in September 2006.

This study is available on the Internet at:


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Content:
This study is a contribution to the parliamentary debate in response to the proposal for reform of the common organisation of the market in wine initiated by the Commission. It provides a brief summary of the situation in the wine market in recent years in the 25 Member States of the European Union, assesses the shortcomings of the current CMO mechanisms, analyses the Commission's proposals and puts forward specific proposals for reform of the CMO.

IP/B/AGRI/ST/2006-2230
30 September 2006
Acknowledgements

Our special thanks go to Mrs Odile Trouvé-Teychenné, who coordinated our dealings with the European Parliament very efficiently and hosted and guided us during our meetings in Brussels.

We also wish to thank Mrs Katerina Batzeli, rapporteur, for her interest and availability and Mr Albert Massot, who gave us the benefit of his vast European experience in the course of several informal meetings.

This report has benefited from extensive consultations and important contributions. Besides the international team of experts, we also wish to thank all of the individuals and institutions who were willing to give us their time and the benefit of their knowledge and skills, namely:

Faustino Aguirrezabal, EVENA, Navarre, Spain
Patrick Aigrain, Viniflhor, Paris, France
Itziar Artázcoz, Unión de Cooperativas Agrarias de Navarra, Spain
Jean-Gabriel Chevrier, Viniflhor, Libourne delegation, France
Maurice Crouzet, SICA Finedoc, France
Alix Dreux, ESITPA, Val de Reuil, France
Jean-Louis Escudier, INRA, Pech Rouge, France
Jesús Echeverría, Government of Navarre, Spain
M. Gouzon, Viniflhor Montpellier, France
Pierre Leclerc, CEVISE, France
Denis Loeillet, Cirad, Montpellier, France
Gérard Miclet, Lameta, Montpellier, France
Michel Moutonnet, Montpellier, France
M. Ochoa, Customs Service, Montpellier, France
José Oroz, EVENA, Navarre, Spain
Michel Remondat, Vitisphère, Montpellier, France
Sylvain Rousset, Ministry of Agriculture, France
Julian Suberviola, EVENA, Navarre, Spain
Francisco Uña, D.O. Ribera del Duero, Spain
Les Vignerons Indépendants de France
La Fédération des Syndicats des Négociants-Eleveurs de Grande Bourgogne
The organisers of and participants in the Third International Wine Business and Marketing Conference, Montpellier, 6-8 July 2006.
Consejeria de Agricultura de Castilla-La Mancha, Spain
Instituto del Vino de Castilla-La Mancha (IVICAM), Spain
The ASJA - UPA federations, Castilla-La Mancha, Spain
Union de Cooperativas de Castilla-La Mancha (UCAMAN), Spain
Lastly, we should like to express our gratitude for the support we received from the board of the UMR MOISA, the staff of the Pierre Bartoli documentation centre, and the technicians and the administrative and accounting team at INRA, especially Magali Aubert, Gérard Desplobins, Myriam Escobedo, Ariel Meunier and Marie-Thérèse Meunier.
Glossary

AOC: appellation d’origine contrôlée (registered designation of origin)
AWBC: Australian Wine & Brandy Corporation
CAP: common agricultural policy
CEEC: Central and Eastern European countries
CMO: common market organisation
EAGGF: European Agricultural Guidance and Guarantee Fund
EU: European Union
IGP: indication géographique protégée (protected designation of geographical origin)
OIV: Organisation internationale de la vigne et du vin (International Organisation of Vine and Wine)
Onivins: Office national interprofessionnel des vins (French national office for the wine trade)
QWPSR: quality wine produced in a specific region
SICA: société d’intérêt collectif agricole (agricultural cooperative)
SPS: single-payment system
UAA: utilised agricultural area
Viniflhor: Office national interprofessionnel des fruits, des legumes, des vins et de l’horticulture (French national office for the fruit, vegetable, wine and horticultural trades)
wine CMO: common organisation of the market in wine
WTO: World Trade Organization
Summary

This study is a contribution to the parliamentary debate in response to the proposal for reform of the common organisation of the market in wine initiated by the Commission. The study meets Parliament’s four requirements: (1) a brief summary of the situation on the wine market in the Europe of 25 over the last six years, (2) an assessment of the shortcomings of the mechanisms of the current CMO, (3) a critical analysis of the Commission proposals and (4) specific proposals for reform of the CMO.

1. The situation on the wine market

The analysis of the situation on wine markets both at European and world level converges to a great extent with that of the Commission on the main trends in operation. However, we have emphasised points where there are differing assessments of certain trends as well as the failure to take full account of underlying market mechanisms, of market segmentation by country of origin, by category and by price and of the great diversity of the trade flows both within Europe and between Europe and the rest of the world.

At the level of production potential, Europe grubbed up its vineyards in the 1980s and 1990s while at the same time the New World was busy planting. The new CMO of 1999 reversed this trend but was very quickly confronted with overproduction and illicit planting. Europe embarked on a new wave of grubbing-up in response to a crisis that was partly cyclical.

Production and yields show sharp fluctuations that trigger cyclical crises that become structural ones, both as a result of insufficient clearance of markets by crisis distillation and through lack of growth potential in outlets in the face of very powerful competitors. Production has also continued to grow outside Europe and the present situation remains heavily influenced by world overproduction in 2004. Over and above the cyclical aspects, the trends of yields vary widely according to the vineyards. Extensive vineyards with low yields are converting to irrigated productive vines and improver varieties, and highly productive vineyards are converting to improver varieties with lower yields. Vineyard performance makes sense therefore only in terms of productivity adapted to the dual concept of product-market segment.

Consumption has stabilised on average. It continues to decline in the traditional producer countries and to rise in the non-producer and consumer countries. The trend is towards virtual stability on average in Europe and towards a slight increase at world level. Some countries show exceptional growth (UK, USA).

International trade continues to grow. It remains highly diversified and complementary in terms of quality, colour and price. Intra-European trade plays a key role. Major differences are observed between markets. Competition with New World countries is becoming increasingly tough mainly in two keenly contested growth markets, i.e. the UK and the USA. Exports from the EU of 25 have been expanding since 2001 (after falling in 2000), but growth is lower than that of the rest of the world. Conversely, in terms of unitary value, the rate of increase exceeds by 33% that of countries outside the EU of 25. Since 2001 the gap has widened from USD 0.4/litre to USD 0.7/litre but half of this amount can be explained by changing exchange rates. The crisis and the fluctuations affecting exchange rates have exacerbated the price war.

Analysis of the world market in the light of the wine CMO focuses directly on the competitiveness factors in a market that is highly differentiated according to country and highly segmented in each country. The growing areas confronted with surpluses will vary according to their location, their yield, the nature of the products which they supply, their regulatory
classification and the price level on the market for which they are intended. Seeking a balance with a perennial plant sensitive to climatic variations at this level of accuracy and in the presence of a wide range of players requires a miracle.

Faced with the drop in consumption and the decline in exports in 2003-2005 on the one hand and substantial production on the other, distillation has failed to eliminate enough of the surpluses from the market. Analysis of surpluses confirms our view that the optional nature of crisis distillation, the fact that it is insufficiently attractive in terms of price and its late implementation do not enable it achieve the objective of market clearance intended by the CMO.

2. Assessment of shortcomings of CMO mechanisms

The 1999 reform of the wine CMO maintained the main objectives of the common agricultural policy (CAP) for wine while modifying its instruments: abolition of compulsory distillation which controlled table wine yields, abolition of the guide price, introduction of potable alcohol distillation, careful management of potential through reserved rights, recognition of producer groups and economic committees.

Guiding production potential has become tricky. The simple strategy of eliminating vineyards from the 1980s is no longer appropriate but the management of potential is much influenced by the cyclical analyses immediately preceding the decision. The policy for managing production potential has been characterised by an approach involving successive phases of stop and go. It has not anticipated the impact on production of quality reconversion in Spain (and probably in part of southern Italy) with its resulting increases in yields. The reconversion model was based on pursuing a policy of quality involving lower yields obtained with improved grape varieties (the Languedoc model). Simultaneous implementation of permanent grubbing-up and reconversion according to the Languedoc model speeded up the fall in production. Distribution of new planting rights and reconversion according to the Castilla-La Mancha model has speeded up the growth in supply.

Distillation schemes are costly by virtue of the way they are structured. The schemes are compartmentalised and the outlet for wine alcohol has been entirely administered without price review for over 20 years. The cost of wine deliveries is linked solely to its processing into industrial alcohol. The distillation of potable alcohol has achieved its objectives of regularly supplying the market in alcohol as a raw material for spirits. Although it is low, the price of wine for distillation of potable alcohol acts as a floor price and constitutes a secure outlet for a whole range of table wine producers. The alcohol produced is therefore overall in surplus and its market is not managed since balance is achieved only by its release for industrial uses at low prices. Crisis distillation is resorted to on a very irregular basis. It represents the only significant means of intervention in the event of a serious crisis but its use raises the problem of low (so as not to act as an incentive) and standard prices whatever the country and wine quality. Moreover, signing up to the scheme is optional and hence a source of free riding. It is costly by virtue of the fact that it is channelled towards industrial alcohol.

Aids for the use of concentrated musts and rectified concentrated musts are justified by the need to comply with the standard rule compensating for the difference in the cost of enrichment between methods, regions and producers whether or not authorised to use them. Enrichment techniques encourage higher yields but the need for a method to correct for climate variables cannot be disregarded. The impact on volumes differs for the subtractive method (CM, RCM) and the additive method (saccharose).

Wine-making practices are crucial in the competition with the New World countries by virtue of their impact on costs. The arguments are admissible within the two camps of producer countries.
Although many aspects arise from technical discussions it has to be concluded that it is more a confrontation between two product philosophies.

Overall, some of the criticisms of the wine CMO voiced by the Innova study and the Commission documents relate more to the implementing arrangements for measures than with the actual mechanisms of the existing CMO: (1) the problem does not lie with the introduction of grubbing-up premiums or qualitative reconversion but with the fact that they are underused or overused or with the failure to take sufficient account of the consequences of past decisions as in the case of the increase in yields in Castilla-La Mancha and southern Italy; (2) likewise, the lack of market clearance leaves a legacy of surplus supply which means that balance cannot be re-established in terms of prices and earnings; (3) the effectiveness and the cost of distillation derive from the previous choice of economic policy, i.e. supplying the alcohol market with a level of quantity and at a given price.

An assessment of the shortcomings of the CMO must instead highlight the alignment of the mechanisms: (1) either with the changed objectives of the common agricultural or wine policy (environment, World Trade Organisation constraints, rural development); (2) or with the new budgetary constraints (reduction in expenditure, arrival of new Member States); (3) or with changes in world competition with the domination of New World countries. It does seem difficult in our view to maintain conventional intervention mechanisms on the market by regulating supply when there are practically no longer any tariff barriers to trade. We feel it is essential for the objectives and means to be spelt out clearly in order of priority in the current reform plan before doing away with any given existing instrument.

3. Critical appraisal of Commission proposals

Large-scale indiscriminate grubbing-up as proposed encounters many criticisms: it is ineffective in a Europe open commercially to the world, the message conveyed to competitors is counter-productive. The approach is at total variance with the policy of the last seven years in this area and neglects the problem of illicit plantings. Grubbing-up appears to be the only possible solution in the shortterm for producers in difficulty. Selection results more from the ability to resist the crisis than from productive performance. This proposal disregards the strategies developed by the producers who resort to it. Grubbing-up will also mean the disappearance of a populating and ecological culture without alternative in regions which will continue the process of desertification contrary to the objectives of the CAP.

Planting rights constitute the main instrument of a sensible policy of sectoral development. Their cost and the argument about economies of scale are minor in the light of market volatility and the ensuing sectoral dislocation. The abolition of planting rights would therefore encourage the relocation of vineyards, the development of large firms skilled in mobilising capital and the rapid appearance of surpluses and would raise problems of interaction between QWpsr associated with a specific area and the other categories of wine.

The abolition of planting rights is also at variance with the previous decision to grub up 400 000 hectares of vines with a view to bringing supply back into balance. Once liberalised, plantings will increase and cause surpluses. Two years of the wine CMO budget would thus be wasted.

The market in alcohol associated with distillation is an entirely managed one: the prices paid to producers are laid down in regulations as are the distillation margins and the acceptable price on the market. As it would appear difficult not to cover the cost of distillation, the budget could be modulated by the two other variables, i.e. the price paid and the selling price of alcohol. For example, the price of distilling potable alcohol could be divided into two and ‘compensated’ by a direct aid.
Wine alcohols are to a large extent interchangeable: the choice of definition and of purpose modulates the beneficiary or beneficiaries from the mechanism. The rigid categories established by the rules could therefore be called into question. For example, wine deliveries could be used for potable alcohol. In that event, distilling could be continued in France. The production of alcohol by Article 29 distillation (distillation of potable alcohol) would then need to be reduced accordingly.

Environmental functions have not been taken into account: the role of distilleries should also be assessed in the light of this environmental service in the form of pollution management. Energy functions geared to bioethanol policy, i.e. the production of alcohol for fuel, would merit an additional assessment.

The wine-growing sector can with difficulty dispense with a regulatory mechanism in view of the volatility of rates reflecting fluctuating harvests and inelastic demand. The implementation of crisis distillation could be improved and costs reduced in the context of a harmonisation of the two CMOs for wine and wine alcohols. The detailed provisions of the regulation could be settled at regional level and limited within the context of the national envelopes. Income stabilisers could be introduced.

We share the Commission’s view on enrichment while remaining alert to any possible compensation for higher costs incurred by vineyards with low-price products in northern Europe. This decision would place Europe in a position of strength in the negotiations about winemaking rules and practices with the New World countries.

4. Further analyses and specific proposals for reform of the CMO

The New World countries have invaded the British market, mainly in the premium wines segment, by developing young vineyards with high productive potential oriented towards aromatic grape varieties that enable a number of very large companies to market wines that are good value for money based on grape variety and on labels backed by huge public relations and advertising budgets. They now dominate the off-trade circuit. Furthermore, they totally control the supply chain, quality control and commercial innovation. They are very favourably positioned in relation to the major retailers.

The Australian wine industry is experiencing an unprecedented crisis of over-production. This overproduction is due to the combination of overplanting carried out with tax incentives by farmers and investors during a boom time and to an over-abundant 2004 harvest. The crisis of overproduction benefits consumers who can buy increasingly cheap wines, the major retailers who exploit their dominance to improve their margins and, lastly, the very large wine producing companies who exploit the oversupply of grapes to negotiate ever lower rates. The losers in this crisis are the independent winegrowers who can no longer find buyers for their grapes or who have seen their margins cut because of lower prices. Large quantities of grapes are not harvested. There are many bankruptcies. Australia’s only policy for the winegrowing sector consists of promoting Australian wines in Australia but also, and above all, abroad.

Part of the world wine market is dominated by an oligopoly on the fringes, with most of the firms being located in the New World. Competition is increasingly keen downstream in the sector. The expansion and competitive gains of the major world wine companies over the last 25 years have been based on a wave of mergers and acquisitions with the objective of rationalisation of production and development of labels. Their critical size procures them significant competitive advantages on the most contested markets which are the UK and the USA.
Experience with the establishment of producer organisations in the fruit and vegetable industry can shed light on the plans for the wine-growing sector. We should therefore like to focus on the usefulness of organising producers into producer groups and the detailed management arrangements for the operational fund. Here, in particular, we can observe the joint participation of European funds and producers’ funds involving greater shared responsibility and the possibility of defining a list of eligible measures that could be adapted to the wine-growing sector. A large number of these measures could already be copied at the present time.

Intervention in the market can be performed at the more elevated level of the economic committees which, over and above quality rules, can implement decentralised regulation of supply through organised collective measures to establish reserves and joint funding.

We share the Commission’s view that generalised and uniform application of decoupling is impossible, but it is nevertheless possible to use these mechanisms in a more limited and targeted way. Decoupled aid implemented in a homogeneous region where the majority of products would be of the same nature, sold at the same price (e.g. delivery for distillation into potable alcohol) and satisfying criteria of rural development, environmental conservation, specific landscape features and lack of alternative production could be established within the framework of the single payment scheme without the drawbacks of generalised application.

Proposals that take account of these analyses:

1. While indiscriminate widespread grubbing-up is ineffective, it is essential to retain a form of grubbing-up that is targeted and differentiated according to strategic objectives that are both economic (grape varieties, yields) and social (grower in difficulty, planned abandonment of activity, absence of successor). Such grubbing-up would therefore be progressive, limited, monitored and evaluated during the course of its implementation. This would allow budgetary savings in relation to Scenario 2 thus allowing redeployment towards other measures.

2. Planting rights should be retained in order to guide policy. However, it should be possible to activate them much more easily by better organising the allocation, exchange and transfer of rights. Implementation of the reserve mechanisms could be evaluated and adjusted to resolve malfunctions. By extension, illicit plantings should be addressed, thanks in particular to the control systems introduced by the new CAP. The management of production potential could be carried out at regional level by a regional ministry, an interprofessional body or an economic committee on the basis of overall market figures with a fixed ceiling and national and European arbitration.

3. The arrangements for distillation should be reconsidered both in their entirety and for each category. The system of purchase prices could be revised in the interests of budgetary reduction and market orientation. The whole range of manufactured alcohols should be redefined and potential outlets should be developed. The selling price of wine alcohols should be revised upwards. The entire alcohol market should be updated at the level of its various components: potable alcohol, marc alcohol, industrial outlets (carburation) according to environmental (pollution control, alcohol as fuel) and energy (tax changes) objectives. Preventive distillation could receive payments solely for its environmental function. The practices of composting raw marc and of spreading lees need ecological evaluation. The distillation of potable alcohol could see a price reduction with the latter being compensated by a partially decoupled direct aid. The dual purpose distillation of wine is no longer on the agenda having been replaced by plot allocation (Zonta Plan). It is therefore abolished. Crisis distillation must be retained but with better implementation. It should be steered at regional level in the light of market balance and be able to assume compulsory dimensions according to differentiated criteria. It should be possible for it to be jointly financed by the interprofessional bodies or economic committees in order to
take account of price differentials. It could be aligned with the establishment of qualitative reserves.

4. Sugaring, chaptalisation, enrichment with exogenous beet sugar and cane sugar should be abolished according to the Commission proposal. Endogenous enrichment with concentrated and rectified concentrated grape must should be authorised but on a reduced scale and the subsidy should be abolished. The increase in the cost price of low-price wines in northern producer regions could be partially offset by a subsidy administered within the national envelopes.

5. The regions concerned by the distillation of potable alcohol should be eligible for the single payment scheme and partial decoupling in order to maintain plant cover and should benefit, according to cost studies to be carried out, from a subsidy for green harvesting.

6. Producer groups and sectoral organisations should be strengthened, reactivated and allocated financial resources in order to develop downstream functions. This change could be inspired by the functions and resources of producer organisations in the fruit and vegetable sector. They should in particular be focused on strategic objectives: mergers, regroupings, associations, partnerships, search for critical size and commercial development projects, creation of labels, promotion.

7. The rules about labelling do not seem to need to be modified for the reasons stated: room for manoeuvre exists under existing rules. There is no need to do away with references to specific districts for table wines without geographical indication. Large geographical areas of reference for local wines are sufficient for the purposes of this adjustment.

8. The ban must remain on the import of musts from third countries by virtue of the very definition of wine – as a product obtained by the processing of fresh grapes – and in the light of the problems of traceability, risk of fraud and market balance.
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Introduction

With the approaching end of a summer in which heatwaves have alternated with periods of unseasonable chill, the harvesting of grapes has already begun. Growers are concerned about the harvest that awaits them and the economic conditions in which they will be able to sell their produce. Crisis distillation has finally been opened throughout Europe, and initial estimates allow us to hope for a price recovery.

It was, in fact, against a backdrop of global crisis that the reform of the common organisation of the market in wine was launched. The ground had already been well prepared by the Commission's studies, its summary reports and the seminar held on 16 February 2006. The official presentation of its draft on 22 June triggered numerous responses from trade organisations and associations from the wine sector, which were reported by the media, and thus fuelled the democratic debate within our own institutions. In July there followed a parliamentary hearing on the wine trade and several meetings of the Council's working group.

It was in the midst of this political activity that we undertook the study on which this report is based for the European Parliament. In the course of these past three and a half months, numerous statistics and economic data have also been regularly published. While keeping a watchful eye on the many responses to these developments, we continued to pursue the aim defined in the call for tenders, namely to fulfil the following four criteria set by the European Parliament: (1) provide a brief summary of the situation in the wine market over the past six years in the 25 current Member States of the EU, (2) assess the flaws in the mechanisms of the present wine CMO, (3) give a critical appraisal of the Commission's proposals, and (4) put forward specific proposals for reform of the wine CMO.

We followed the method proposed in our response to the call for tenders, namely to mobilise specialised teams from the wine sector in various producer countries in Europe and the New World, but also market specialists from consumer countries, from other sectors and from other common market organisations. Several local, national and international meetings were held, and intermediate contributions, communications and original reports were submitted. This document is a synthesis of these inputs. Final responsibility for the text lies with the two project coordinators.

Scenario 2, which was presented by the European Commission as the one most likely to deal with the difficulties facing the sector, was based on a particularly liberal approach, modelled on the way in which the wine sector operates outside Europe and on the new guidelines for the common agricultural policy, Agenda 2000 and the Luxembourg Agreement. The purpose of this report is not to brush aside the proposal, let alone present a fifth scenario or a winning formula that somehow escaped the Commission's notice.

On the basis of the available data, of market analyses that have been compiled and updated, of specific published studies and of the views of the experts involved in the present study, our chosen approach consists in highlighting various points of divergence in the interpretation of the present situation in the wine sector, exploring new avenues on the basis of complementary studies and reviews, proposing a more variegated set of change-management strategies which minimise social costs and the risk of forecasting errors, which do not destroy more than they create, which achieve budget savings involving less drastic cuts, and which prioritise measures differently, while not losing sight of the challenges posed by international competition.
Reform of the common organisation of the wine market

Part 1: Summary of the situation in the wine market over the past six years in the 25 Member States of the European Union

Europe leads the world in vine growing. In terms of production, in 2005 Europe possessed almost 45% of the total surface area of the world's vineyards and produced 59% of the world's wine. Its average annual production for the period from 2000 to 2005 was 170 million hectolitres for the 15-member European Union and 176 million hectolitres for the current 25 Member States. Enlargement did not greatly alter the situation, since the volume of grapes made into wine throughout the wine-producing countries that acceded to the European Union represents only 5% of the output of the 25-member European Union in 2004. The consumption of wine in the 25-member Union in the 2004/2005 wine year is estimated at 132 million hectolitres, which represents almost 54% of the global consumption figure for 2005. As for international trade in wine, the EU is both the main exporter and the largest import market in the world. Exports of wine averaged 4.5 billion euros in value and 13 million hectolitres in quantity in the years from 2002 to 2004; this corresponds to 34% of the volume of exported beverages and 0.4% of total EU income from exports. Over the same period, imports averaged €2.3 billion and 10 million hectolitres, which amounts to a balance-of-trade surplus of more than two billion euros. If we are to understand the wine market more clearly and gauge the production surpluses more accurately, it is essential to analyse trends in the various market factors, namely production, demand (i.e. consumption), exports and imports, for the EU and its competitors.

Chapter 1: Surface area

The total surface area devoted to vine growing reflects the development of production potential. This general indicator is not a good means of assessing structural change, because there are wide variations in the yield of vines that are permanently uprooted or converted to uses other than wine production. An accurate assessment of this potential must therefore take account of changes in the nature of vineyards in terms of grape varieties, production practices and quality targets, and of specific yield trends within each category of wine and each region.

From the early 1970s, there was a significant decline in the total area planted with vines in the world (see Figure 1), chiefly as a result of developments in Europe and, within Europe, in the six, then nine and latterly 15 Member States of the European Communities. These developments were driven by the political will to resolve the crisis caused by a glut of table wine and comprised the subsidised uprooting, or grubbing-up, of vineyards, which was supplemented, on the basis of the Dublin agreements of December 1984, by the draconian measure of compulsory distillation. In this way, over a period of some 30 years, the area of the world's surface under vines was reduced by 25%. In Europe as a whole the figure was 30%, and in the EU it was 34%. The total area of the world's vineyards has now settled at a figure slightly below 7.5 million hectares, with EU vineyards accounting for 3.5 million hectares. In the course of the last five years, the 25 Member States of the EU have seen a reduction of some 150 000 hectares in the total surface area of their vineyards, whereas vine growing in the rest of the world has continued to expand, which explains an overall increase in the global area.

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These data provided by the OIV should be interpreted with caution, because they include areas where grapes are grown for marketing as table grapes and raisins, which are important products of countries such as the United States, Turkey and Greece. There is also a need to be aware of the imperfections of the categorisation system, since some of the grapes grown for these purposes may be used to make wine, depending on the state of the market.
Reform of the common organisation of the wine market

The decline in the area planted with vines in Europe (Figure 2) is ascribable to the three main producer countries, which accounted for 91% of the total grubbed-up vineyard area on average over the 17 years from 1988 to 2004. The rate of decline varied in the course of this period. When the common organisation of the market in wine was established in 1999, only France and, to a lesser extent, Germany continued to pursue a policy of grubbing-up, though the areas involved were very small in both cases. The distribution of new planting rights led to a slight increase in the total vineyard area in the three years following the reform, before market difficulties blocked any further progress. During that period, from 1999 to 2004, Spain, which had more land under vines – a total of 1.2 million hectares – than any other country in the world, was able to increase the surface area of its vineyards by 61 000 hectares, an increase of 5.4% over the whole period.

The enlargement of the EU to 25 countries increased the total wine-growing area of the Union by only 150 000 hectares, which represented a 4% addition. Hungary alone accounted for 93 000 hectares or 62% of the combined vineyard area of the new Member States. There has been an observable decline in the total area planted with vines in these countries. This has been a general trend in the Central and Eastern European countries (CEEC) since the 1980s, but the process accelerated with the transition to market economies. Hungary, for example, lost 35% of its total vineyard area between 1985 and 2000. The prospect of entering the EU encouraged replanting in Hungary, but the crisis of 2004-2005 triggered more grubbing-up.

After the stabilisation of the acreage figures for Europe's vineyards, a new wave of grubbing-up was unleashed by the economic crisis in the sector during the 2005-2006 wine year (see Figure 3). In France, for instance, provisional figures suggest that 15 000 hectares of vines were grubbed up, 12 500 hectares of which were in the Languedoc region. This amounts to 4.5% of the total vine-growing area of the region. In Hungary, 4 000 hectares were grubbed up.

The countries of the New World and the southern hemisphere (see Figure 4), especially Australia and Chile, have established export-oriented development programmes for their vineyards. Australia has supported vine-planting by means of generous tax deductions. These programmes have been bolstered by growth in the target markets, namely the United Kingdom, the countries of Northern Europe, the United States and Japan, most of which are non-producers with high standards of living. In Argentina, the virtual stability of the country's vineyard acreage conceals a quality drive, along the lines of the Languedoc campaign, in which old vines and old varieties are being replaced by modern vineyards with internationally known varieties, selected plants, trellising and drip irrigation. The same phenomenon is observable in South Africa.

In China, the growth of winemaking has been spectacular. Vines covered 450 000 hectares in 2005, 60 000 hectares of this area being devoted to wine grapes and producing 3.9 million hectolitres of wine, which represents a yield of 80 hectolitres per hectare. With this surface area China has already overtaken the United States. The stock of Chinese vines intended for wine production is currently increasing at an annual rate of 38 000 hectares. China's objective is to achieve an output of five million hectolitres in 2005*. Wine production is encouraged by the Chinese Government, which prefers to develop the wine sector rather than the cereal-consuming production of spirits. Besides, the health benefits of wine are taken very seriously.

*Translator's note: The figure of five million contradicts the figure of 3.9 million earlier in the paragraph.

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Chapter 2: Production

The vine is a perennial plant. Areas planted with vines develop slowly, and, since yields fluctuate very widely, production is also subject to significant variations. The slump in European production was accompanied by falling global output (see Figure 5), but since the mid-1990s the trends have diverged to the benefit of the New World countries.

Over the past few years European production (see Figure 6) has ranged from 165 million hectolitres in the poor vintage of 2002 to 194 million in the good vintage of 2004. The effects of this variation are compounded by its unpredictability: two good harvests in 1999 and 2000 were followed by three more meagre harvests then another good harvest in 2004, followed in turn by an average harvest in 2005. The absence of a regular pattern translates into a real difficulty in stabilising the level of supply from year to year. These fluctuations go a long way to explaining how the market 'naturally' corrects itself. If we examine the three-yearly averages (see Figure 7), we can see that the average total harvest for the 25 Member States of the EU over the last three years is the same as that for the first three years of the period analysed, i.e. 1998 to 2000. Viewed in this light, then, the production figures for the most recent period cannot be regarded as abnormal.

The abundant harvest of 2004 and the return to normal levels in 2005 triggered a new market imbalance which affected the biggest wine producers such as Italy, Spain and France, and activated distillation measures (see Figure 8). Italy and Spain have more or less ridden out the crisis, but France is still enduring its effects, because its attempts to rebalance the market have not been sufficiently effective. Moreover, in the case of France, some AOC wines, i.e. wines with a registered designation of origin, especially those with generic designations, as well as some table wines (vins de table) and regional wines (vins de pays) were hit by the crisis. The fact that yields of AOC wines are very limited tended to have an adverse effect on efforts to manage the crisis because, in the context of falling prices, low yields mean high production costs, which affect the profitability of winemaking operations. In Italy, the yield restrictions are more flexible and allow producers to recoup some of their losses. Moreover, distillation with a stabilised price effectively serves to limit the erosion of incomes; while distillation measures do not increase incomes, they do ensure that prices do not plummet too drastically.

In the New World, the United States and Australia registered record harvests in successive years, in 2004 and 2005 (see Figure 9). In 2005, production fell in Europe, while a contrasting trend was observable outside the 25 Member States of the EU, with the United States, Australia and Chile all registering record levels of wine production, although there was also a decline in the volumes harvested in New Zealand and South Africa. Production in Argentina has remained stable. At 227 million hectolitres, global wine production remains higher than average and is close to the levels recorded in 1999 and 2000.

The CEEC (see Figure 10) have also stabilised their wine-production levels after the decline experienced during the transitional period when the Eastern bloc collapsed, markets were lost, state enterprises were privatised, demand fell, the market was liberalised and production costs rose. In all of those countries, harvests fluctuate very widely because of the vagaries of the climate, which is at the root of economic crises. In Romania, grape production oscillates around 1.1 million tonnes and in Hungary around 600 000 tonnes. Bulgaria saw its production fall during the period from 2000 to 2005.

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4 We made this estimate on the basis of FAO figures expressed in tonnes, converting each tonne into 6.5 hectolitres of wine.
Chapter 3: Yields

When it comes to assessing yields, we must emphasise the divergences in levels and trends. Yield levels are due in part to climatic conditions and cultivation methods and in part to the nature of the wines being produced. The production of white wines in the fertile soils of more northerly vineyards, such as those in Germany and Hungary, is conducive to high yields. Yields in arid areas of southern Europe, such as parts of Spain, tend to be lower. In other countries the average yield is determined by both the location of vineyards and the quality factor: yields are lower for products classified as quality wines produced in specified regions (QWPSRs) and wines with registered designations of origin than for table wines. In the New World, the high yield levels are obtained through the use of irrigation to control water stress (see Figure 14).

Observation of yield trends over the course of time obviously takes account of climatic fluctuations, but also of changes in the production system (see Figure 11). In this respect we can emphasise the divergence in trends between the EU and the rest of the world (see Figure 11). Such changes are best illustrated by the case of Spain, where the upgrading of vineyards in Castilla-La Mancha has been reflected in an increase of more than 50% in average yields over the past ten years. We encounter the same phenomenon in southern Italy (see Figure 12). Among the newer entrants, Hungary and Austria show marked upward trends (see Figure 13). All of the wine-growing countries of the New World are managing to exceed an average of ten tonnes per hectare (see Figure 14). No obvious medium-term trends are observable. The good vintage of 2004 is most clearly in evidence in the Australian data. Among the new competitors, South Africa and Chile have seen their yields increase since 2000 (see Figure 14). The other main producer countries have stabilised their yields.

Chapter 4: Consumption

We shall now examine some consumption trends that need to be considered in the context of any attempt to adapt Europe’s production potential. Over a lengthy period, we can distinguish several global phases (see Figure 15): rising consumption until 1975, which was due primarily to the liberalisation of trade in Europe, a ten-year period of stagnation from 1975 to 1985, with a ceiling of about 290 million hectolitres, followed by ten years of decline from 1985 to 1995, when consumption fell to 220 million hectolitres (- 20%), and then a process of stabilisation and even gradual recovery since 1995, bringing the average level for 2003 to 2005 up to 235 million hectolitres, according to data from the International Organisation of Vine and Wine (OIV).

The level of consumption in the 15 older Member States of the European Union corresponds to over 55% of wine sold in the world market. Consumption trends in the EU tell a slightly different story, with a decline that began in the late 1970s and continued until the mid-nineties. It does seem to have settled, however, over the past ten years within a band ranging from 126 to 130 million hectolitres. According to OIV estimates, total wine consumption in the 25 Member States of the European Union is likely to amount to 132 million hectolitres in 2006 (see Figure 16).

In order to explain these developments, we must take account of behaviour patterns that differ between countries, even if practices are tending to become rather more uniform in consumer

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5 It should be borne in mind that, while consumption represents the main commercial use of production output, it is not the only one, as wine can also be used in the manufacture of products such as vinegar, brandy and other alcohols. The information here is based on OIV statistics, which can be heterogeneous: consumption may include wine retained by producers for consumption in their own premises, or it may be restricted to the volume sold within the internal market.
countries. The demand for wine is a special case, because it is not an essential beverage. On the one hand, in the main producer countries, such as the Latin countries, it is a traditional drink and part of the national culture; on the other hand, it is a fashionable drink and a status symbol for some sections of the population in the new consumer countries. A distinction must therefore be drawn between market trends and development mechanisms in the traditional wine-drinking countries, such as France, where consumption is falling, and in the new wine-drinking countries, where consumption is generally tending to rise, as in the United Kingdom. We must also stress, however, that only a limited part of the world's population has access to wine, that 90% of wine consumption remains concentrated in a group of countries inhabited by about a quarter of the global population and that about 15 developed countries account for more than 80% of the market.

The consumption of wine, an alcoholic beverage, is subject to heavy constraints: on the one hand, factors deriving directly from lifestyles, such as urbanisation, an increase in sedentary occupations and car use and nervous exhaustion, reduce physical tolerance of alcohol; on the other hand, there are factors connected with the level of acceptance of alcohol consumption within societies. Any assessment of trends in wine consumption must therefore take account of the subject of the market to social control by means of price policies, advertising rules, prevention campaigns, and so on.

In the traditional wine-producing countries (see Figures 17 and 17a), where wine and water, or wine diluted with water – a practice that persists today – were invariably drunk with meals, wine consumption has fallen sharply as lifestyles have changed and other beverages, marketed with the aid of vigorous advertising campaigns, have emerged as competitors. France is a good example of the sort of country where consumption patterns have changed in this way.

Consumption trends can be illustrated by reference to the percentages of those who regularly consume wine, those who occasionally consume it and those who drink no wine. In the year 2000, a regular consumer drank an average of about five times the volume of wine drunk by an occasional consumer (190 litres a year, compared with 35 litres). Occasional consumers mainly drank quality wines. The consumption of wines with a registered designation of origin (AOC wines) increased steadily until 2000, doubling in the course of 25 years to reach between 16 and 17 million hectolitres. Since then the market has settled at that level, and some wines in this category have gone downmarket, with AOC wines now being found in most price categories, as competition, particularly in the form of varietal wines, has emerged from countries with growing reputations. Although the market has declined in volume, its value has risen. Wine remains the favoured beverage for convivial gatherings, but it is moving away from being part of the staple diet, i.e. the drink that accompanies everyday meals, to become a luxury item, served with meals on special occasions.

The reason for this development is that, as one generation replaces another, consumption patterns are changing. The younger generations are opting for refreshing non-alcoholic drinks, even with meals, and are tending to drink alcohol on an occasional basis, at weekends and outside mealtimes, often in the form of beers and strong spirits – two fast-growing markets. In these countries, supply is structured on the basis of production (QWPSRs, AOC wines, wines with a protected designation of origin and table wines), and low-priced wines are still drunk in large quantities. More than 60% of the non-sparkling wine sold in France in 2003 was bought for home consumption at less than €2.50 a litre, and almost 20% cost less than €1 per litre. Wines from the New World still do not feature much in the markets of these countries. A distinction must be drawn between the former Communist countries of Central and Eastern Europe, where the decline in production has led to a fall in consumption, and the other traditional wine-producing countries.
In other countries, where there is no major wine production and where other, more industrial beverages predominate, such as spirits, beer and soft drinks, the role of wine as a rival beverage, particularly outside of mealtimes, has developed gradually through trade. In global terms, however, the increase in wine-drinking in the new consumer countries has not always made up for the reduction in the volumes of wine consumed in the traditional producer countries.

The UK is Europe’s main growth market (see Figures 17, 17a, 48 and 49). Consumption there was apparently close to 12 million hectolitres in 2005, having doubled in the course of ten years, and average per capita consumption was nearing the 20-litre mark. This consumption volume is close to that of Spain, the world's number-three producer. The UK market, along with a few others, especially the US market, is one of the main arenas in which the various suppliers in the world compete. The American market is among the fastest-growing. Forecasts indicate that it is set to become the world's top wine-consuming country in terms of total volume in 2008.

In these countries, wine is both a fashionable drink and a status symbol. Especially since the conclusion of the Marrakesh agreements in April 1994, the development of wine as a fashionable drink has been supported, and indeed driven, by a powerful industry, located chiefly in the New World, in which the growers at the top of the supply chain are integrated into a demand-based marketing strategy featuring easily accessible wines, brand names and varietal labelling – see Part 4 below. These are premium wines, the average price of which is governed by excise duty (in the United Kingdom, there are no wines at less than £3 (about €5) a bottle). Nevertheless, as consumption increases in these countries, prices are tending to fall. Wine is also a status symbol for people in certain social categories, who have an elitist urge to consume top-of-the-range and iconic wines, the bulk of which still come from the great European wine regions.

Among the new Member States we find traditional consumer countries such as Hungary and Slovenia, where the average level of wine consumption is fairly high and close to the European average (32 litres a year per head of population in Hungary and 42 litres in Slovenia). The Czechs are major beer consumers, but wine sales in the Czech Republic have almost tripled since 1999. In Poland, wine consumption is very low, but it has risen significantly since 1999. Wine-drinking has become fashionable in these countries.

Chapter 5: International trade

1. Exports

Of the world's ten major wine exporters, which account for 87% of the total volume of exports, the top three – France, Italy and Spain – are responsible for two thirds of the total trade volume (see Figure 18). The main development over the past ten years has been the doubling of Spanish exports (see Figure 19). In 2004, Spain's export volume almost drew level with those of Italy and France. The second significant trend is the exponential growth of exports from countries in the New World (see Figures 23 and 24).

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6 In order to analyse global trends in wine trade, we used the Comtrade database, which publishes statistics up to and including 2004. To complete our analysis, we used the Ubifrance statistics for 2005. The Comtrade database has to be treated with a certain degree of caution, since it shows the values of exports and imports in US dollars, and the dollar was subject to considerable devaluation over the period from 2003 to 2005, with the exchange rate falling from €0.864 to €0.803. With regard to the analysis of the value of European countries' exports and imports, it should be noted that the sharp increases are due in part to the depreciation of the dollar.
Reform of the common organisation of the wine market

The wine-exporting countries are not all at the same position on the price scale (see Figures 20 and 21), although, in the case of France, the high price of champagne tends to inflate the average price. In 2004, with a weak US dollar, the average price of wine exported from France was double that of exported Italian, Greek and German wine and four times that of Hungarian and Spanish wine. This dimension of the quality strategy (high-priced QWPSRs) must be borne in mind whenever export volumes are discussed. We can also discern a downward trend in the price of German wines in relative terms (see Figure 21).

The same disparities exist in the New World, where the average price of Australian wines is far higher than that of US or Chilean wines. The price of South African wines, now situated between the US and Chilean levels, has overtaken the latter as a result of exchange-rate effects.

- **Exports from the main wine-producing countries of the 25-member EU**

**France:** Since 2003, the volume of wine exported from France has been declining (see Figures 26, 27 and 28) after a slight recovery in 2001 and 2002. The value of French exports was also eroded in 2004 and 2005, with a sharp drop in exports of table wines and regional wines, while QWPSRs lost only a little ground in terms of volume and value. The main markets for French wine, in order of value, are the United Kingdom, the United States, Germany, Belgium and the Netherlands. From 2001 onwards, the volume of French wine exported to these expanding markets has been declining. By contrast, the value of France's exports to all its main markets, with the exception of Denmark, continued to grow steadily between 2002 and 2004, after a sharp fall in 2002. Following a drop in the value of exports to the UK in 2000, these have risen steadily, reaching an average price of 5.80 US dollars per litre. The steepest rise in export prices was registered in the United States, where the price per litre reached a peak of $9.80 in 2003. This development is explained in part by exchange rates.

**Italy:** Following a period of decline from 1999 to 2003, the volume of wine exported from Italy rose in 2004 (see Figures 32, 33 and 34). In terms of value, on the other hand, the growth began in 2002, especially in the German market and, to an even greater extent, in the US market. Unit prices of Italian wines are highest in the Japanese and US markets ($4.50 per litre), in Switzerland ($3.80 per litre) and in Canada ($3.60 per litre). Prices are also rising in the UK and Germany, but they have come from a far lower starting point and, at $1.70 a litre, are still a long way behind the average price for French wine. Italy exports low-priced wines to France, i.e. wines costing less than a dollar per litre, because French winemakers have abandoned some of their production of table wines, and domestic demand is satisfied with table wines from Italy or Spain, depending on current prices.

**Spain:** The volume of Spanish wine exports doubled from 1995 to 2004 but dropped off in 2005 (see Figures 29, 30 and 31). Spain's main trading partners are France, Germany, the UK, Portugal and the United States. In terms of the value of its exports, Spain registered considerable increases in Germany, the UK, the United States and France, as well as smaller increases in the Netherlands and Switzerland, until 2004, when exports to Germany, the UK and France declined; the value of Spanish exports to the United States, however, increased very sharply, rising by 10% from 2004 to 2005. According to national statistics, Spanish wines do well on the US market, with a unit price of €3.80 per litre, and in the UK, where they command an average price of €2.20 per litre, because most of the Spanish wines sold in those countries are quality wines. In France and Portugal, Spanish wines are bought in for a mere €0.30 per litre, since those countries chiefly import table wines. Unit export prices have declined since 2002, when the average price was €1.34 per litre. Today they are down to €1.09, which represents a

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7 The unit prices for Spanish wines recorded in the Comtrade database are not reliable.
20% drop and makes it difficult for producers to operate at a profit, but has enabled them to keep their foothold in export markets.

The Spanish case is one of price-based competitiveness. Spain has doubled the volume of its exports within a few years. In 2005, for the first time, the volume of exported wine exceeded the volume consumed in Spain, a result of the rapid growth since 2003 in exports of bulk table wine, essentially to France and Portugal. Price elasticity of demand was the key to penetration of foreign markets. Moreover, for the first time, the volume of wine exported from Spain now exceeds the volume of French wine exports, which puts Spain second only to Italy in the global league table of wine exports by volume.

**Germany:** As a traditional producer of wine, Germany is one of Europe's wine-exporting nations, but it falls far behind the major exporters – Italy, France and Spain (see Figures 35, 36 and 37) – in terms of both volume and value. The main purchasers of German wines are the UK, the Netherlands and the United States. Exports to the UK declined from 1999 to 2002, but then the volume of wine exported began to increase again. German wines have been gaining ground in the Netherlands. In Japan, on the other hand, they have suffered a considerable decline in terms of both volume and value. The total value of Germany's wine exports has risen sharply since 2001 after declining from 1995 to 2000. Unit prices of German wines have been rising since 2001 in all the major markets and are highest in Japan and the United States, where they average $4 per litre. By contrast, the price obtained for German wines in the UK, the Netherlands and Sweden is only in the region of $1.60 per litre.

**The new Member States:** Of the new Member States, Hungary (see Figures 38, 39 and 40) is the main wine exporter; the other vine-growing countries essentially produce enough wine to satisfy their own domestic demand. A marginal volume is exported and is only sold in the form of specialities and niche products. Hungary exports 20% of its total production, and these exports amounted to 560 000 hectolitres in 2005, but there has been a downward trend over the past eight years, during which time Hungary has lost 50% of its export markets, especially in Ukraine and Russia, because its prices cannot compete with those for Moldavian, Romanian or Bulgarian wines. Table wines, in fact, account for 90% of the wine sold in those two markets. In Germany and the United Kingdom, the decline of Hungarian wine is linked to strong competition from other European countries and the New World. Nevertheless, after falling in Germany, the UK and the Czech Republic, the value of Hungarian wine exports has been rising again since 2001, and average prices have also been rising. Most Hungarian wine products, however, are still in the price bracket of $1 to $2 per litre, which corresponds to the category of basic or premium wines.

- **Exports from countries in the New World and the southern hemisphere**

The countries of the New World and the southern hemisphere, foremost among which are the United States, Argentina, Chile, Australia, New Zealand and South Africa (see Figures 23, 24 and 25), accounted for 23% of global trade in wine in terms of volume in 2005, compared with 14% in 1998, 8% over the period from 1991 to 1995, and an average of only 3% over the previous five-year period, from 1986 to 1990.

Of the major exporters in the New World, Australia has managed to increase its exports in volume and value in every single year since 1996. The average price of Australian wine, on the other hand, fell in the course of 2000 and 2001 from $5.40 to $4 per litre, but recovered again to reach $4.60. The price of US wine has been fluctuating around $3 per litre since 2000. The price of Chilean wine has been rising since 2001, but the average price remains below the US level. These unit prices are, of course, sensitive to changes in exchange rates.
United States: The bulk of US wine exports go to the UK market, where the volume and value of US wine practically doubled between 1999 and 2004 (see Figures 44, 45 and 46). The unit price, on the other hand, suffered erosion until 2003, before recovering to its 2000 level of $3.20 per litre. The volume and value of wine exported from the United States to other destinations, such as Canada, the Netherlands and Germany, have increased since 2002, whereas US wine exports to Japan have declined.

As for average prices, the United States obtains the best return on its exports to Switzerland, where the average unit price is $3.10 per litre, and the Netherlands, followed by Japan, the UK and Canada, where it obtains a price of around $2 per litre. US wines are sold at the lowest price to the German market, where the prices have fallen sharply from $2.40 to $1 per litre. We are confronted here with a typical feature of the German market, where pressure from distributors, hypermarkets, supermarkets and, above all, hard discounters drives wine prices down to very low levels.

Australia: The structure of Australian exports is highly concentrated. The two main markets in terms of volume and value are those of the UK and the United States (see Figures 41, 42 and 43). The value of the Australian wine imported into both countries is about the same, but the UK imports a greater volume than the United States. The value of Australian wine exports to the UK almost doubled between 1999 and 2004. In the case of the United States, this growth was even more impressive, with exports doubling in three years from 2001 to 2004. Unit prices differ between the two markets: in the UK the average price is lower, at $2.70 per litre, whereas the average export price in the United States amounts to $3.50 per litre.

Lastly, we should emphasise that these competing countries focus their export efforts on the most lucrative markets, with the bulk of Australian and US wine exports going to only two countries.

In conclusion, we can say that exports from the 25 Member States of the EU have been growing since 2001, following the downturn of 2000, but this growth is slower than in countries in other parts of the world. The rate of increase in unit prices, by contrast, is 33% higher than countries outside the 25-member EU. Since 2001, the gap has widened from $0.40 per litre to $0.70 per litre, but half of this increase is ascribable to exchange-rate trends.

2. Imports

In order to understand the structure of global imports, we must first remember that three of the world’s four main importers are also producer countries (see Figure 48). This fact, which is surprising at first sight and is often forgotten, is due to markets seeking to complement the range of domestic products, with fine French wines being brought to the United States, red wines to Germany and table wines to France, combined with the fact that Germany and the United States do not produce enough wine to satisfy domestic demand.

Global wine imports, in terms of volume, are closely correlated with those of Europe (see Figures 47 and 49). General import trends follow export trends. Germany, which has long been the world's main importer, now has the UK breathing down its neck, and UK wine imports are poised to move in front within one or two years, given the rapid growth in the UK’s wine consumption, which registered 10% increases in 2003 and 2004. The United States increased its imports by 57% between 1999 and 2004, thereby becoming the world's number-three importer ahead of France. France itself has been registering high import levels. This is due to a strategic choice, made in the late seventies, to leave the production of table wines to its Southern European partners. Russia, the fifth-largest importer (see Figure 48), is also a vigorous growth
market. Following the considerable slump caused by the national economic crisis, Russia’s wine imports have grown fivefold since 1999 to overtake those of Belgium.

- **Imports into the 25 Member States of the EU**

  **Germany** is the world’s leading importer of wines, with 12.6 million hectolitres imported at a cost of €1.7 billion (see Figures 50, 51 and 52). After a period of fluctuation, the volume of wine imported into Germany rose at a steady rate from 2000 to 2004 but dropped by 6% in 2005.\(^8\) The value of these imports followed a more irregular pattern, declining from 1999 to 2002, increasing again until 2004 then falling by 8% in 2005.

  Italy is the main supplier of the German market in terms of both volume and value, with France and Spain in second and third place respectively. Italy and France have retained their 33% and 30% shares of the market, whereas Spain’s share is diminishing after strong growth from 2002 to 2004. Among the countries of the New World, Australia, Chile, South Africa and the United States have seen an increase not only in the volume but also in the value of their wine exports to Germany. In 2004, only the United States cut its prices. Lower prices for imports have been a widespread phenomenon in the German market since 1995. From 2002 onwards, only three suppliers have managed to increase their prices, namely France, Italy and South Africa. In the German market the price scale has been squeezed into a band ranging from $0.50 to $2.80 per litre under pressure from hard discounters. In this price war, France obtains the highest prices, whereas Australia, the United States, Spain and Chile have had to reduce theirs.

  **The United Kingdom** is the world's number-two importer of wine (see Figures 53, 54 and 55). This market is an excellent indicator of the state of global trade, since it operates in an open economy with both new consumers and established aficionados of wine. It is one of the most competitive markets. The volume of wine imported into the UK doubled between 1995 and 2004, and its value tripled. In 2005, the volume of imported wine fell by 8%, which suggests that the growth of the UK market has peaked.

  The segmented British market is a microcosm of the global market, in which quality categories are defined by price brackets. This categorisation does not coincide with the quality definitions prescribed by the wine CMO for table wines and QWPSRs. This makes it imperative to analyse suppliers’ prices.

  Over the past decade, there have been radical changes in the supply structure of the British wine market. In 2004, Australia was closing in on France, which remained the top supplier country. While suppliers from the New World only accounted for 4% of the volume of wine imported into the UK in 1995, by 2004 this figure had risen to 45%. In 2005, apart from Italy (+8%) and Spain (+13%), which were better able to cope with price competition, all supplier countries suffered a reduction in their wine exports: the volume imported from the United States fell by 40%, 12% less wine was imported from France, and a 7% drop was registered for both Australia and Chile. The keenest competition takes place in the premium and super-premium segments. The main losers in this fiercely competitive market, where the major exporting nations of Europe and the New World do battle, have been Germany and the CEEC. These countries have become less competitive in this market, and their respective market shares have been drastically reduced. Germany, which used to be the third-largest supplier, has slipped back to seventh place.

  Prices in the UK market have displayed an interesting pattern: over ten years, the average price range has widened from a scale of $1.70 to $3.10 per litre to one of $1.30 to $5.10. French

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wines command prices at the top end of this scale, and German wines are at the lower end. The other main suppliers, namely Australia, Italy, Spain, South Africa, Chile and the United States, are bunched together in a band ranging from $2.40 to $3.40 per litre. This is the segment where competition is keenest.

France ranked fourth among the wine-importing countries in 2005 (see Figure 48). Since the value of French wine imports dipped to a low in 2001 in terms of volume and in 2002 in terms of value, French wine imports have been rising, in spite of a slight drop in 2005 (see Figures 56, 57 and 58), when France imported 5.4 million hectolitres of wine, down by 1.9% on 2004, with a value of €477.1 million, which was 2% less than in 2004. France essentially imports low-priced Spanish and Italian wines at prices ranging from $0.60 to $0.90 a litre in order to supplement its stocks of wine for everyday consumption. The volumes of wine imported from Italy have been falling since 1999, but a slight recovery was observable in 2005, when the Italian share of the market amounted to 21%. The volume of imported Spanish wines, on the other hand, has been rising and now accounts for 50% of the market.

The Netherlands is in sixth place among the world's wine importers (see Figures 59 and 60). France is the main supplier of the Dutch market, with 31% of the total imported volume. South Africa comes second with 14%, and has been registering vigorous growth since 2000. The average price was in decline until 2000, when it began to rise again. The price scale ranges from $1.90 to $4.10 per litre.

Belgium imports the seventh-largest volume of wine and constitutes a major market for European exporters. France dominates the Belgian market, providing 63% of the volume and 68% of the value of imported wine. The market is growing strongly, thanks to the increased consumption of fine wines. In 2005, however, imports fell by 7% from their 2004 level. Of the New World countries, Chile has seen its exports to Belgium increase in volume and value. As far as average prices are concerned, French wines fetch some of the highest prices, averaging $11 per litre, while the prices paid to other exporters are far lower down the scale, ranging from $3 to $6 per litre.

- **Imports into countries outside the EU**

The United States is the world's number-three importer of wines (see Figures 61, 62 and 63). Italy, with a 29% share of the market, is the main supplier, with Australia close behind and rising fast. France is in third place in terms of volume but first in value ahead of Italy and Australia, although its lead is clearly being eroded. The US market is one of those in which wine is most highly valued. Prices are high, because domestic wines are mostly quality wines at the upper end of the price scale, but there is, of course, cheap US wine too, which Americans refer to as ‘two-buck chuck’.

- **Effects of exchange rates**

The US dollar plays a key role in commercial transactions. The value of the dollar is an important factor in international trade in wine, not only because sales in the US market are increasing rapidly, but also because the currencies of most of the new producer countries that export wine are sensitive to the strength of the dollar. So what are the consequences of shifts in exchange rates between the world's main currencies for international trade in wine?

The strengthening of the Australian dollar in relation to the US dollar from 0.52 Australian dollars to one US dollar in 2001 to 0.76 to one in 2005 resulted in Australian wine exports becoming less competitive, all other things being equal (see Figure 83). Conversely, the
depreciation of the US dollar gave American wines a competitive edge over Australian wines in both the domestic market and export markets.9

In spite of the adverse development of the exchange rate, the Australians maintained the exponential growth of their wine exports to the United States by lowering their prices from an average of US $5.20 per litre to $4.20 between 1999 and 2004, which represented a 40% drop in terms of Australian dollars. Australian exporters of branded wines have focused on the growth segment of popular premium wines. The aim of this strategy is to use the price factor to win over consumers then foster brand loyalty among customers who will become increasingly interested in more upmarket wines of superior quality sold at higher prices.

In the course of the period from 1997 to 2004, several apparently contradictory developments were observable in the UK market (see Figures 88 to 91): (1) from 1997 to 2003, the Chilean peso depreciated in relation to the pound sterling but rallied in 2004 and 2005. This exchange-rate advantage made it possible to reduce the sterling price of Chilean wines steadily from 2000 onwards, which generated a gradual increase in the volumes being exported; (2) despite a small increase in the sterling value of the euro, unit selling prices of Spanish wines have been falling slightly since 2002; this drop in unit prices has also been conducive to an increase in the volume of wine exports; (3) the average unit selling prices of Italian wines have been rising steadily since 2001, which is due, to a great extent, to the growth in exports of bottled or boxed wines; (4) average unit selling prices of French wines fell slightly during the period from 1999 to 2001 and again in 2004; nevertheless, French wines command the highest average unit prices in the market; it is worth noting that the price reduction in 2004 helped to increase exports to this market in terms of volume; (5) average unit selling prices for German wines declined, falling below one pound in 2004; this drop in unit prices helped to increase the volume of German wine imported into the UK, which rose very substantially in 2004; (6) over the period, the average unit price for Australian wine remained stable (see Figure 89), and the volume of imported Australian wine increased.

So what role is played by exchange rates in the export of wine to the highly competitive markets in the UK and the United States? Observations of the UK and US markets have shown us that trade and price trends are not dependent on exchange rates alone but are also a product of the pricing policies of exporting companies. There are three types of scenario: exporters in some countries reap the benefits of shifts in exchange rates by reducing their prices and expanding their markets, in others they pursue strategies of quality enhancement or increase the added value of their products, while in a third scenario productivity reserves are mobilised with a view to increasing exports by lowering prices in spite of an adverse exchange rate. In short, the depreciation of the national currency is an ally in price wars, but it cannot of itself ward off competition.

On the other hand, differences in the relative value of currencies are a major factor in the performance of exporting companies. It therefore appears that the extent to which exchange-rate fluctuations can be absorbed differs widely according to the size of companies and whether they are involved in production or marketing.

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Chapter 6: The EU and international trade in wine

Global trade has risen sharply since 1995, both within and outside Europe and between the EU and the rest of the world. During this period, imports from non-EU countries have more than doubled from 4.4 million to 12.4 million hectolitres. Exports of European wine to countries outside the EU, by contrast, have increased by little more than 20% from 11 million to 13.3 million hectolitres. In this way, the volume of wine imported into the EU is catching up with the volume exported from the EU. The balance is still tipped in favour of the EU, but the trend is none the less alarming. By contrast, the value of wine exports in 2004 remained far higher – 50% higher – than that of wine imports. European unit prices also exceeded those of the rest of the world.

In fact, competition intensifies around the $2-per-litre mark, a segment of the market in which Italy and Spain have proved most resilient and in which France cannot compete. France, on the other hand, is holding its own in the higher price categories.

An analysis of the world market in relation to the wine CMO focuses attention directly on the factors of competitiveness in a market which differs widely between countries and which is highly compartmentalised within each country. The acreage producing surpluses will vary according to its location, its yield, the nature and regulatory classification of the produce it delivers, and price levels in the market for which its produce is intended. Achieving such a finely tuned balance with a perennial plant that is so sensitive to climatic variations and with such a huge number of players would be nothing short of a miracle.

Chapter 7: Surpluses

The world wine market is characterised by substantial surpluses, which make for a fiercely competitive situation in the global marketplace (see Figure 65). The ‘potential global surplus’ may be described as the difference between the production and the consumption of wine. This gap is narrowed by other uses – the various distillation processes by which wine is made into potable alcohol (spirits such as eau de vie or brandy), into raw alcohol for use in carburation or into other industrial products, such as vinegar and vermouth – and by losses. Since these data are not available on a global scale, we must assess the surplus on the basis of a size of gap regarded by experts as ‘normal’. Experience has shown that, during periods when markets have been in balance, the normal gap between the volume of wine produced and the volume consumed throughout the world is in the order of 35 to 40 million hectolitres. When the gap exceeds that level, it creates a surplus which exerts downward pressure on the market.

Over the period of the CMO of 1999, we can verify that two major peaks occurred, one in 1999 and 2000, when the gap amounted to about 55 million hectolitres, producing a surplus of 15 to 20 million hectolitres, and the other in 2004, when the gap was estimated to be in the range of 48 to 68 million hectolitres, making a surplus of 13 to 33 million hectolitres. World data for 2005 are not yet available, but estimates indicate that the main producer countries will have had normal harvests, which will only serve to maintain the pressure created by this surplus.

In order to analyse the development of this surplus and the European crisis, we calculated the difference between the volume of wine available (production output + imports) and the normal uses of wine (consumption + exports + other uses); this difference represents the potential surplus in the Community market, in other words the volume that would have to be eliminated from the market to restore the balance (see Figure 66). This method is used to a great extent by the Commission in its justification of the reform proposals it has put forward for the wine CMO. The criticisms of this method are analysed in the next chapter. Nevertheless, to shed more light
on the arguments that are advanced in the Commission’s studies, we shall adopt the same calculation method for the period from 1998 to 2005 in the present study.

The figures show that the European surplus diminished considerably between 2000 and 2004, but that it rose again in the wake of the bumper crop of 2004, whereas the normal uses of the available wine have remained virtually stable since 2001. During that period, the initial stock of wine in Europe diminished after a sharp increase in 2001 and almost returned to the level at which it had stood at the start of the 2000 wine year. In particular, considerable stocks of QWPSRs accumulated between 1998 and 2002, after which the trend was reversed. In the case of table wines, compulsory distillation and the poor harvests of 2002 and 2003 significantly lowered stocks between 2001 and 2004, bringing them back to their 2000 level. The market surplus, in other words, affects some of the QWPSRs. If the distillation financed from the European Agricultural Guidance and Guarantee Fund (EAGGF) is also taken into account, it emerges that compulsory distillation was not enough to correct the market imbalance during the wine years 1999/2000, 2000/2001 and 2004/2005. The Member States, however, found various different ways to overcome the crisis caused by the abundant harvest in the 2004/2005 wine year.

The surplus in Spain has been growing since 1996 at a more regular rate in the case of table wines and has fluctuated more in the case of QWPSRs, where an increase in stocks was observable in 2003/2004 and 2004/2005 (see Figures 68, 69 and 70). Distillation has sharply reduced the surplus that was burdening the market. In terms of prices, it is noticeable that, after falling sharply to €2.30 for each percentage point of alcohol volume per hectolitre (% vol/hl) for red wines and €2.90 per % vol/hl for white wines, compared with €4.50 per % vol/hl for red wines and €3 per % vol/hl for white wines in 1999, prices recovered to €3.70 per % vol/hl for all wines by the end of 2003. Then another slump brought prices down to €2.60 per % vol/hl for red wines and €1.90 per % vol/hl for white wines at the end of the 2004/2005 wine year. It may therefore be assumed that Spain has emerged relatively unscathed from the crisis caused by the good vintage of 2004 and that the distillation of potable alcohol and crisis distillation served their intended purpose in the Spanish market. These measures were certainly successful in halting the significant decline in producers’ incomes by virtue of the prices they obtained for wine for distillation into spirits and for crisis distillation of alcohol.

The surplus in France diminished considerably between 2000 and 2003 after peaking in the 1999/2000 wine year, but then a sharp rise was registered in 2004/2005. Wide fluctuations are observable in the cases of QWPSRs and table wines (see Figures 68, 69 and 70). In 2004/2005, distillation did not eliminate the market surpluses. This situation triggered a significant fall in the prices of table wines. At the beginning of 2004, prices stood at €4.60 per % vol/hl for red wines and €4.70 per % vol/hl for white wines. By the end of the 2004/2005 wine year they had plummeted to €2.90 per % vol/hl and €3.40 per % vol/hl for reds and whites respectively, resulting in falling incomes for producers.

In the case of wines with a registered designation of origin (AOC wines), the relevant wine-growing regions were hit less hard by the crisis. In the Côtes du Rhône and Languedoc regions, the prices of AOC wines fell by 50%. The trade organisations responded by implementing a package of measures designed to push prices upwards and thus restore producers’ incomes. These measures included crisis distillation, the creation of a quality reserve, the limitation of yields, the reclassification of generic AOC wines as regional wines (vins de pays), which are more profitable because of the less stringent yield restrictions, and a redoubling

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of efforts to promote wine sales on the part of trade organisations and companies. Market-management mechanisms of this kind have recently been activated by Anivit, the national association of producers and marketers of table wines and vins de pays.

**Given the combination of falling consumption and a decline in exports from 2003 to 2005 on the one hand and high output on the other, distillation measures have not eliminated enough of the market surpluses.** The sales slump prompted a request for crisis distillation of 1.5 million hectolitres of AOC wine in 2004/2005 and of three million hectolitres, divided equally between AOC and table wines, in 2005/2006. At the same time, France asked for an allocation of permanent abandonment premiums for 2006 to cover the grubbing-up of 15 000 hectares. Such extensive use of that facility had not been made since 1995.

Italy’s surplus has grown since 1998, except in the poor vintage year of 2002 (see Figures 74, 75 and 76). The surplus problem chiefly affects table wines, whereas the QWPSR market is in balance. The imbalances of 1999 and 2002 were successfully corrected by means of distillation measures. In 2003 and 2004, on the other hand, the market remained in surplus in spite of distillation. Prices fell considerably at the beginning of 2005, dropping from €3.50 to €2.70 per % vol/hl in the case of red wines, while the price of white wines dropped from €2.90 to €2.30 per % vol/hl. That situation led to a decline in producers’ incomes. Because of the more flexible rules governing permissible yields and the arrangements made for the distillation of spirits and crisis alcohol, however, Italian producers were less seriously affected than their French counterparts.

If we compare the big three European producers, France was hit hardest by the crisis and is finding it most difficult to recover (see Figures 71, 72 and 73). France is the only one of the three countries to have activated the procedure for the permanent abandonment of vineyard areas. Of the other wine-producing Member States, Portugal has managed to keep its market in balance. The crisis has also manifested itself in Greece (see Figures 77, 78 and 79), where the surplus has been growing since 1998 as a result of the production of an excess of table wine that could not be absorbed by distillation. The market in QWPSRs is more or less in balance. Of the new Member States, Hungary faced an economic crisis in 2004-2005 because of the good vintage, which swelled the ample stocks that were already available at the start of the wine year, and falling demand, mostly in export markets (see Figure 80). This is why Hungary asked for crisis distillation of 500 000 hectolitres. The decision, however, was not taken until October 2005 and coincided with a poorer harvest of only three million hectolitres in the autumn of 2005; consequently, producers sent only 45 000 hectolitres for distillation. The surplus disappeared from the market, but prices rose by very little at the end of 2005 before declining again. The resulting loss of profitability drove producers to apply for the grubbing-up of 4 000 hectares in 2006.

Our analysis of surpluses confirms our view, discussed in the next part of this report, that the optional nature of crisis distillation, the fact that it is insufficiently attractive in terms of price, and its late implementation prevent it from achieving the purpose assigned to it by the CMO.
Reform of the common organisation of the wine market
Part 2: Assessment of shortcomings of the wine CMO mechanisms

Chapter 1: The objectives of the present CMO

The CMO guidelines have remained practically unchanged since the reform of 1976. Under Regulation (EC) No 1493/1999, the aims of agricultural policy in the wine sector remain the stabilisation of markets, the achievement of a fair standard of living for producers and the promotion of quality. Accordingly, the policy is designed to achieve a better balance between supply and demand, to exploit expanding markets, to make the sector more competitive in the long term, to avoid making intervention stocks an artificial outlet for surplus production, to maintain distillation of spirits as an outlet, to take account of regional diversity and to recognise the role of producer groups and sectoral organisations.

As far as the management of production potential is concerned, the ban on new planting will be maintained until the end of the 2009/2010 wine year. A reserve system of planting rights has been established with a view to ensuring that production potential will no longer be lost and to facilitating the transfer of planting rights. New planting rights are granted for 1.5% of the total vineyard area in Europe, with scope for an increase to 2%. This means that 68,000 hectares were available for new planting for the period from 1999 to 2003. The planting rights are granted by Member States to growers for areas earmarked for the production of QWPSRs or table wines with a geographical designation of origin. Grubbing-up aid has been maintained, but the procedural rules are defined in each Member State. The role assigned to this permanent-abandonment premium has changed, because it is no longer a matter of eliminating a structural surplus with the aid of compulsory distillation but simply of eliminating any production for which there is no outlet. It should be remembered that the CMO of 1999 was established in the context of a balanced market.

The policy of providing restructuring aid is pursued with the aim of matching supply to demand in terms of quality. The aid must be part-funded by Member States, which are to meet 50% of the cost and 25% in areas supported under Objective 1 of the Structural Funds. Specific procedures are prescribed for accelerated restructuring, known as deferred qualitative conversion. The corollary of this measure remains the maintenance of a vineyard registry or inventory.

With regard to market intervention, the system has been simplified. Storage aid has been continued, as has the distillation of wines from dual-purpose varieties, the release of wine for distillation of by-products and aid for the use of concentrated grape musts. The guaranteed outlet provided by preventive distillation, compulsory distillation and support distillation has disappeared, replaced by crisis distillation and distillation of potable alcohol. Crisis distillation has become an optional and exceptional measure, granted on a case-by-case basis. The low price it offers will surely no longer be conducive to the maintenance of a specialised outlet.

The Commission has also set up a cross-sectoral arrangement for the organisation of Community-wide facilities for the distribution and promotion of agricultural products, including wine, in countries outside the EU.

In general terms, the CMO maintains a set of rules that are specific to the wine sector, encouraging the quest for quality while trying to minimise the points of incompatibility with the rules of the World Trade Organization. This objective is reflected in the disappearance of the guide price, the abolition of compulsory distillation and the reduction in export refunds.
Chapter 2: Management of production potential

1. Grubbing-up and new planting

The new CMO of 1999 permitted the distribution of new planting rights while maintaining the ban on planting, which is a device designed to control the size of the area planted with vines. The new CMO replaced a policy of drastically reducing the area under cultivation by means of a permanent-abandonment premium, designed to eliminate the overproduction which affected the market in the 1980s and which persisted into the mid-nineties. The appraisal made by the Innova study\(^\text{11}\) of the efforts made during that period was very favourable, recognising that 500 000 hectares of vines had been grubbed up in Europe and that those vines could otherwise have produced an annual surplus estimated at 25 million hectolitres.

The criticism expressed in the Innova report relates to the distribution of new planting rights under the new CMO and the additional increase by means of illegal planting. In practice, not much use was made of grubbing-up premiums. As the CMO Regulation suggested, such intervention was reserved solely for the elimination of vineyards that were ill-equipped to satisfy demand (see Figure 3).

Even though, with the benefit of hindsight, we share the view of the evaluators on the excessive distribution of planting rights, we can nevertheless say in defence of the legislature that these measures were adopted after a succession of poor harvests. From their observation of the market, many analysts had concluded that the grubbing-up policy had gone too far and that there were too few products available in some markets to enable them to compete with the wine-producing countries of the New World. The problem is that the way in which some of the intervention mechanisms of the wine CMO were devised seems to have been strongly influenced by an appraisal of preceding economic developments, or at least those reflected in the most recently published statistics. The experience of the abortive reform project of 1993 is another case in point.\(^\text{12}\)

As far as illegal planting is concerned, the case is far from having been fully investigated and resolved. The reasons why this situation and these practices occur have to do with whether Member States have the means and the political will to enforce the rules or to create enforcement mechanisms. A legalist view would support a policy of sanctions, while a realistic view would propose compromise and mediation. The areas in question are considerable: the Innova report estimates the total planted surface at 40 000 to 70 000 hectares. The European Commission’s report on the subject\(^\text{13}\) indicated that it was not yet in possession of all the facts, particularly with regard to Italy. At that time, the Commission indicated that 94 200 hectares of the 148 000 that had been reported still had to be examined. The Italian experts we consulted told us that they had until the end of 2007 to regularise the situation.

The evaluation undertaken in the Innova study also sets limits on the extent to which yields can be influenced by emphasising that the amount of grubbing-up cannot predetermine the future

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yields of the remaining vines. In our view, however, confusion persists between two measures with **synergetic effects**: in high-yield vineyards, grubbing-up was more effective where the degree of **compulsory distillation** rose sharply in line with the yield of individual plots.\(^{14}\) This was particularly noticeable in Languedoc-Roussillon, where the rate of low-priced compulsory distillation was very high in the case of plots yielding more than 90 hectolitres per hectare, even amounting to 100% of the harvest in some cases. The use of this sliding scale was slightly less effective in Italy and even less so in Spain, where the low yields did not warrant such a measure. In fact, an average regional rate was applied and served only to reduce prices. The amount of the premium was enough of an incentive in itself.

The change of policy has made permanent abandonment far less of an incentive, and the abolition of compulsory distillation has allowed growers to increase the yield of vines grown for the production of table wines. The overall impact of this change, however, has been minimal in France, since table wines without an indication of geographical origin now account for less than 20% of total production. These increases in yield have therefore been offset by restructuring measures in which growers have switched their focus to **vins de pays** and wines with a registered designation of origin, to which lower maximum yields apply. The effect has been more conspicuous in Italy, where yields have fallen by 0.6 hectolitres per hectare. Here too, the average impact conceals contrasting situations. The lowest yields are encountered in the south of Italy. An area totalling 80 000 hectares was converted in Italy over the period from 2000 to 2004. Relatively little is known about some parts of the total area planted with vines, because these parts lie within numerous smallholdings growing a mixture of crops; at the other end of the spectrum, new ‘modern’ vineyards have been established. In statistical terms, some trends cancel each other out.

The distribution of new planting rights has been broken off in the realisation that surpluses are re-emerging. Like the Innova evaluators, we note that the impact of this measure had not been adequately anticipated.

### 2. Vineyard restructuring

The main impact of the reversal of the trend in yields has been felt in Spain. The qualitative conversion of vineyards was initiated there either by illicit plantings without recourse to subsidies or through the establishment of restructuring grants, Spain being the country that has made most use of this measure. In the course of three wine years, from 2000 to 2003, an area of 85 000 hectares was converted in Spain, representing an annual conversion of 2.5% of its total vineyard area. The region of Castilla-La Mancha was the main user of the facility, converting 34 813 hectares, equivalent to 41.2% of the national total. In the converted vineyards, extensive low-yield vines were replaced with vines producing far higher yields of modern red varieties with the aid of trellises and drip irrigation. This explains the impact of the measure on the growth of production and hence of the notorious surplus. Moreover, we must emphasise that these vineyard areas have only recently started producing, and indeed some are not yet producing to their full potential, which means that there is probably yet more growth to come. Greater account could be taken of these mechanisms if developments in regional restructuring programmes were more closely monitored in terms of surface areas, production systems, yields and quality.

Reform of the common organisation of the wine market

The management of production potential has been marked by a succession of ‘stop and go’ phases. It did not anticipate the impact on production of qualitative conversion in Spain (and probably in part of southern Italy too), with its resulting increases in yields. The conversion model was determined by the pursuit of a quality-based policy involving lower yields obtained with improver varieties (the Languedoc model). Distribution of new planting rights and conversion in accordance with the Castilla-La Mancha model have been accelerating the growth in supply.

Chapter 3: Interventions in the market

1. Method by which surpluses are assessed

The question of the method used to calculate a surplus is very important. Experts have, in fact, used several different methods. We have studied those used by the European Commission, by the Onivins organisation and by Jean Dubos. We should like to stress the following: (1) over the period covered by our appraisal of the wine CMO (1999-2005), experts agree on an estimated type-1 average annual surplus of 24 million hectolitres and a type-2 surplus of 12.7 million hectolitres, with the subsidised distillation of potable alcohol being regarded as a normal outlet for the remaining 11.4 million hectolitres; (2) these surpluses are spread very unevenly and come from the abundant vintages of 1990 and 2000 and from that of 2004; (3) the intervention methods adopted by the Commission translate into only a partial rebalancing of the market throughout the period; this accentuates the significance of the surplus from the last wine year, which, added to the ample stocks that existed at the start of the wine year, intensifies its adverse effect on prices.

The Commission calculates the differential between supply (production output plus imports) and uses (direct consumption plus exports plus other uses, i.e. brandies, fortified wines, vinegar, aromatised wines and distilled by-products). This first calculation provides what the Innova report calls ‘Surplus 1’, in other words the surplus including any wine that might be distilled into potable alcohol. If subsidised distillation into potable alcohol is regarded as a normal outlet and the volume of wine distilled into potable alcohol is deducted, a smaller differential (Surplus 2) is obtained. Where the calculation is based on a six-yearly average, the surplus is clearly identifiable. The Commission concluded that this surplus accumulates among private stocks and ultimately depresses the wine market and thus exerts downward pressure on prices.

This calculation based on averages, however, does not take account of the Commission’s intervention stocks nor of its intervention practices in the market. Yet these are undoubtedly available assets (stocks + production output + imports) which weigh on the market and thereby affect prices. By incorporating the variation in stocks into its calculations, Onivins/Viniflhor comes up with the estimate of what it calls the ‘degree of rebalancing’ of the market. The purpose of this assessment is to estimate the quantity of wine for which no outlet has been found in the course of the wine year. It involves calculating the difference between the volume stored

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15 Onivins: the French national office for the wine trade, which in 2006 became Viniflhor, the national office for the fruit, vegetable, wine and horticultural trades.
Source: Patrick Aigrain, personal communication.


at the start of the wine year and the average volume of stock. This method makes it possible to estimate the level of intervention in the form of crisis distillation that would have been needed to ‘stabilise the market’. It also serves to reveal the cumulative effect of insufficient annual intervention. Over the entire period under examination, an average of seven million hectolitres a year was not eliminated. This finding amounts to a fairly severe criticism of the way in which the Commission manages the market; it shows how inadequate intervention from year to year is reflected in a gradually worsening imbalance. In exceptionally abundant wine years, this inadequacy leads to a disastrous situation in the market, a situation that is interpreted as structural overproduction. Moreover, the Onivins/Vinifilflor assessment begins after the bumper harvests of 1999 and 2000, which also exacerbated the market situation.

The method used by Professor Jean Dubos is based on the classical statistical approach of smoothing data by using moving averages, which are calculated over five years for growing areas and over seven years for production output. The components in the calculation are those provided by the Commission, with supplementary estimates for the most recent years. Professor Dubos estimates that the ‘structural production surplus is tending to diminish, though not to the point of disappearance’.

The advantage of this method is that it takes account of the great variability of harvests. In so doing, it underlines the difficulty of estimating precisely at any given moment how much of a surplus is cyclical and how much is structural.

The assessment of a structural surplus is methodologically difficult. The analysis of the overall annual surplus shows that market balance has never been fully restored. The surplus accumulates and weighs heavily on the market whenever output is high.

2. The distillation regime

All distillation measures

Our intention here is to subject to critical examination the hypothesis that short-term crises are not resolved by intervention in the form of distillation measures, because it has no price-enhancing effect.

This argument is not a genuine response to the supposed inefficacy of the method. First of all, the level of price increase, or the extent to which a price decrease is minimised, depends on the volume that is actually distilled. If that volume is insufficient, prices will not rise. We saw above, of course, that the Commission has never fully rebalanced the market. So the result is hardly surprising. We can also say that the effect of intervention will depend on the sensitivity of imports to this reduction in supply, which itself is linked to the prices of competing products and their suitability as substitutes. To determine these factors, we would need to calculate import-demand elasticities, which is methodologically difficult in the case of a highly segmented market. This remark is put into sharper focus at the regional level. In fact, the annexes to the present report show that the regions where extensive use is made of distillation, namely Apulia and Sicily (see Figures 74, 75 and 76 and Table 92), have seen their prices rise. The mechanism, in other words, functions well in the case of markets with relatively little competition.

For the income effect to count, the volume distilled must be sufficient, and distillation must not generate an increase in the volume of imports.

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Distillation of spirits

Before proceeding any further, we wish to comment on and discuss the analyses of this distillation regime contained in the Innova evaluation report and endorsed by the Commission.

Our first remark concerns the effect of distillation measures on imports. The evaluation report indicates that imports are indirectly supported. We are dealing here with a comment on every means of market intervention in the framework of the wine CMO: whenever overproduction occurs, the elimination of part of the output, whether through storage, distillation or grubbing-up, reduces the supply of European wine and eases the pressure on a market in which all the world’s wine-producing countries are becoming increasingly active. It is a classic case of free riding, in which regulation relating to some players benefits all players. The effectiveness of distillation as a means of intervention is therefore impaired by the absence of protection or of any distinction between two groups of producers following different sets of rules. Intervention is certainly incompatible with more open markets.

Our second remark concerns the hypothesis that distillation of spirits is a significant source of income for some producers, especially in Spain. In fact, the intervention price of €2.50 for each percentage point of alcohol volume per hectolitre, corresponding to the old level that applied to preventive distillation before 1999, i.e. 65% of the guide price, is higher than the price obtained for table wines, particularly white wines, in the year when overproduction occurred. This price does therefore function as a floor price, but at a level that may be considered very low. Can the price be regarded as remunerative? Conversely, the ways in which this measure is applied limited the proportion of wine that any producer can deliver for distillation to 40% of his individual production from 2000 to 2002 and then to 25% after 2002. The floor-price effect is therefore diminished since it only relates to a fraction of the volume of supplies. The mechanical effect of income support, in other words, corresponds to a quarter of the differential between the market price and the distillation price, but does not take into account the effect of easing the global supply situation. Lastly, it seems contradictory to us to criticise both the insufficient price enhancement and the remunerative aspect of distillation.

Our third remark concerns the assertion that this mechanism encourages the quest for higher yields. This allegation is refuted by the facts observed, because the extensive vineyards with low yields but very low production costs, such as those in Castilla-La Mancha in Spain and in Italian wine regions, are the very ones that deliver these wines for distillation. Increases in yield result from the conversion of vineyards, combined with the adoption of more productive techniques, especially irrigation. This makes production costs far higher, which means that producers who improve their vineyards must seek more remunerative markets for their products and could not be attracted by very low prices.21

Our fourth remark concerns the particularly ambiguous allegation that distillation acts as an incentive to perpetuate structural surpluses. We believe that the CMO of 1999 established this distillation for the precise purpose of maintaining what is regarded as a normal outlet, namely the market in wine-based spirits. Unlike the preventive distillation that preceded it, the distillation of potable alcohol cannot therefore be regarded as an instrument of anti-

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cyclical market regulation. The budget allocated to this intervention mechanism must be recognised as support for a subsidised outlet. The isolation of this market is where we see the problem, for the distillation system prevents most alcohols resulting from other distillation measures from re-entering the spirits market, which is more lucrative than industrial outlets. Moreover, the volume channelled into this outlet is directly linked to the price level for marketed alcohol. A reduction in aid would translate into an increase in the selling price, which would lower the consumption of spirits derived from wine, although it is difficult to predict the extent of this fall in demand. We cannot therefore speak of an ‘incentive’, but rather of the organisation of a secondary market.

It would be possible to abolish this aid. In response to the price change this would trigger, it would also be necessary to eliminate the part of the supply structure that had become surplus to requirements by grubbing-up, the targeted areas being those belonging to producers of wine intended for distillation into spirits. That is a political choice. This remark prompts us to call for a full evaluation of the markets in spirits, especially the workings of cross-price elasticities between spirits of various origins, to provide a better understanding of the effects of such a decision. In addition, statistics and information on the needs of the European markets seem to be sorely lacking. The evaluation report confirms this opinion in an additional comment to the effect that this measure protects the market from low-priced competition from wine producers based outside Europe.

The distillation of spirits represents a normal outlet established by the CMO. It has little impact on surpluses. The volumes involved and the costs arising from intervention depend on the role that the CMO assigns to this outlet. It may be maintained, reduced or scrapped. The impact on areas under cultivation and on wine producers will depend on the extent to which spirits of other origins, i.e. spirits derived from other products or wine-based spirits from outside the EU, establish themselves in the market as substitutes.

- Crisis distillation

Crisis distillation has been opened on an ad hoc basis at the request of Member States. The volumes have been significant in glut years (6.5 million hectolitres in 2001/2002, 6.7 million in 2002/2003 and 5.8 million in 2004/2005). This represents an annual average of a little less than four million hectolitres over a five-year period. Crisis distillation applies both to table wines and to QWPSRs, of which 1.5 million hectolitres were distilled in five years. The price remains high, albeit slightly lower than for wine distilled into spirits. The Innova report criticises its cost on the same grounds as it criticises the cost of distilling potable alcohol.

We believe that the very principle underlying this distillation measure makes it difficult to implement. The fact that signing up to the scheme is optional leaves it open to free riding, in that many wine producers do not deliver wine for distillation but wait for prices to rise as a result of the distillation of other producers’ wines. The consequence is often the delivery of insufficient volumes (see Part 1, chapter 7, above). Besides, the late implementation of the measure generally makes it impossible to correct prices at the beginning or in the course of the wine year. Similarly, the addition of national aid is subject to agreement from Brussels. Market managers are caught between the devil and the deep blue sea – on the one hand, an excessively high price will induce growers to produce for distillation, which is not the intention; on the other hand, an excessively low price will not provide an incentive to eliminate a sufficient volume of wine from the market. The only course they can take is to wait for prices to tumble – let the situation deteriorate – so that producers are compelled to sign up, but by then the scheme can no longer function as an instrument of income support. The same issues arise with regard to the balance of the market in spirits.
It therefore seems that, if the market is to be regularised, the options are either to apply the current system of crisis distillation more effectively by making it compulsory and activating it quickly, or to return to the graduated intervention mechanisms of the old CMO, namely preventive distillation, compulsory distillation and support distillation, or else to change the system. Upstream intervention in the form of summer pruning is worth examining. Other systems such as the compulsory establishment of reserves by producers’ organisations could also be envisaged (see Parts 3 and 4 below).

- **By-product distillation**

By-product distillation has always been presented as an important means of **safeguarding the quality of wines**. It has been so much ‘part of the landscape’ in France since 1936 that the optimum rate has ceased to be an issue there. In fact, the rate depends on prevailing conditions and was **set with a Malthusian economic objective in mind**. Opinions differ on the need for this measure, particularly in the production of white wines. The rate applied to red wines is also the subject of occasional discussion. In any event, the cost of the measure seems to be very high. For example, in the case of a French red table wine with an alcohol content of 10° sold in bulk at €45 per hectolitre, the distillation scheme costs €15 per hectolitre, comprising €6 for the purchase of by-products and €9 for the storage and sale of the alcohol intended for carburation or other industrial uses; in other words, a third of the price obtained for the wine is spent on the distillation scheme. This represents some 20% (€200 million to €230 million) of the total CMO budget of €1 200 million. With this measure, about six million hectolitres of wine, corresponding to 3% of the total harvest, are removed from the market every year. The expense incurred in removing these products is disproportionately high. This imbalance derives essentially from the cost of releasing this surplus alcohol onto the world market in industrial alcohol at a derisory price that bears no relation to the Community’s expenditure, but this point can be reconsidered (see Part 3 below).

It would therefore be feasible to terminate aid for this measure, as the Commission is proposing, while maintaining the obligation to distil excess production at a revised rate in accordance with technical standards (quality effect). At the same time, the income shortfall resulting from non-intervention could be offset by a regulatory measure authorising the sale on the spirits market of alcohols distilled from wine lees and grape marc. This outlet already exists for marc spirits with a designated geographical origin, such as *marc de Bourgogne*, and for Italian *grappa*. Here too, the question of interference with the operation of the spirits market merits further careful analysis.

- **Distillation of wines derived from dual-purpose grape varieties**

Wines derived from dual-purpose grape varieties are now only ever distilled in France. The only wines involved here are those which are suitable for the production of cognac and armagnac. The mechanism is effective, thanks to the existence of the system of ‘quantities normally vinified’. The volumes involved are dwindling. The price paid for this wine is low, which is justified by the existence of another remuneration scheme for cognac. This distillation measure is tending to disappear (see Part 3 below).

### 3. Storage contracts

Private storage contracts do not pose any problems for the Commission or for the evaluators. They play their part as price stabilisers, although it is difficult to assess their contribution in global terms and independently of other intervention measures. Their cost is judged to be
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moderate, at 5% of the CMO budget. The only request, for more flexibility to shorten the
duration of contracts, which currently stands at nine months, makes good sense. Storage from
one wine year to another for the regulation of supply and demand should be the only measure of
intervention that exists in a market in sustained equilibrium. Since private storage is ineffective
in such a case, public intervention is needed. The real uncertainty concerns the volumes to be
stored in relation to fluctuations, including cyclical fluctuations resulting from harvests. On
average, the volume in storage scarcely ever actually exceeds 30% of the variation in output,
one rare exception being 2000-2001, when it averaged 45%. It would be important to assess
these needs in the absence of other, distillation-based, intervention measures.

4. Aid for the use of concentrated must and rectified concentrated must

The argument used in defence of this aid is that it is a means of compliance with the principle of
‘one law for all’. The idea is that the cost of enrichment should be set at the same level for all
wine producers. The decision to do this does not say anything about the choice of enrichment
method. Until now, the political pressure exerted by the regions where sucrose is used has been
sufficient to preserve this form of ‘compensation’. While, from a technical point of view,
enrichment is warranted by fluctuations in climatic conditions, there is no economic justification
for choosing one method or the other apart from the divergence in the cost of the raw material. It
is possible to reduce budgetary expenditure by abolishing the aid and choosing one single
enrichment method. The choice of this method is linked to the cost level, estimated by reference
to the amount of aid, and to the debates on standards, particularly in the WTO. The countries of
the New World prohibit the use of sucrose. This choice can be justified by the definition of the
wine they produce as additive-free.

Chapter 4: Winemaking practices and product definition

The debate on winemaking practices is directly linked to competition with the countries of the
New World. In fact, practices such as the use of wood chips, blending with wines or musts from
other countries or regions on the basis of rules such as the 85% rule, whereby only 85% of the
content of marketed wine need come from the grape variety and vintage indicated on the label,
and enrichment or aromatisation methods have a major impact on the competitiveness of
businesses and their products. Some of these contradictions have already been resolved by
recent legislation, as in the case of wood chips. But it took about ten years to argue the case for
the new rules and put them into effect, during which time competitors had a free rein.
Enrichment and de-alcoholisation methods still differ very widely in practice. These issues have
technical dimensions that transcend the scope of this report. It does seem, however, that
compromises can be achieved through a genuine debate on the definition of the product in one
framework or another, be it the CMO, the Codex alimentarius or the WTO.

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23 This term refers to the Murret-Labarthe report, compiled in the 1970s, which justified the plea from vine
growers in the south of France that they should not be penalised by a ban on the use of sugar (sucrose).
Chapter 5: Trade with non-EU countries in the WTO context

Refunds made by way of export subsidies amounted to an average of no more than 2% of the budget allocated to the common organisation of the market from 2001 to 2003, so the sum in question is not a major issue for future WTO negotiations. The refunds relate only to table wines exported to certain destinations, mainly in Africa. The volumes in respect of which they are granted nevertheless represent 18% of Community wine exports, amounting to 2.3 million hectolitres. The aid budget totals €20 million to €25 million.

The main issue concerns the sensitivity of these exports to price increases in proportion to the amount of the abolished subsidies. The average of ten euros per hectolitre can represent up to a third of the selling price. Price elasticity in the importing countries may be high enough to take away a large part of this outlet.

Chapter 6: Summary of criticisms

This is how we see the evaluation of the wine CMO:

- A number of the criticisms made of the wine CMO by Innova in its study and by the Commission focus more strongly on the ways in which measures are implemented than on the mechanisms of the existing CMO. For example: (1) it is not the introduction of permanent abandonment premiums or qualitative conversion that poses problems, but the fact that too much or too little use is made of them or the fact that insufficient account is taken of the implications of decisions, as in the case of the increased yields in Castilla-La Mancha and in southern Italy; (2) similarly, the legacy of failure to rebalance the market is a glut that makes it impossible to stabilise prices and incomes; (3) the efficiency and cost of distillation measures are determined by a prior economic policy choice, namely to supply the market with a given quantity of distilled alcohol at a given price.

The evaluation of malfunctions in the CMO ought rather to envisage the adjustment of its mechanisms, either (1) to adapt them to changes in the objectives of the common agricultural policy or wine-production policy, such as protection of the environment, compliance with the rules of the World Trade Organization (WTO) and rural development, or (2) to take account of new budgetary constraints, such as the need to reduce expenditure and the accession of new Member States, or (3) to respond to the development of global competition and the dominance of countries in the New World. It seems difficult, in our view, to maintain traditional market-intervention mechanisms based on the regulation of supply in the virtual absence of tariff barriers. We consider it essential, in the context of the current reform project, that objectives and resources should be clearly defined and prioritised before any existing instrument is abolished.
Part 3: Critical appraisal of the proposals for reform of the wine CMO put forward by the Commission in its communication

Chapter 1: Grubbing-up

The grubbing-up scheme mooted by the Commission in its reform proposals is certainly the measure that has provoked most of the adverse reactions from within the wine trade in all of Europe’s wine-producing countries. The Commission is effectively proposing the abandonment of 400,000 hectares, which represents 12% of the area planted with vines in Europe, over a five-year period, supported by a system of degressive incentives. On the basis of an average amount of €6,000 per hectare, this measure would account for twice the amount of the annual budget currently allocated to the wine CMO. It would be accompanied, either from the outset or at a later date, by the disappearance of planting rights.

A virtually unanimous angry response from the trade organisations, relayed by the press, presents an apocalyptic vision of the implications of this reform, perceived as a ‘disaster scenario’. Growers speak of losing their livelihood, of ruin, of the death of their trade. Behind these very understandable emotional reactions, what arguments have been advanced, and what facts offer a suitable basis for analysis?

1. Inefficiency in an open global market

The main criticism is levelled at the long-term inefficiency of the measure, which is also regarded as very costly, in an open global market. In fact, from the 1980s until the mid-nineties, Europe rebalanced its supply structure by means of a grubbing-up scheme. During the same period, the countries of the New World were developing their vineyards to meet the demand for domestic consumption and the growing demand for exports. From 1988 to 1996, about 500,000 hectares of vineyard in Europe were grubbed up, then the process was more or less suspended until 2004-2005. Meanwhile, from 1990 to 2005, Australia was tripling its vineyard area with the addition of 200,000 hectares, in the United States the planting of 80,000 hectares increased the vineyard area by a quarter, Chile increased its planted area by half with the addition of 60,000 hectares, and South Africa’s new plantations covered 25,000 hectares, adding 25% to the total area of the country’s vineyards, not to mention the fact that 350,000 hectares have been planted with vines in China in recent times, tripling the surface area of Chinese vineyards. Even if part of this effort, namely the Chinese plantings, is essentially focused on domestic consumption, another part of the growth in the area of these vineyards has intensified global competition in the marketplaces of the main consumer countries, foremost among which are the UK, the United States, Japan, Canada and the countries of northern Europe. It is therefore very probable that any gap created by grubbing up the part of the vineyard area considered surplus to requirements will be filled with products from the New World. Such a decision by the Commission would encourage or even speed up an ‘outsourcing’ of production activity. In short, it is illusory to regulate production potential in the context of an open global market.

Besides, the New World, and more especially Australia, have also been overproducing as a result of the abundant global vintage of 2004-2005. These countries do not have the same method of regulating surplus supply. In 2006, grapes equivalent to 1.5 to 2 million hectolitres of wine have been left unpicked on vinestocks or uncollected. The crisis does not show up in the balance sheet of the wine trade, but its impact is borne by producers. Argentina and Brazil are
transforming their surpluses into grape musts or concentrated grape musts. They are leaving their production potential untouched while they wait for the crisis to pass. **Any signal from Europe indicating its desire to remove a large percentage of its vineyards will send a powerful message to the new producer countries to maintain their present strategy.**

2. CMO reforms: swimming against the tide of history

The wine CMO has been somewhat inconsistent in the practices it has employed to manage production potential. From 1980 to 1996, it operated the grubbing-up scheme but at the same time channelled only a small proportion of new planting rights – 10% – into regions whose wines with registered designations of origin were expanding into new markets; this practice earned it a rebuke at the time from the European Court of Auditors.\(^{24}\) In its reform project of 1993, the Commission had already recommended an intensification of grubbing-up, to be achieved by increasing the amount of the premium. Two years later, however, the reform plans were abandoned because of a shortage of wine and a forecasting error. In the reforms of 1999, which followed three years of poor grape harvests, the Commission distributed new planting rights representing 1.5% of the existing surface area of European vineyards, with 0.5% remaining in reserve. The total area planted with vines was thus increased again, a situation compounded by illegal planting (see above). Scarcely had the new wine CMO been established before it was confronted with a first global overproduction scenario in 2000, followed by a second in 2004.

Without underestimating the difficulty of foreseeing the volume of wine that a given production potential will actually deliver, we cannot but observe that faith in present-day assertions regarding the size of the surplus vineyard area may be misplaced. It is, in fact, very difficult to estimate accurately and convincingly how much of a surplus is structural and how much of it derives from a cyclical factor. Attempts at estimation are made with the aid of particularly crude statistical tools and data that are too general to reflect the diversity of vineyards, products and production conditions; such estimates cannot fail to elicit a number of reservations. Accordingly, intervention focused on potential should only ever be gradual and should be subject to very close monitoring in order to avoid overcorrection and wastage of budgetary resources.

3. Hungary: example of a succession of contradictory policies

Hungary’s entry into the European Union focuses attention on this alternation of subsidies for planting and premiums for grubbing-up, albeit on a far smaller scale.\(^{25}\) From 1997 onwards, the Hungarian Government operated an aid scheme to encourage growers to plant new vines and thus to preserve the country’s wine-production potential, funding 40% of the total planting costs. The effect of this aid was obvious, with 16 500 hectares planted out between 1996 and 2004, which corresponds to some 15% of Hungary’s entire vineyard area.

Since accession, the new areas created by the replanting rights have been considerably reduced as the result of a crisis in the wine market and a lack of differentiation between replanting subsidies and aid for the qualitative conversion of vineyards. The accelerated increase, prior to accession, in the planting of vines did not succeed in preventing the shrinkage of the total surpluses.

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\(^{24}\) Over the entire period, Bordeaux benefited from new planting rights for some 10 000 hectares. This is the area that the region estimates it will have to grub up in order to rebalance its market. The total amount of the premium, which incorporates regional aid, is €15 000 per hectare, making a total budget of €150 million.

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vineyard area, but it did contribute to modernisation and qualitative conversion in some vineyards. During the accession negotiations, the EU agreed that the authorised\textsuperscript{26} grubbing-up of vines between 1 May 1996 and 30 April 2004 would qualify growers for replanting rights. The area affected amounts to 12 500 hectares. These replanting rights are valid until 31 July 2010.

In Hungary, premiums for grubbing-up did not exist before the country’s accession to the EU, and no provision was made for the introduction of the measure in the first two years of membership. Planting and qualitative conversion were the priorities. However, because of the bumper harvest of 2004, which yielded 4.8 million hectolitres of wine, and the ample stocks, amounting to 3.3 million hectolitres, at the beginning of the following wine year, the purchase price of grapes plummeted by 30 to 40%. Growers wishing to give up the wine business because of falling incomes and a lack of profitability asked for permanent-abandonment premiums to be introduced for the 2005/2006 wine year. This year in Hungary, premiums are being paid for the grubbing-up of 4 000 hectares of vines, mostly in areas where table wines or regional wines are produced. The permanent-abandonment premium is a great incentive for producers, because it ranges from €4 600 to €6 300 per hectare, depending on the average yield over the past five years.\textsuperscript{27} For this reason, producers are asking for a continuation of the premium scheme in the 2006/2007 wine year.

From the Hungarian experience we can observe that: (1) subsidised grubbing-up and planting schemes are launched on the basis of a very short-term view of the market; (2) in times of crisis, the size of the premium in relation to growers’ incomes is such that they will resort to a structural instrument to solve a cyclical problem; (3) the incentive is so great that an excess of production potential is quickly overcorrected, and the excessive destruction of production potential may provoke the rapid growth of imports.

4. Results of past grubbing-up

Over the period from 1980 to 1996, the three main European producer countries made very substantial contributions to the reduction in Europe’s wine-production potential. A significant part of the grubbing-up was even done without the aid of public funding. The pace and duration of the process varied: the decline in production potential began very early in France, then Italy and Spain followed suit on the basis of the Dublin agreements of 1984. The focus of these grubbing-up efforts was very much on regions that specialised in the production of table wines. In France, the Languedoc-Roussillon region was the main target, losing a third of its vineyard area; in Spain, it was the region of Castilla-La Mancha, which lost 114 000 hectares from 1990 to 1998; in Italy, the Mezzogiorno region bore the brunt of the grubbing-up. Few studies, however, have fully analysed the social, economic, agricultural and environmental impact of these programmes.\textsuperscript{28}

\textsuperscript{26} In Hungary, grubbing-up and planting in vineyards have been subject to official authorisation since 1920.

\textsuperscript{27} The premium becomes remunerative by virtue of its relationship to income from vine-growing and to land prices. If the calculation is made on the basis of average prices in 2005 (40 to 180 Hungarian forints (HUF) per kilogram of grapes), incomes vary according to quality and region between HUF 300 000 and HUF 1 200 000 per hectare, in other words between €1 150 and €4 800 per hectare, but the cost of producing grapes is in the range of HUF 500 000 to HUF 700 000 per hectare, i.e. €1 900 to €2 700 per hectare.

\textsuperscript{28} A call for tenders was certainly issued by the Commission in the early 1990s, but the study was never commissioned because of the launch of the CMO reforms in 1993. A few studies have been conducted by French researchers, but these are either quite dated now, as in the case of P. Bartoli’s study of 1980, or limited to geographical aspects, as in A. Sieniuk and J. Strohl, 1996 and 1997.
The main issues concerning the future of producers who have grubbed up their vines and the future of the grubbed-up areas have not, to our knowledge, been the subject of any European studies. Several consequences have nevertheless been regularly mooted: the exodus from the countryside, the destructuring of rural areas and their communities, desertification, land lying fallow, excessive building in the countryside and the disappearance of rural landscapes, but also the formation of cooperatives as a means of limiting the impact of falling turnover. Viladomiu and Rosell (1997) sum up the importance of preserving vine-growing in La Mancha in the following five points:29 (1) the need to preserve tradition, culture, identity and lifestyles; (2) the absence of alternative crops, reforestation not being a viable option; (3) the fact that the vine is the ideal plant for the area in terms of its water requirements; even allowing for irrigation, it still needs four times less water than other crops such as maize, alfalfa or beet; (4) the wine sector generates employment and plays a vital role in the maintenance of a local productive system; (5) because of the climatic conditions in La Mancha, vine plants tend to remain healthy and need little plant-health treatment.

The case of Castilla-La Mancha typifies the ineffectiveness of efforts to rebalance the market by means of grubbing-up measures alone, without taking account of their effects on local development. From 1988 to 1996, vineyards with a total area of 111 000 hectares vanished from that region; this represented almost a quarter of all grubbing-up in Europe. The elimination of this production potential coincided with two successive years of drought, and within two more years the trend was reversed. From 1999, production in Castilla-La Mancha began to reach record-breaking levels. The policy of conversion and restructuring introduced by the new CMO encouraged a switch to different grape varieties, which was accompanied by technological advances and the adoption of irrigation systems. Of the 566 000 hectares of vineyard in the region, more than 120 000 hectares have been restructured.30

The surface area planted with irrigated vines grew sixfold from 18 000 hectares in the late 1980s to 120 000 hectares at the start of the 21st century, while grubbing-up took place in less intensively cultivated areas with lower yields.31 A large part of southern Spain and almost the entire regions of Castilla-La Mancha and Extremadura depend on the vine for the protection of their environment and their rural development. These regions have no alternative means of protecting their soil against erosion and degradation and of keeping their rural communities alive. The presence of vineyards, in fact, correlates directly with the maintenance of population levels in the rural areas of La Mancha.

The dimensions of regional development and of the preservation of economic activity in these specialised rural areas, aims that are proclaimed in the new CAP guidelines, do not seem to have been taken into account in this case.

5. Results of recent grubbing-up

From 1997 onwards, France and, to a lesser extent, Italy maintained a very limited degree of subsidised grubbing-up. During the 2002/2003 and 2003/2004 wine years, the bulk of the 1 535 hectares that were grubbed up in France and of the 340 hectares in Italy were located in regions whose wines are produced for distillation into the geographically designated brandies of

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31 According to data from the Spanish Instituto Nacional de Estadistica.
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Cognac and Armagnac. During the 2004/2005 wine year, permanent-abandonment premiums were paid in respect of 1 740 hectares planted with vines. These grubbing-up measures took place in French départements where growers faced difficulties, namely Pyrénées-Orientales, Loire-Atlantique and also to some extent in Charentes, where cognac is produced. The crisis of 2004/2005 reactivated the grubbing-up process in the following wine year, reflected in the funding of measures covering 16 427 hectares in 2005/2006. All of the wine-producing regions were affected, most of them in the south of France, where 9 000 hectares were grubbed up. Vines covering 2 400 hectares were even grubbed up in the Bordeaux region, thanks to an injection of regional funding, which boosted the premium to €15 000. The Loire Valley was next in area, with 820 hectares being abandoned.

A qualitative analysis based on experts’ opinions reveals three types of behaviour pattern in Languedoc-Roussillon: (1) growers cease all, or almost all, of their activity, either by retiring or by moving to a town or city; a statistical analysis of cases shows that 30% of growers who applied for the premium, representing 20% of the grubbed-up area, grubbed up more than 90% of their respective utilised agricultural areas (UAAs); (2) growers seek liquid assets, decapitalise or sell land for other uses on an opportunist basis: 30% of growers, who likewise represented 20% of the grubbed-up area, grubbed up less than 20% of their UAA; (3) growers reduce the size of their holdings in order to withstand the crisis more successfully; they pay off their workers, curb their expenditure and become sole traders.

These findings draw our attention to the potential social role of the premium, particularly as regards retirement and changes of occupation. In times of crisis, apart from some anomalous cases of investments in luxuries, in leisure facilities or in property, the land market does not function, and prices fall. The grubbing-up premium and the value of the land itself enable growers to realise some of their assets as a safety net or as a form of damage limitation.

6. Impact assessment of grubbing-up; strategies to pursue

An impact assessment of permanent abandonments was undertaken by the monitoring centre for the wine trade of the Hérault département in France. Its findings cannot be applied to all French vineyards, let alone all European vineyards, but they do put forward original arguments that are worth considering in the context of the parliamentary debate.

The study covers the period from 1980 to 1996 and stresses the following points: (1) grubbing-up involves both full-time growers (who received 53% of all abandonment premiums) and part-time growers; (2) grubbing-up is not evenly spread throughout the territory of Hérault but is concentrated in the coastal plain, the hinterland and the vicinity of towns; (3) the incidence of subsidised grubbing-up increases with the age of growers; (4) all sizes of holding are affected, from small wineries to large domaines; (5) it is estimated that the grubbing-up of four hectares costs the job of one directly or indirectly employed person; (6) the fate of the grubbed-up land varies: some is sold, and some is devoted to other crops, but one hectare in five still lies fallow two years after being grubbed up; (7) grubbing-up changes the face of the countryside by releasing land for building and creating areas of fallow land; (8) there is confusion between the productive asset and the capital asset. The study concludes that the permanent-abandonment premium is suitable for producers ‘who cannot adapt to market developments’, but does not constitute a means of regulating supply.

The study puts forward scenarios in which the permanent-abandonment premium is administered collectively on the basis of eligibility criteria. A first scenario focuses on the economic development of the wine trade and the vineyard, centring on the two primary factors of variety and yield. In this case it is a matter of grubbing up insufficiently high-yielding vines dedicated to the production of table wines and vins de pays as well as vines bearing grape varieties that are ill suited to the target markets. The scheme in the second scenario applies the principle of social support by helping producers who are in difficulty or ready to abandon their activity. Factors that could be taken into account in this scenario are the existence of a recovery procedure for growers in difficulty, economic performance ratios, the age of the grower and the absence of a successor.

The Commission’s proposals exclude social and economic grubbing-up criteria from the outset. The studies we have outlined emphasise the benefit of letting the various Member States determine their own approach to the political and strategic aims of this measure.

Chapter 2: Abolition of planting rights

The Commission is proposing the abolition of the system of planting-rights restrictions, either immediately, as in Variant A of the Commission’s second scenario, or in 2010, after the market balance has been restored (Variant B).

1. The Commission’s hypotheses

The Commission advances explicit hypotheses: ‘Planting rights increase the cost of production and act as a brake on the rationalisation of the structure of holdings, reducing competitiveness. Non-EU countries do not apply such planting restrictions.’ To these we can add the implicit argument that, since the wine CMO first took effect in 1970 and the planting rights in 1976, a number of countries have not made sufficient efforts to compile an effective vineyard register and prevent illicit planting. The view presented by the Commission does not seem to be very well justified, and we believe it is contestable.

2. Discussion of the Commission’s view

1 – For young vine-growers, the new rights are free, even if they are only available in limited quantities. This promotes one means of developing wine production, namely the establishment of young growers. For other vine-growers, the planting right constitutes a direct cost for those who wish to expand their production capacity. The cost of these rights depends on the market in rights transfers where they exist or is fixed by the competent administrative body. For the 2005/2006 wine year, the amount earmarked from the national reserve in France was equivalent to €1 750 per hectare. This amount corresponds to 5% of the cost of planting in areas where prestigious wines with registered designations of origin are produced and 10% in areas producing vins de pays. Given a 40-year productive lifespan of vines, this charge represents €43.75 a year, or 0.7% of the cost price of the wine.

In more general terms, the cost of the planting right is included in the price of exchanged vines. The value of the vines follows fairly closely the development of the value added per hectare with a time lag of two years.\textsuperscript{34} Vine prices vary (see Figures 104 and 105) from €11 000 in Languedoc to €578 000 in Champagne. \textbf{The cost of rights is therefore more than offset by its influence on land prices.}

A different criticism is sometimes voiced by Italian vine-growers regarding the difficulty involved in finding planting rights. Some growers apparently devote a great deal of energy to the quest for these rights, while others seem to grub up vines without a premium. We are no longer faced here with a production cost but with a transaction cost. This difficulty is a fair point of criticism, but it does not compromise the principle of planting rights. It merely highlights the lack of organisation of the transfer system. \textbf{The fact is that the CMO of 1999 clearly provided scope for these rights to be managed by means of a reserve. It is the functioning of that reserve which needs to be assessed.}

2 – The second argument invokes the classic theme of economies of scale. Holdings are supposedly prevented from reaching their optimum size by a lack of access to planting rights. The fact is that numerous studies on production costs in France have demonstrated that there are few economies of scale in vine-growing. To put it more precisely, cost variations are greater within a given size category than between different categories. Indeed, the determining factor in the cost price of a hectolitre of wine is the yield per hectare.\textsuperscript{35} The economies-of-scale argument in relation to production output also seems weak. Moreover, in terms of vineyard management, planting rights are regarded as an asset by business partners, especially banks, which treat them as a guarantee. Abolishing planting rights could deprive growers of this guarantee. \textbf{The abolition of planting rights would reduce the capital value of vineyards and would probably result in falling land prices.}

3 – The reference to the New World merits attention, because it provides a comparison with different regulatory systems. For a country like Australia, planting rights were never an issue as long as wine production was growing, since the produce of every new area of vineyard found an outlet. Tax incentives were even used by the government to foster that development. It could have achieved the same purpose by issuing planting rights free of charge. By contrast, the political authorities established a system of rights for the use of water – water quotas – because that is the production factor which is in short supply in Australia. Not until the onset of an overproduction crisis did this question arise as prices fell, contracts were terminated, grapes were not harvested and vines were grubbed up. The social cost of this crisis has not yet been assessed, but the issue relates to other production options and alternative land uses as well as to the future of producers. The policy proposed by the Commission may be fairly well suited to a production structure in which grape varieties and technology, rather than location, are the key variables. It is far less suited to specialised regions which have no other production options and which depend on vineyards to preserve their landscapes and the life of their communities.

The Argentinian example also merits our attention. The transformation of the specialised vineyards of Mendoza province, which account for 80\% of Argentina’s wine production, was effected through the elimination of small-scale producers who had no access to credit to convert their vineyards. With the local interest rate standing at 37\%, large companies possessing capital obtained in the international financial market at a rate of 2\% created vast integral domains


\textsuperscript{35} The situation is somewhat different in Australia, which is often used as a reference. There are no great differences in Australia between growing regions, and land is available. This, however, is a far cry from the production structures in Europe.
alongside the traditional vineyards or in neighbouring provinces. **Planting rights and collective management of those rights limit the relocation of vineyards and help to prevent competition between grossly unequal players.**

**In more general terms, these experiences are not comparable. They relate to forms of winemaking with different histories, production conditions and structures, markets and social structures.**

3. **Reasons for the existence of planting rights and risks involved in their abolition**

The planting of vines, perennial plants which take a long time to become fully productive, is characterised by susceptibility to forecasting errors regarding the state of the market and to wide fluctuations in harvests – factors which, in a situation of inelastic demand, exacerbate crises.\(^{36}\) It is an established tenet of economic theory that the alternation of excess production and shortages generates surpluses with detrimental effects on producers and consumers. The absence of regulation is a source of inefficiency in this respect. From a social point of view, the maintenance of a rural population managing the land and conserving the environment depends on the preservation of an acceptable standard of living, obtained either through remuneration for productive activity or through an income transfer within society, as in the case of the single-payment scheme. The abolition of planting rights can only encourage the relocation of vineyards and disregard for the objectives of the common agricultural policy.

Planting rights are an instrument for the management of supply, in which they complement the policy of grubbing-up. Their history goes back to 1936, when they were created in France to curb the production surpluses that had regularly provoked economic and social crises. They were also introduced into European legislation in 1976, in the wake of the ‘wine wars’ between France and Italy. In recent times, they have also been an instrument for the development and protection of areas producing quality wines. Their implementation has, in fact, been governed by collectively formulated development criteria, which define the conditions in which rights may be distributed and transferred between growers, regions and countries.

**The abolition of planting rights would therefore foster the relocation of vineyards, the development of large companies with the ability to mobilise capital, and the rapid appearance of surpluses, and would pose problems with regard to the relationship between the regionally rooted QWPSRs and the other categories of wine.**

The abolition of planting rights is also incompatible with the previous decision to grub up 400 000 hectares of vine in order to rebalance supply with demand. As soon as planting is liberalised, the surface area planted with vines will increase, causing new surpluses. The equivalent of two years of CMO budgets would thus be poured down the drain.

**Chapter 3: Vineyard restructuring**

Vineyard restructuring has been given a minor role in the communication presenting the Commission’s reform proposals.\(^{37}\) The communication simply says that it would be maintained under the budgetary appropriation made available to each wine-producing Member State (the

\(^{36}\) See the analysis of the Australian crisis below.

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‘national envelope’). Its budgetary impact, however, is crucial, because the measure accounts for about a third of the annual budget allocated to the wine CMO.

The annex to the communication is rather more forthcoming. It states that ‘the policy of restructuring and reconversion of the vineyards would continue, possibly with some adjustments to overcome the current problems (stricter control that the measure is not used for normal renewal of vineyards and/or that it does not lead to increased yields; improvement of the monitoring tools put in place to assess the effectiveness of the scheme).’ It is indicated later in the same document that the need for restructuring should be carefully verified and, if necessary, that the national appropriation should be reduced, the funds being transferred to the other envelopes or to rural development. A closer link with the latter could be sought by allocating larger sums in the case of more extensive grubbing-up operations. We cannot but welcome the commitment to verifying the proper administration of public funds.

This measure seems to be unanimously accepted. After having been applied nationally for many years under Directive 78/627/EEC and Regulation (EEC) No 458/80, it was then implemented at the European level with the establishment of the major programme resulting from the CMO reform (Regulations (EC) No 1493/1999 and No 1227/2000). Under these instruments, France has restructured an average of 10 000 hectares a year since 1978. The measure served as the basis for a major qualitative conversion of vineyards from the production of table wines to the production of regional wines (*vins de pays*) and then, under the latest CMO, for an improvement in vineyards producing AOC wines.

Vineyard restructuring enhances the competitiveness of vineyards by altering working methods and adapting the stock of vines. It benefits consumers by shifting the focus of vineyard production to wines that are in demand and to the various categories of quality wines.

It encourages the establishment of young growers and acts as an incentive in a sector where the capital assets, the vines, have a productive lifespan exceeding a third of a century. The Innova evaluation report of 2004 also passes favourable judgement on the results of the measure. Lastly, the mechanism is WTO-compatible, according to the Agreement on Agriculture, Annex 2, paragraph 11, headed ‘Structural adjustment assistance provided through investment aids’.

The only point meriting attention is the constraint imposed in the communication from the Commission that restructuring programmes must always reduce yields. To the extent that yield is a competitiveness factor at the entry level, and in the light of the technical data that are currently available, it would be inefficient to deprive extensive vineyards of the opportunity to make such substantial improvements in the quantity and quality of their products, improvements deriving essentially from the use of rational irrigation. Given the choice between controlling supply by limiting yields or by seeking higher productivity, the Commission should opt for the latter. The level of yield should be determined by the desired product quality within a particular category and by the targeted segment of the market. Yield should not be limited ‘on principle’. On the contrary, in restructuring plans this mechanism should be clearly linked with the

39 ‘Structural adjustment assistance provided through investment aids: Eligibility for such payments shall be determined by reference to clearly-defined criteria in government programmes designed to assist the financial or physical restructuring of a producer’s operations in response to objectively demonstrated structural disadvantages. Eligibility for such programmes may also be based on a clearly-defined government programme for the reprivatization of agricultural land.’
management of regional potential and hence with grubbing-up and market-rebalancing measures. It is only in the light of this aspect that the confinement of restructuring measures to an allocated national appropriation begins to make sense.

It is also important to link the future restructuring policy to trade policies that complement this renewal of the productive potential. In fact, during the massive and heavily subsidised conversion of vineyards from white to red varieties, the markets anticipated the subsequent growth. This anticipation was reflected in a fall in the price of red wine, which corroborated the economic theory of rational expectations.

Chapter 4: Distillation

Distillation is the preferred instrument of market intervention in the framework of the common organisation of the market in wine. The Commission’s second proposal is that all distillation measures be abolished on the grounds that they are not very effective and cost too much. No replacement mechanism is proposed.

1. The budgetary cost of distillation measures

Budgetary expenditure on the wine CMO represents between 2.5% and 5.5% of the total budget of the EAGGF, Guarantee Section. Distillation measures account for a little less than half of this expenditure; their cost varies from year to year and depends on the size of the harvest. In relation to the absolute value of European wine production in 2004, estimated at €17 billion, the €1.2 to €1.4 billion allocated to the budget of this CMO, equivalent to between 7 and 8% of the value of output, may or may not be considered excessive, depending on the effectiveness of these measures. In any event, the objectives of budgetary stability and of redeployment of resources for rural development and the new Member States invite us to assess these forms of intervention.

Our analysis will focus first of all on the overall mechanism and then on a detailed appraisal of each type of measure. The ways in which the four kinds of distillation operate is very clearly documented in the Commission documents and in the Innova report, but these sources do not deal very explicitly with the economic mechanisms that explain the level of this expenditure.

2. The distillation mechanism

‘Alcohol produced through distillation either takes the form of raw alcohol and spirits obtained from grape wine or grape marc which are sold for the manufacture of potable alcohol, or takes the form of raw or neutral alcohol which is taken into public intervention storage for later use in chemical or carburation processes.’

We have schematised the workings of flows, prices and costs (see Figures 106 to 109). We are dealing here with several totally administered markets, in the sense that it is the CMO which determines the price paid to the grower, assesses the cost of the distiller’s service, and fixes the selling price of spirits for human consumption in accordance with the type of product. It also administers this market by defining products and determining the markets in which they can be sold. In the case of alcohol for industrial use, on the other hand, the OCM ‘defers’ to the market price.

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The prices paid to growers have remained the same for winemaking by-products delivered for distillation under the new CMO of 1999, but they are now expressed as an absolute value and no longer as a percentage of the guide price. The price paid for wine delivered for distillation into potable spirits is the same price that applied to preventive distillation under the previous CMO. The price paid in the event of crisis distillation is a more political decision, depending on the state of the wine market, because it must offer enough of an incentive to induce producers to deliver their wine, given the optional nature of the scheme since the start of the new CMO in 1999. The latter price differs according to the quality classification of wines and the country concerned, since some governments pay national price supplements. This price could be revised or restructured on the basis of budgetary objectives or the state of the wine and spirits markets. For example, halving the price of wine delivered for distillation would save €65 million of the €130 million paid to producers every year.

With regard to the market in distilled alcohol, it is also the OCM that defines the conditions of sale and the prices of potable alcohol. The option of delivering alcohol into intervention storage effectively defines the quantities to be delivered and the prices. This type of alcohol is a raw material for the spirits industry. It is not known how sensitive this market would be to an increase in selling prices. Conversely, in view of the volumes of alcohol produced through all the intervention measures, the immediate liberalisation of the market would cause prices to collapse completely.

These remarks therefore prompt us to stress that the market in wine-based distilled alcohol is inextricably linked to the wine market. The level of expenditure could be varied by altering the prices paid to producers or the transfer prices for potable alcohol. The abolition of these forms of intervention should also take account of the consequences for the market in distilled alcohol.

3. Nature and classification of distilled alcohols

The CMO has restricted the destination of distilled alcohol, which consequently circumscribes the scope of the distillation outlet and the value it can add. For example, alcohol obtained by means of crisis distillation (Article 30 of Regulation (EC) 1493/1999) cannot be sold as potable alcohol, even though it is distilled from the same wine that is normally distilled under the potable-alcohol scheme. The market in distilled alcohol is thus segmented, not by categories of consumers or of purchasers/spirit manufacturers but on the basis of regulatory distinctions.

To simplify matters, let us say that a distinction is made between alcohol intended for the production of brandy made from grape marc, potable alcohol intended for the manufacture of wine-based brandy, or eau de vie, and alcohol intended for the manufacture of the designated brandies of Cognac and Armagnac. None of the ‘intervention’ alcohols, i.e. those bought in through the EAGGF, are marketed as ‘potable alcohols’ – inputs for the production of spirits – but a large percentage of them have been sold on the market in alcohol for industrial uses.

It may be considered technically feasible to earmark all of the distilled alcohol for use in the manufacture of spirits, and the Commission could ‘optimise’ the quantities of distilled alcohol by ensuring that they were suitable for exclusive use as potable alcohol. This would be tantamount to reducing the production of alcohol distilled from wine to a third of its present level.
4. Delivery of winemaking by-products for distillation (Article 27)

- Alcohol intended for the production of brandy

The delivery of by-products of the winemaking process for distillation is the most complex issue. These by-products are used in the production of alcohols from wine lees and from grape marc, which are then refined into brandies or distillates for marketing as marc-based spirits or, through the intervention agency, as alcohols for industrial uses. Brandies made from grape marc do not pose a great problem, because this outlet accounts for a tiny fraction of production in France, amounting to between 5,000 and 7,000 hectolitres of pure spirit every year, in the form of marc brandies such as Languedoc, Burgundy and Muscat de Rivesaltes. In Italy, on the other hand, this market represents a significant volume, which varies, according to estimates from within the trade, between 100,000 and 140,000 hectolitres of pure spirit per annum and mostly takes the form of grappa. The outlet for potable alcohol thus accounts for only a little more than 10% of annual production.

If the delivery of by-products for distillation were abolished, the question is whether the market in this raw material for spirits manufacturers could absorb the amount of aid. One argument is based on an assessment of the impact of this increase in the price of the raw material on the final price of a bottle of marc brandy. If we consider that a bottle of grappa contains 28 centilitres of pure spirit and that grappa can contain up to 25% of alcohol from wine lees, this amounts to €0.10 per bottle.\(^{41}\) The raw material, at €0.38,\(^{42}\) accounts for a very small part of the final price per bottle, and the increase resulting from the abolition of aid would only be a quarter of that value. The bulk of the value added by the manufacturer, in other words, derives from ageing, bottling, marketing, distribution and taxes. It is worth mentioning that in France, for example, the excise duty on a hectolitre of pure alcohol amounts to €1,450, which is equivalent to €14.50 per litre and €4.06 per bottle, or ten times the cost of the raw material! The CMO aid represents only about 2% of the excise duty. In fact, the ‘subsidisation’ of a strong alcoholic beverage by the CMO, which is often regarded as politically incorrect, should be seen in the proper perspective, because it is recovered a hundredfold through taxes on the final product.

- Alcohol delivered to the intervention agency

But what happens to the alcohol that is delivered to the intervention agency and so does not enter the marc-brandy market? It actually accounts for the bulk of the distillation volume, about 90% of the 1.2 million hectolitres of winemaking by-products produced in Europe. This alcohol cannot be sold legally as potable alcohol in the brandy market. It is therefore marketed as alcohol for industrial uses, particularly for incorporation into fuels in countries outside the EU, an outlet that has been in abeyance since 2005, for the manufacture of bioethanol within the Community, for use in yeast-making, etc. The price varies from €10 per hectolitre of pure spirit for industrial uses to €50 per hl for bioethanol production.\(^{43}\)

In the event of the abolition of the distillation subsidy, the shortfalls would be far greater. It is therefore possible to imagine that growers would accept the absence of remuneration for the delivery of alcohol (the price for the delivery of winemaking by-products is €99.50 per

\[^{41}\] \(\left((€27.77 \times 0.25) + (€39.85 \times 0.75)\right) \times 0.01 \times 0.27 = €0.099\).

\[^{42}\] \(\left((€115.96 \times 0.25) + (€147.35 \times 0.75)\right) \times 0.01 \times 0.27 = €0.38\).

\[^{43}\] The selling price of bioethanol has steadily increased. Prices rose from €19 per hectolitre of pure spirit in 2001 to €22 in the middle of 2004, and the latest contracts awarded since April 2005 have been in the order of €45 to €50 per hectolitre. In April 2005, the Commission changed its procedures for the marketing of alcohol for use in fuels, switching from public sales to a tendering procedure. In fact, the estimates of the Commission’s costs in the various reports are based on grossly underestimated prices.
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hectolitre of pure spirit), the waiver being a ‘payment in kind’ for the waste-disposal service provided by the distillery. Supplementary aid of €37.50, representing the difference between the cost of transport and distillation (€87.70) and the return from the alcohol distilled for use in fuel production (€50) could then be paid for the administrative waste-disposal monitoring service (collecting by-products and measuring their weight and alcohol content) through a reliable centralised system. A fraction of the amount presently allocated to this form of aid would be enough to provide a grant for each hectare converted to energy crops.

● The environmental and energy dimension

The abolition of aid for the delivery of winemaking by-products for distillation could result in the disappearance of distilleries that became unprofitable in the wake of such a reform. This opens up a whole debate on the environmental function of distillation. In the countries of northern Europe where white wines are produced, in fact, there is a practice of returning grape marc and wine lees to the soil after they have been composted and spread. This practice seems to raise numerous questions about its supervision. Experts could also debate the problem of greenhouse gases produced in the form of alcohol or by the degradation of this marc. The Commission of the European Communities recently commissioned the consultancy firm Oréade-Brèche to compile a report on the environmental role of wine distilleries, which has been cited by representatives of the wine trade. The distilleries are separating waste products from by-products and are producing other economically useful products from them, such as alcohol, composts, grapeseed oil, tartar and colouring agents. These two dimensions of the problem of alcohol and distilleries merit more thorough analysis.

5. Alcohol distilled from dual-purpose grape varieties (Article 28)

This highly specialised scheme resulted from the establishment of a new CMO in 1979, which made special provisions for the vineyards of Charentes and Emilia-Romagna. ‘It was in 1982, however, that a new regulation established a truly separate status for “wine […] produced from a grape variety listed in the classification for the administrative unit as both a wine grape variety and a variety for use for another purpose”. In fact, it established a requirement that any of this wine which was produced in excess of the normal quantity and not exported was to be distilled. This was the distillation clause contained in Article 40 of the 1982 Regulation, which became Article 36 in 1987 then Article 28 in 1999. In other words, the distillation measure introduced at that time is the “dual-purpose” scheme which is still in force today.’

For a long time, the aim of this special scheme was to resolve the overproduction crisis affecting wines suitable for use in the manufacture of cognac and armagnac. We shall not enter into the complexities of the scheme in this report. The fact is that negotiations between France and the

44 The biofuel dimension should also be taken into account, since Europe has developed biofuel projects in which the wine sector, astonishingly, plays no part. Bioethanol, as well as cutting energy bills, would produce an energy-efficiency quotient (energy recovered ÷ non-renewable energy consumed) of 2.05, compared with 0.873 for petrol. It also achieves a net reduction of 60% in greenhouse-gas emissions. The selling price of bioethanol currently varies between €45 and €50 per hectolitre of pure spirit, and in France it benefits from a reduction of €37 per hectolitre of pure spirit in the national tax on petroleum products (TIPP) and a specific exemption from the general tax on pollutant activities (TGAP) that is applied to other fuels.

45 Rapeseed grown as an energy source could be supported by means of public aid amounting to €45 per hectare of food crops converted to the cultivation of energy crops, subject to an EU-wide ceiling of 1.5 million hectares.

Commission have served to maintain a transitional arrangement that was supposed to end in the discontinuation of the dual-purpose scheme by 2006 at the latest. The solution recommended by France is the establishment of a blueprint for the future of the Charentes vineyards as part of the contractual framework applicable to registered designations of origin; this would assign the vineyards of Charentes to specific purposes, namely cognac, Pineau, table wines, vins de pays and products of viticultural origin intended for processing. When the new CMO is introduced, therefore, this scheme should finally disappear. The remedial grubbing-up measures in these vineyards and the distillation of the quantities normally vinified (QNVs) will serve to smooth the transition by gradually adjusting the production structures.

The proposals for reform of this aspect of the CMO, then, are merely anticipating an adaptation process that is already under way. In any case, the budgetary impact of the scheme was fairly limited; at €15 to €30 million, it accounted for only about 5% of the budgetary appropriation for distillation measures.

6. Distillation of potable alcohol (Article 29)

The rationale behind this distillation measure, introduced in 1999, is now well known and is summed up by the Commission as follows: ‘The aims are manifold: (1) to withdraw the expected surplus from the market at the beginning of the marketing year in order to exert a positive impact on prices (and, consequently, on producers’ incomes); (2) to improve the quality of the wines sold by withdrawing poorer quality wines from the market; (3) to supply the potable alcohol market, by making available to the spirits industry and to producers of brandy and liqueur wines raw material (wine alcohol) from the Community at a price rendered competitive through aid. This market, which was in the region of 14 to 15 million hectolitres of wine up to the end of the 1990s, currently ranges between 10 and 12 million hectolitres. The potable alcohol market is thus subsidised and, by way of compensation, there is an obligation to pay a minimum price for the raw material (wine).’

The mechanism of price-fixing and aid is the same as for alcohol made from grape marc, except that the price paid to producers is far higher and there is no intervention (see Figure 109). Every year, distillation is only opened for a fixed quantity, corresponding to the estimated volume of market demand for potable alcohol. The price paid to the producer, which was set by the Commission, matched the price payable for preventive distillation under the previous CMO. This price did not vary between countries or regions, because we are still within the scope of the single market. The low price level meant that the guaranteed outlet of potable-alcohol distillation gradually dwindled in importance, leaving producers of cheap wines for which no market could be found as the only regular users. This form of distillation, in fact, was chiefly used by producers in the Castilla-La Mancha region in Spain and in the major Italian wine regions of Apulia, Sicily, Emilia-Romagna and the Abruzzi.

It cannot really be said that any vineyards specialised in the production of wine for this purpose, but these regions, whatever their yields, found a stable outlet paying a guaranteed price, which was often close to the market rate for table wines, especially for white wines. We had such a vineyard in Languedoc in the 1980s which managed to be profitable because of its high yields and which regularly supplied the distillery. The introduction of compulsory distillation for a low price, which increased with the yield of a vineyard, finally sealed the fate of that vineyard and accelerated the process of qualitative conversion.

In some of the aforementioned regions, the absence of other production options and the important role played by distillation in terms of the income distributed to producers through the

support scheme for the distillation outlet make it very difficult to abolish that form of intervention. Abolition presupposes the introduction of other compensatory mechanisms in tune with the new CAP guidelines, such as decoupling. So far, however, this scenario has not been embraced in the Commission’s proposals.

Another problem that arises is the distribution of distillation activity within the territory of the Union. The new CMO and the proposed price have effectively excluded France from the distillation scheme. The potable-alcohol outlet could be supplied through the distillation of by-products or even by crisis distillation of stockpiled wine during periods of surplus. In this case, however, the benefits would accrue to a different set of countries. As soon as access to this market starts to depend on cost prices, it will be time to consider the option of developing or creating vineyards to be truly specialised suppliers of this outlet. When that time comes, the productivity of the Charentes vineyards, with yields that can reach 160 or 180 hectolitres of wine with an alcohol volume of 8 or 9%, could serve as a reference point for such deliberations.

In the final analysis, the main point about the distillation of potable alcohol is that the scheme has achieved the third objective set by the CMO of 1999, namely the provision of a regular outlet. Because of the incomplete restoration of market balance by crisis distillation and the major fluctuations of vintage levels in an open market, the impact of this measure on prices at the start of the wine year and on quality enhancement is secondary. In short, the onus of regulating harvest fluctuations rests entirely with crisis distillation. Aid from the EAGGF thus resembles the subsidisation of alcohol consumers and ensures that all the other forms of alcohol production feed the surplus.

7. Alcohol from crisis distillation (Article 30)

The aim of the measure is to: (1) eliminate specific pockets of surplus; (2) guarantee continuity of supply from one vintage to another. This type of distillation has existed for a long time in the common organisation of the market, but since the 1999 reform two substantial amendments have been introduced: (a) its application is subject to acceptance of the Member State’s request but is voluntary on the part of producers and may be restricted to certain categories of wine or certain production areas. It may be applied to quality wine psr only at the request of the Member State concerned; (b) it may affect not only table wines, but also quality wines. One of the criteria for introducing the measure is a demonstrable deterioration, over time, in the market price for a specific category of wine or for wine from certain production areas.48

The price paid is also fixed, but it can be varied by country and by product quality. France, for example, receives a higher price, and the price paid for QWPSRs is higher than that for table wines. Here too, the alcohol is delivered to the intervention agency so as not to disrupt the market in potable alcohol. Its value is therefore realised at the price of industrial alcohol or of fuel alcohol.49 This surplus could be stored and used to supply the potable-alcohol market. A distinction will have to be made between the regions that ‘habitually’ produce potable alcohol and those that are engaged in efforts to eliminate their surpluses.

Created during a period of relative market balance, this distillation measure, along with private storage, has become the main instrument for the regulation of a fluctuating supply in the market.

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49 Growers of numerous other major crops, such as beet and wheat, aspire to benefit from the status of fuel-alcohol providers, which should put the analysis of this product into perspective. Conditions in this market will therefore depend on the performance of all processing chains and the associated rules and regulations, especially the tax rules.
It poses major management problems: (1) being optional, the measure is faced with the classic problem of collective free riding, as producers or regions wait for others to distil so that they can benefit from the subsequent increase in prices; (2) prices are set at a low level because of a concern to avoid creating a permanent, stable and remunerative outlet; this further reduces the incentive to sign up to the distillation scheme; (3) it is activated late, is insufficiently effective and is driven by the pressure of an enduring crisis; (4) it generates additional ‘local’ mechanisms to offset these weaknesses: national quality-based price top-ups, appeals to collective solidarity to motivate producers and the use of indirect threats, such as the arbitrary setting of yields in regions with registered designations of origin; (5) this distillation measure is ultimately costly because the wines cannot be channelled into the spirits market, which has already been supplied to saturation point through the potable-alcohol distillation scheme; (6) its efficiency is limited by the opening of markets; as in the case of grubbing-up, any measure to control supply partially and indirectly benefits competitors in the New World; (7) this intervention measure does not comply with the WTO rules, because it affects prices.

This distillation measure actually represents the major argument in the reform proposals presented by the Commission. As a matter of fact, the Commission is proposing its abolition! Can the wine sector function without regulatory intervention in the market? Alternative strategies can be proposed, based on certain elements in the Commission’s scenarios that were discarded:

- improving the operation of the scheme through more rapid intervention, a return to compulsory elements, price differentiation and differentiation by product type or by region (scenario 1);
- reducing the budgetary impact of the scheme by rebalancing the market in wine-based alcohol and through price intervention (scenario 1);
- more precise targeting of market segments that are out of balance, leaving the choice to the regions in the framework of a national budgetary envelope (scenario 2);
- adoption of decoupling measures designed to stabilise the highly volatile price trends that will ensue from the abolition of the intervention mechanisms (scenario 3).

8. Conclusions

The market in alcohols associated with the distillation measures is a totally administered market. The prices paid to producers are fixed by regulations, as are all the distillation margins and the ‘acceptable’ market price. Since it seems difficult not to cover the cost of distillation, the budget could be modulated by means of the two other variables, namely the price paid to distillers and the selling price of the distilled alcohol. For example, the price for the distillation of alcohol could be halved and distillers ‘compensated’ by means of direct aid.

Most alcohols derived from wine lend themselves to substitution – the choice of definition and destination modulates the beneficiary or beneficiaries of the mechanism. The restriction established by the regulations could therefore be challenged. For example, winemaking by-products delivered for distillation could be used for potable alcohol. In that case, distillation activity could be pursued in France, but the volume of potable-alcohol distillation under Article 29 would have to be reduced accordingly.

Environmental functions are not taken into account: the role of the distilleries should be assessed in the light of the environmental service they perform by removing and processing waste products. The energy functions, particularly the contribution of fuel alcohol to the pursuit of pro-bioethanol policies, merit analysis in their own right.
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It would be difficult for the wine sector to manage without a regulation mechanism, given the price volatility associated with harvest fluctuations and inelastic demand. The operation of crisis distillation could be improved and costs reduced in the framework of a harmonisation of the CMOs for wine and wine alcohol. The more precisely targeted aims of the regulatory system could be achieved at the regional level and limited within the framework of the national envelopes. Income stabilisers could be introduced.

Chapter 5: Enrichment

The Commission’s proposal on enrichment comprises three components. The first two relate to the regulatory aspect with, on the one hand, the prohibition of chaptalisation 50 and, on the other hand, the reduction in the maximum level of enrichment. The last component is budgetary and proposes the abolition of aid for the use of concentrated grape musts and rectified concentrated grape musts.

Enrichment is a remedial technique necessitated by the vagaries of the climate. Whatever precautions vine growers may take, temperatures and rain can lead to insufficient grape-sugar content. For almost a century, the role of this practice in wine surpluses has been the subject of debate. In 1929, the division of France into two wine-producing sectors was based on chaptalisation, which was prohibited for table wines and the southern regions but authorised for the wines with registered designations of origin (AOC wines) in the northern regions and Bordeaux. It has always been limited in quantity, although it has also invariably been quite difficult to verify compliance with the prescribed limits. It was regarded as a source of overproduction of table wines in an area of activity where yields were not subject to control. It was accepted for AOC wines to the extent that yields were voluntarily limited as part of the quality-centred policy of awarding designations of origin.

This opposition was maintained until the 1960s, when the Murret-Labarthe report recommended the application of ‘one law for all’, in other words the provision of compensation for the difference between the price of extraneous sugar (sucrose from beets or sugar canes) and that of endogenous sugar from concentrated grape musts and rectified concentrated grape musts, in order to put all wine producers on an equal economic footing. That provision was incorporated into the first wine CMO. When overproduction crises occurred, however, the discussion resurfaced. The main economic issue stems from the fact that chaptalisation involves the use of an additive. By transforming the added sucrose into alcohol, it makes wine marketable which could not otherwise be sold for want of sufficient alcoholic content. Recourse to concentrated and rectified concentrated grape musts, on the other hand, is a subtractive method which eliminates part of the water content and thereby reduces the volume of wine. A study conducted in the late 1980s at the request of the Commission estimated that chaptalisation had added a total of some 15 million hectolitres to the volume of wine in Europe. 51

At that time, two uncertainties were nevertheless raised, one being the possible quality bias and the other concerning the verification of compliance with a ban on chaptalisation. The first was

\[50\] Jean-Antoine Chaptal (1756-1832), French chemist and politician, Minister of the Interior under Napoleon I, perfected the ‘chaptalisation’ of wines, which he described in his book L’Art de faire les vins (‘The Art of Winemaking’), first published in 1801. The method involves adding sugar from a source other than grapes (sugar beet or sugar cane) to the grape must before or during fermentation. The term ‘sucrose’ is sometimes used.

resolved by a set of technical studies conducted throughout Europe and summarised in a report by Pierre Dupuis.\textsuperscript{52} The second was resolved through the development of a patented method of determining the origin of sugar in alcohol by means of nuclear magnetic resonance.\textsuperscript{53} Thereafter, the Commission funded a network of laboratories and a reference database with a view to applying the new method. In spite of this, a ban on chaptalisation has never been obtained.\textsuperscript{54}

The status quo having prevailed, the Commission continued to believe that aid for the use of concentrated musts and rectified concentrated musts was a source of surpluses and overenrichment. Levels of enrichment, it argued, would be all the higher if the premium encouraged producers to increase yields which they could subsequently correct with the aid of subsidised concentrated musts. The two phenomena certainly coexist, but it has always been difficult to assess the role of the climatic effect in relation to that of the incentive effect of the premium. Econometric studies have shown that the full scope of the premium has not been used and that the percentage of wine volumes enriched through the premium scheme varies with the average level of natural sugar content in the grape harvest.\textsuperscript{55} These findings weaken the hypothesis about ‘premium hunters’ but have not demolished it. Low-priced sucrose is open to the same criticisms.

The issue resurfaces in negotiations with partners outside the European Union. In fact, countries of the New World, particularly Australia and the United States, do not use chaptalisation but employ subtractive techniques such as reverse osmosis. It is therefore becoming difficult to persist in a conservative stance on practices such as the addition of wood chips or water or the blending of wines from different countries when we continue to use an extraneous additive, even though it is a traditional practice. Some support the view that production practices should be indicated on wine labels to give consumers the final say.

In this context, the Commission’s proposal is the most rational, even if it has taken 20 years of compromise to materialise. Prohibiting sucrose for the sake of harmonising the rules of winemaking will put us in a strong position in negotiations within the WTO or in bilateral frameworks when it comes to defending or trying to prohibit other practices. In one fell swoop we would also be reducing a source of surplus production, because the subtractive method involving the use of concentrated grape musts and the limitation of the authorised level of enrichment would also promote less intensive cultivation techniques. Lastly, since the cost differential between the two methods would no longer be a problem if one of them were banned, there would no longer be any justification for the compensatory subsidy.

The only remaining constraint would be the increase in the cost price of wine produced in the more northerly regions, particularly in Germany and Hungary. For wines in the lowest price bracket, the increase could be as high as 20 to 30%, which would pose problems with regard to outlets and competitiveness. One solution would be compensation through the national envelopes, especially for those countries that make little use of the other intervention measures such as the distillation schemes for by-products and potable alcohol. Experience of the

\textsuperscript{52} Research Director at the Oenology Department of the French National Institute for Agricultural Research (INRA).

\textsuperscript{53} The system was patented by a married couple, Gérard and Maryvonne Martin, researchers at the National Scientific Research Centre in Nantes.

\textsuperscript{54} Speeches made by German MEPs in the European Parliament, which are reminiscent of contributions to the stormy debates of bygone days, have revealed the extent to which this matter is still a source of tension.

\textsuperscript{55} Dubos, J., Montaigne E., \textit{Economic aspects of the enrichment of wine}, 1990, op. cit.
enrichment issue and the initial reactions of some organisations\textsuperscript{56} show that a compromise on this subject will still be difficult to achieve.

\textsuperscript{56} AREV, Draft resolution on the proposal for the reform of the Wine CMO drawn up by the Directorate for Agriculture and Rural Development, 20\textsuperscript{th} AEWR International Council, Brno, Moravia, 27-28 July 2006, 5 pp.
Reform of the common organisation of the wine market
Part 4: Specific proposals for reform of the CMO

In order to make specific proposals for reform of the CMO, we intend to introduce some analyses which are not normally taken into account in any examination of the common wine policy, or which tend to receive extremely superficial consideration. These analyses should foster a better understanding of certain difficulties encountered by the CMO and thereby lead us towards more appropriate proposals. In the first chapter, for example, we shall try (1) to explain how the countries of the New World and the southern hemisphere have come to capture a dominant share of the UK market, (2) to summarise the reasons for the Australian overproduction crisis and the mechanisms used to manage the crisis in order to understand more clearly how that country, as a new major player in the world market, dealt for the first time with the very difficulties that Europe faces, (3) to outline the dynamics of companies in the global fringed oligopoly of the wines and spirits sector, companies whose financial strategies are interfering with the major international trade flows, (4) to assess the experience of the neighbouring fruit and vegetable sector with regard to the creation of producers’ organisations and, finally (5), to understand the logic of decoupling and direct payments in the wine sector. These analyses will enable us to make a set of proposals in chapter 2 that take account of both the specific difficulties of the CMO which we have just enumerated and the additional considerations that are explained in detail in this part of the study.

Chapter 1: Supplementary analyses

1. Conquest of the UK market by the New World

A review of the main reasons why growing shares of the UK market have been captured by the New World wines from Australia, Chile, South Africa and the United States, to the detriment of the ‘Old World’ wines from France, Germany, Italy and Spain, is an essential starting point. The problems that the CMO reforms proposed by the Commission seek to address are actually rooted in the narrowing of the gap between European exports and imports, and this reduced differential is explained to a great extent by trends observed in the UK market (see Figure 53).

After a period of rapid growth, sales of wine from new producer countries have now overtaken sales of wine from the traditional producer countries in the UK market, particularly in the ‘off-trade’ outlets such as large and medium-sized food stores and off-licences, where wines are bought to be drunk elsewhere. Wines from these new producer countries have had a limited impact, by contrast, in ‘on-trade’ outlets such as cafés, hotels and restaurants, where wines are consumed on the premises. Although the on-trade sector is still dominated by French wines, its share of the market is gradually dwindling. It is therefore clear that it would be wrong to abandon the quality rationale behind wines with registered designations of origin and QWPSRs and only try to emulate the New World.

The truth is that consumers in the United Kingdom have never lost interest in wines from the traditional producer countries, but the growth of the UK market is explained by the advent of new types of wine, backed up by customer-friendly innovations, namely accessible fruity wines, simply and attractively labelled and forcefully marketed. It is also explained by a professional approach to wine marketing in these new producer countries. The inertia of businesses in

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57 This review was compiled in partnership with Nicola Engelbach, Richard Halstead and Rosy Goodrick of the London-based consultancy firm Wine Intelligence, which specialises in the marketing of wine in the United Kingdom.
traditional producer countries contrasts with the commercial dynamism of those in the new producer countries. The key factors of their success, in short, are production methods, cultivation practices, the structure of the supply chain, quality control and regulation, as well as innovation and marketing strategies, which are the main components of dynamism.

- **Vine-growing practices and wine production**

The companies of the new producer countries have benefited from the transfer and inculcation of the best practices and techniques used in the traditional producer countries. These practices and techniques have been adapted to the production of wine on a large scale. Conversely, growers and wine specialists in the traditional producer countries are benefiting today from learning the techniques and practices of these new producers in areas such as fermentation and élevage. The transfer of knowledge, in short, works in both directions. Growers and wine specialists in the new producer countries, on the other hand, have more latitude to explore new ideas and opportunities, especially as regards selection of plants, irrigation, pruning and harvesting. The result is products that are more adaptable and more responsive to market trends.

Secondly, most wineries in the new producer countries use modern technology and equipment, which enables them to produce, on a large scale, products that are characterised by consistency of quality, combined with practices that are generally prohibited in traditional producer countries, such as the use of wood chips and the addition of flavourings. This situation enables them to keep their production costs relatively low. In the traditional wine-producing countries, numerous producers possess modern technology and use mechanised systems, but the wine industry still remains heavily dependent on human capital, which makes for high costs. Moreover, the use of traditional methods does not offer the same guarantees in terms of consistent quality of the final product. In addition, the structure and level of turnover among businesses in the new producer countries enable them to make economies of scale, particularly in their commercial operations, which are out of reach of businesses in the traditional producer countries.

- **Distribution**

Businesses in the new producer countries have managed to secure a competitive edge in the realm of distribution. They respond more effectively to the expectations of wine buyers, particularly in terms of product coherence, reliability of delivery and product availability, thanks to large production volumes and highly professional key accounts. Buyers keep a sharp lookout for possible frictions arising from unreliability or lengthy delivery times. In this way they avoid problems that can arise with regard to quality and stocks, thereby reducing their supervision requirement and avoiding disruption of deliveries further down the supply chain.

Being able to purchase wine from a limited number of suppliers who are able to deliver large volumes reduces the number of interactions that are needed between buyers and sellers and thereby serves to optimise business relations. In this respect, the inability of most small and medium-sized enterprises in the traditional winemaking countries to enter into a business relationship that meets the expectations of wine buyers in the United Kingdom is a considerable handicap.

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58 The expression ‘added flavour’ seems to be in general use, though without any indication as to whether the additive is oak powder or other aromatic compounds that are prohibited under the present rules.
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- **Different approaches to quality control and to regulation**

Unlike the supply of wine from the new producer countries, the European systems of designations of origin are perceived in the marketplace as complex and ill suited to the needs of consumers and to present-day distribution channels. Most of the new producer countries have a generic body, such as Wines of South Africa, Wines of Chile or Wines of Australia, which is responsible for promoting the country’s wines. Another body is responsible for quality control in respect of exported wines. The Scheme for the Integrated Production of Wine (IPW) in South Africa is an example of such a body. These two kinds of organisation contribute between them to promotion of their country as a brand in international markets, and help to ensure consistency of quality, price and brand identity. Constrained by the current regulatory system, businesses in the traditional producer countries are simply unable to offer wines with a quality-price ratio that matches the demands of today’s consumers.

- **Brands, marketing and strategies**

Beyond the differences in the factors of production and in the approach to distribution channels, businesses in the new producer countries distinguish themselves by the power of their marketing strategies. For example, the budget of Ernest & Julio Gallo for 2002 was estimated at about 37.2 million US dollars. At the beginning of 2006, the French Government announced its intention of doubling its financial support to the wine industry by allocating it a budget of $18 million. Another distinguishing feature of businesses in the new producer countries is their creative and responsive approach, which entails conducting surveys, running targeted promotional advertising campaigns, sponsoring sporting and cultural events and using the latest forms of communication technology, including text messaging.

Unlike their counterparts in the traditional producer countries, the generic promotion bodies in the new producer countries are responsible for promoting several industries simultaneously. The existence of a single centre through which the whole country can be promoted avoids dissipation of effort and makes it easier to run generic promotional campaigns. **In short, the combination of considerably larger promotion and advertising budgets and the coordination of the efforts of promotion-support institutions go part of the way to explaining the success of the new producer countries.** This recipe has enabled many wineries from the new producer countries to invest in detailed analyses of the UK market. Businesses in the traditional wine-producing countries recognise the need to invest in marketing and to respond to customers’ expectations, but they do not possess the same knowledge of the market and are consequently unable to launch marketing campaigns targeting specific segments of the market.

Brand names also play a decisive role in the success of businesses from the new producer countries in the UK market. New World brands have helped to demystify wine and to present it to consumers as an accessible and intelligible product. Brands such as Blossom Hill, E&J Gallo or Wolf Blass are easily memorised through their name and their packaging. Consumers can easily identify these brands on display shelves and decide to buy them without first having to look for additional information, because the combination of price, packaging, brand name and sales outlet sends out the required signal.

A limited number of businesses from the traditional wine-producing countries, such as French Connection, JP Chenet and Campo Viejo, are just starting to show an interest in this approach. The association of brand and variety and their appearance on the label are one element in the success of the strategies pursued by businesses in the new producer countries. In the traditional

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59 Côtes-du-Rhône has started to sponsor cricket.
producer countries, the region of production is often the main identifiable element for the consumer; Rioja, Chianti and Châteauneuf-du-Pape are examples. Consequently, producers should focus more strongly on the promotion of brands, based on celebration of the characteristics of their region.60

Close attention is paid to the needs of consumers who are not great wine connoisseurs but seek pleasant, simple, easy-to-drink, reliable, recognisable and consistent wines. The businesses of the new producer countries place their products where market prospects are best in order to meet the needs of consumers. This consumer-led sales policy contrasts with the producer-led approach of businesses in other producer countries, which create products before having found an outlet for them. The success of a wine is not based on its origin but rather on business strategies. The contrast is reflected in labelling, with simple labels and brand names on one side and on the other side complex labels struggling to convey their message.

- **Implications for the CMO**

The Commission’s proposals on the labelling and classification of wines are entirely driven by these considerations. The real question relates to the level of definition of the marketing rules. Although a label can be complicated (see Figures 95 to 99), the combination of optional and compulsory indications opens up numerous possibilities. The appearance of new labels intended for these export markets, very similar in their design characteristics to those of competing brands, certainly shows the scope that is already available under the present regulatory framework.61 The only real difficulty relates to the fact that it is currently impossible to put the name of a grape variety on a table wine. The fact is, however, that most varietal wines are classified and marketed as *vins de pays* in France, *vinos de la tierra* in Spain and *vini tipici* in Italy. In order to compete with the wines of the New World by marketing products of the same category, we must give some thought to the size of the geographical area covered by the *vins de pays*. A broad catchment area like the one permitted in the *Vin de pays de France* project or in the new category of *vino de la tierra* known as *Viñedos de España* (‘Vineyards of Spain’) provides every opportunity to create a single source of large volumes of wine. In all other respects, the rules of production, especially those relating to yields, will determine the level of competitiveness. The main aim of this change, of course, is competition between segments of the wine market.

Accordingly, it does not seem to be imperative to reform the labelling rules and the classifications of wines in order to develop a system of marketing attuned to the UK market and modelled on strategies from the New World. The choice between giving precedence to *vins de pays* from vineyards that have already made the effort to develop their grape varieties and favouring table wines, which account for large volumes and whose producers would like to benefit from the support of the varietal name, cannot be made on objective grounds. It is very much a choice between wine-producing regions and between businesses, and must therefore be the subject of a political decision.

The second dominant point in this analysis relates to the size and commercial resources of businesses. It focuses our attention on the dynamic growth of global firms, which we shall address in section 3, and clearly illustrates the need to redirect some resources to the lower end

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60 By way of example, the success of the Campo Viejo brand can be attributed in part to the efforts of the brand owner to make Campo Viejo synonymous with the Rioja region.

61 The *Fruté Catalan* brand uses the same label design for its entire range of wines under the regulatory framework for Côtes du Roussillon AOC wines and the framework governing *vins de pays* in the Côtes catalanes region.
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of the supply chain, as the representatives of the wine trade are demanding. The Commission could therefore make proposals promoting formal link-ups between businesses.

2. The Australian overproduction crisis and adaptation of the wine sector

Since the end of the 1980s, the wine sector in Australia has become a model of success, particularly in the domain of exports. Production and export growth, however, are slowing down, with business bankruptcies, terminations of contracts for the supply of grapes and the collapse of the grape prices paid to growers. This leads us to ask questions about the severity of the crisis, its mechanisms, the role of the various players, the solutions devised, the ways in which they have been implemented, and the lessons that can be drawn for the management of the European wine sector.

• Australian wine ‘crisis’: the facts

During the period from 2004 to 2005, stocks of still wines increased to almost 19 million hectolitres.62 About half of these are regarded as surplus stocks, weighing heavily on prices and on the proper functioning of the wine trade. The crisis63 is likely to continue for another three or four wine years until an acceptable stocks-to-sales ratio of 1.58:1 is reached. These forecasts are based more on the expectation of successful wine sales – a rise in the ‘assessed demand’ curve – than on any drastic reduction in wine stocks.

The glut of grapes has been fuelled by excessive vine planting in the course of the last ten years.64 There are two reasons for this. Firstly, it was a reaction to the success of Australian wines in export markets. In order to satisfy the demand for grapes, a number of growers were encouraged to plant, either by the wineries to which they were contracted or by the price signals coming from the market. The second reason was the arrival in the vine-planting ‘market’ of investors who wanted to put capital to work or were seeking to invest in a sector with high potential returns. The depreciation and taxation system that existed until 2004 increased the appeal of these investments. A vineyard could, in fact, pay for itself within three to five years and start to yield a return on investment.

The combination of these two factors thus drove growers to overproduce, although the surpluses affected some grape varieties more than others. Accordingly, varieties in high market demand, such as Shiraz, Colombard, Merlot and Semillon, are still being planted in Australia. In other words, the crisis has not stopped the fine-tuning of the market.65

The return to a satisfactory balance between supply and demand in the grape market is ‘scheduled’ for 2008 or 2010. Since the market is not regulated, an increase in the quantity of grapes produced triggers a decrease in price. In the Riverland region, the average price per tonne, which stood at 650 Australian dollars in the period from 2000 to 2002, slumped to $A 578 in 2003, $A 531 in 2004 and $A 453 in 2005. The average price for all grapes in Australia rose from about $A 400 in 1992 to about $A 1 100 in 1998 but had fallen to $A 800

62 Figure 101 shows the extent of the grape-glut crisis in Australia
63 The Winemakers’ Federation of Australia (WFA) rejects the idea that there is overproduction in Australia. In its view, the problem is rather one of structural imbalance, relating especially to certain grape varieties used in the production of red wine. This imbalance, according to the WFA, also manifests itself in the shortage of the grape varieties grown in some regions.
64 See Figure 102: Planting of vines in Australia, 1997-2010.
65 Transposed to the EU, this would justify the pursuit of vineyard restructuring in times of crisis.
by 2004.\(^{66}\) The problem, then, is undoubtedly one of surplus grape production rather than any major difficulty in selling Australian wines.

- **Highly concentrated structure of the wine industry**

The Australian wine industry (winemaking and marketing) is a fringed oligopoly. Foster’s Group Ltd, which owns firms such as Southcorp and Beringer Blass Wine Estates, has about a 44% share of the market, Hardy’s Wine Company, a subsidiary of Constellation Brands, has about 20%, and the Orlando Wyndham Group, a subsidiary of Pernod Ricard, has about 13.6%. These large companies, however, coexist with a multitude of very small cellars. In fact, 65% of the Australian wineries transform under a hundred tonnes of grapes, equivalent to some 7 000 cases of wine.\(^{67}\) The number of growers stood at 8 350 in 2003/2004, producing a turnover of some $A 1.7 billion.\(^{68}\) In 2004/2005 the big four wine companies accounted for 6% of production destined for the domestic market. About 80% of all growers own fewer than 50 hectares.\(^{69}\)

This domestic market is controlled by two food-retail chains, Coles and Woolworths Ltd, which offer wines at very low prices, wines with the distributor’s label or unbranded (‘cleanskin’) wines. The Dan Murphy’s chain, a subsidiary of Woolworths Ltd, has been selling wines at $A 1.99 a bottle in 50 Australian liquor supermarkets.\(^{70}\)

The fall in prices has cut the profit margins of medium-sized wineries. According to a survey conducted by the Deloitte consultancy firm, medium-sized wineries were the main loss-makers in the wine trade in 2005. For the larger wineries, pre-tax profits were perceptibly lower than in 2004 because of the increase in marketing costs. Internationally, the overvalued Australian dollar has reduced the competitiveness of Australian wines in export markets.

The industry may thus be divided into two parts.\(^{71}\) The first, described as the commercial sector, comprises the very large Australian enterprises that benefit from economies of scale to produce large volumes at low cost. Highly advanced in technological terms, they are benefiting from overproduction to buy in supplies at low cost. The second part, described as the ‘premium-plus sector’, comprises the small businesses. They benefit from their reputation, putting their winemaking know-how at the service of more mature consumers, and forge special relationships with buyers such as retail outlets and restaurants. An analysis of the annual reports of Australia’s three largest operators – Foster’s Group, Constellation Brands and Pernod Ricard – gives no indication of any particular financial problems.

It may therefore be stated that, in general terms, the overproduction crisis benefits consumers, who are able to buy wines more and more cheaply from the large distribution chains, which use their weight to improve their profit margins. It also benefits the very large wine-producing companies, which exploit the excess supply of grapes to negotiate ever-lower purchase prices. The losers in this crisis are the independent growers, who can

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\(^{69}\) It should be noted that these figures do not include the vineyards owned by Foster’s Group Ltd and Orlando. These companies’ grape production is therefore directly reflected in their wine production.


no longer find buyers for their grapes or who have seen their profit margins shrink in the wake of falling prices.

- **Strategy of growers in the face of the crisis**

Generally speaking, there has been no national plan to structure or limit planting over the past few years. Only a small number of operators have drawn up planting plans. For the years to come, planting programmes will tend to take the form of a rationalisation of old vines and poorly performing varieties. They will be replaced with younger vines and with the varieties demanded by the markets, growers being guided in their efforts by the wineries. A cost-cutting strategy is also envisaged. There are no investment subsidies or operating subsidies in Australia. The only cost reduction that exists relates to fuel. **Public intervention at the production stage, in other words, is fairly limited.**

The percentage of sales made on the spot market is rising. This increase is more significant in the regions that supply the ‘raw material’ for basic wines than in the more renowned regions such as Coonawarra. As far as contractual sales are concerned, the system appears to be very ‘flexible’ in the sense that, when overproduction occurs, any pretext seems to justify the renegotiation or even the termination of a contract, sometimes without compensation. The wineries therefore have the upper hand and use their bargaining power to lower the purchase price of grapes. This situation is possible to the extent that the biggest wineries also have their own vineyard. In fact, the advantage enjoyed by the wineries is put into even starker relief in the case of an adjustment supply of varieties of standard or ‘basic’ quality.

In the event of overproduction, growers are dependent on buyers. Some have put their vineyards into ‘hibernation’, others have left the market, and others again are converting their vineyards to grow varieties that are more lucrative because the wineries still need them. In general terms, purchase prices are tending to fall. At the same time, because of the need to attract prospective buyers, grape quality is tending to improve in relation to price. The situation will therefore return to normal through the elimination from the market of a number of growers, which will lead to a price recovery.

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72 The analysis of growers’ behaviour is based on a survey conducted in May 2006 by Hervé Remaud of the University of South Australia, Adelaide, among five Australian growers’ associations: King Valley Vignerons, Mudgee and Hunter Valley (response from a representative of Orlando), Riverland, Coonawarra – Limestone Coast and Murray Valley Wine Grape Association.

73 In the case of Southcorp, for example, the plans were based on previously selected grape varieties.

74 A study conducted as part of the quest for solutions to the overproduction crisis revealed that potential for economies of scale still existed. The total cost of production, including 8% interest on capital, was found to range from $A 763 per tonne of output for a holding of under 10 hectares to $A 636 per tonne for a holding of 10 to 50 hectares, $A 430 per tonne between 50 and 170 hectares and $A 330 per tonne between 170 and 600 hectares (Government of South Australia, 2005).

75 We define as a spot market all those transactions that are conducted privately on an ad hoc basis at the time of the vintage or shortly afterwards without further commitment or agreement on anything but price and quantity. It therefore complements contractually based transactions or serves as an alternative to them.

76 The term ‘hibernation’, which is also used in French, means, in the figurative sense, a state of inertia and non-productivity. It is used to indicate the practice of minimal maintenance of vines – reduced plant-health treatment and no harvesting – with a view to minimising production costs while waiting for the market to recover. This practice is clearly less costly than grubbing-up followed by replanting when the market recovers. It is similar in principle to the Spanish ideas on summer pruning.
Effectiveness and future of the contracting system

Contracting is not about to disappear from the Australian wine trade – on the contrary. The course pursued by the largest companies has been to refocus on their core business, which is the manufacture and marketing of wine, not the production of grapes. One way in which they could optimise their performance and maximise their investments is precisely by outsourcing capital-intensive activities that are not critical to their business. The fact that grapes are these companies’ basic raw material does not mean that the companies themselves need to possess vines. The company can divert its financial resources to marketing in order to boost its sales while buying in its grapes at a low price from a flooded commodity market. This means that contracts are still essential to the proper functioning of the wine trade, even if it means making their provisions more flexible, chiefly through renegotiation.

A unique form of cooperation enables growers in the Barossa Valley to protect themselves from price fluctuations. This is a partnership between Hardy’s Wine Company and Barossa Valley Estate (BVE), an umbrella body for growers organised in the form of a cooperative. The wine produced by the growers is delivered to Hardy’s for marketing. This enables Hardy’s to market the wines of the Barossa Valley, which fill a gap in its portfolio. It also enables BVE and its growers to benefit from the marketing power of a company like Hardy’s, which is a subsidiary of Constellation Brands.

The contributions of the Australian liberal economic model

The Australian economy took a more liberal turn in the mid-1970s, a shift initiated under the government of the centre-left Australian Labour Party. Given an internal market of limited size, the only way for Australian businesses to grow is by exporting, hence the need for the Australian Government to lower tariff barriers and advocate freer trade. The result of the policy at that time was that a number of operators, or enterprises, were unable to stand up to foreign competition.

The wine industry was thus built on a foundation of trade liberalisation. For this reason, it seems to be out of the question to protect companies again with state aid, which would allow ‘underperforming’ companies to survive. According to Mike Rann, Premier of the state of South Australia, and contrary to the situation we have experienced in Europe, the best way for growers to confront the overproduction crisis would be to sell more wine, not to subsidise the unsold surplus with state aid.

This point of view reflects a line of management policy that is encountered throughout the various sectors of the Australian economy. The role of government policy is not to support production, which could help to keep substandard products on the market. In the Australian system, it is up to businesses to win a vote of confidence from the consumer; it is not the task of government to protect or bail out unprofitable enterprises.

Solutions and incentives adopted

The main solution to this situation of overproduction is thus for companies to sell more wine, especially overseas, while rationalising their planting and grape production for future years. For the wine industry and the Australian Government, this means supporting the market in Australian wines by promoting them.

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77 ‘It’s not in our interest to see that everyone survives’ (Stephen Strachan, Chief Executive of the Winemakers’ Federation of Australia).
Conscious of the decline in the export value of a bottle of Australian wine in recent years, from $A 4.44 in 1998 to $A 3.93 in 2006, the Australian Wine & Brandy Corporation (AWBC) and the Australian Wine Council launched a promotion campaign in 2004 with a view to demonstrating that Australia also has high-quality wines. The main vehicle for this campaign is tourism in Australia, and the leading Australian companies are spreading the word in their publicity campaigns.

- **To sum up …**

There is practically no government policy on the wine sector in Australia, certainly not in the European sense, although there are regulations concerning production methods. The way the Australian system of designations of origin works is that producers can use the designation Barossa Valley, for example, if – and only if – at least 75% of the grapes come from that region, but there are no other requirements governing the nature of the blend. In the absence of a wine-sector policy limiting quantities produced and yields, the industry is regulated by the market.

The only real government policy relating to wine production in Australia consists in promoting Australian wines, both in the internal market and overseas. In that respect, the promotion policy serves as a link between supply and demand at the top and bottom of the supply chain. The link at the foot of the chain takes the form of statistical analyses and market research conducted by the AWBC or the Wine Export Council. These data are available and can be consulted by Australian businesses. The link at the top of the chain comprises communication and promotion campaigns for Australian wines, targeted chiefly at overseas markets. The market guides or steers the Australian wine industry, and the Federal Government focuses on providing support for the exporting and promotion of national wines.

Contracting practices are no longer enough to stabilise relations between wineries and growers. The wineries are increasingly gravitating towards grape purchases on the spot market, where competition is based on price. The largest cellars should see their profit margins improve as a result of the opportunities to obtain cheaper supplies. Even if the situation cannot be termed a crisis, this environment is proving difficult for growers who cannot make medium-term and long-term investments, and there have been numerous bankruptcies.

- **What pointers does this provide for the reform of the wine CMO in Europe?**

Big investors, more than growers, have been induced to invest heavily in the creation or enlargement of vineyards. These investments have been stimulated by a policy of tax incentives pursued by the Federal Government since the mid-1990s, which has permitted accelerated depreciation of investments.

Australian grape-growers are not tending to opt for a policy of grubbing-up, but lean more towards rationalisation of the means of production. In the short term, the most commonplace...
strategy is that of letting some vineyards ‘hibernate’ and replacing the vines and varieties that provide the lowest yields. Growers nevertheless remain very attentive to recommendations from the wineries relating to market trends.

The intervention of the Federal Government takes the form of a support policy for the promotion of wine, for wine exports and for the sustainable development of the production system, particularly through the management of water rights and the provision of incentives to adopt environment-friendly cultivation practices. Support for grubbing-up (‘vine pull’) and direct production aid have been ruled out.

The Australian model, however, is not transferable to Europe because it is tailored to a new production system with large-scale holdings and opportunities for crop diversification. Moreover, it does not place much emphasis on local soils, unlike the AOC system. The wine sector is clearly based on a managerial, capitalist philosophy, with investors who take economic risks and are prepared to accept the sanctions of the market. Lastly, firms are large and benefit from the balance of power at both the top and bottom of the supply chain. In Europe, by contrast, the wine-production system combines tradition and culture with a history and social model associated with the soil and geography of a region.

The CMO can therefore incorporate strategic variables of a similar nature, such as aid for the concentration of enterprises, support for product promotion and the administration of a market observatory. At the same time, however, it must preserve the unique features of its CAP, particularly the emphasis on ensuring that rural populations can continue to inhabit the countryside, on maintaining a strong social fabric and on supporting the environmental functions of the farming community – and this rules out large-scale grubbing-up – while seeking at the same time to rationalise the means of production.

3. The global fringed oligopoly

In the Commission’s portrayal of the wine market, businesses are conspicuous by their absence. The analysis of a competition that has become international homes in on what is conventionally called the top of the supply chain, in other words the production of grapes and wine. This is a perfectly normal perspective, especially since the very purpose of the CMO is to ‘manage’ an agricultural policy and not, apparently, a supply chain. Even though the number, the dispersal and the diversity of businesses in the wine trade still largely justify this ‘ruralist’ approach, the main trends in global competition, and especially the loss of market shares in Europe to competitors from the New World, cannot be explained without an analysis of the forces at work. We shall therefore sum them up briefly in order to make proposals with regard to the CMO.

Two main dynamic factors must be highlighted if we are to understand the trends in international competition in the wine sector: corporate development strategies and the way businesses are changing their style of governance towards financialisation.

- Corporate development strategies

The development of the large global wine companies and the growth of their competitiveness over the past 25 years have been based on a wave of mergers and acquisitions designed to rationalise production and to develop brand identities. This is that of letting some vineyards ‘hibernate’ and replacing the vines and varieties that provide the lowest yields. Growers nevertheless remain very attentive to recommendations from the wineries relating to market trends.

The intervention of the Federal Government takes the form of a support policy for the promotion of wine, for wine exports and for the sustainable development of the production system, particularly through the management of water rights and the provision of incentives to adopt environment-friendly cultivation practices. Support for grubbing-up (‘vine pull’) and direct production aid have been ruled out.

The Australian model, however, is not transferable to Europe because it is tailored to a new production system with large-scale holdings and opportunities for crop diversification. Moreover, it does not place much emphasis on local soils, unlike the AOC system. The wine sector is clearly based on a managerial, capitalist philosophy, with investors who take economic risks and are prepared to accept the sanctions of the market. Lastly, firms are large and benefit from the balance of power at both the top and bottom of the supply chain. In Europe, by contrast, the wine-production system combines tradition and culture with a history and social model associated with the soil and geography of a region.

The CMO can therefore incorporate strategic variables of a similar nature, such as aid for the concentration of enterprises, support for product promotion and the administration of a market observatory. At the same time, however, it must preserve the unique features of its CAP, particularly the emphasis on ensuring that rural populations can continue to inhabit the countryside, on maintaining a strong social fabric and on supporting the environmental functions of the farming community – and this rules out large-scale grubbing-up – while seeking at the same time to rationalise the means of production.

3. The global fringed oligopoly

In the Commission’s portrayal of the wine market, businesses are conspicuous by their absence. The analysis of a competition that has become international homes in on what is conventionally called the top of the supply chain, in other words the production of grapes and wine. This is a perfectly normal perspective, especially since the very purpose of the CMO is to ‘manage’ an agricultural policy and not, apparently, a supply chain. Even though the number, the dispersal and the diversity of businesses in the wine trade still largely justify this ‘ruralist’ approach, the main trends in global competition, and especially the loss of market shares in Europe to competitors from the New World, cannot be explained without an analysis of the forces at work. We shall therefore sum them up briefly in order to make proposals with regard to the CMO.

Two main dynamic factors must be highlighted if we are to understand the trends in international competition in the wine sector: corporate development strategies and the way businesses are changing their style of governance towards financialisation.

- Corporate development strategies

The development of the large global wine companies and the growth of their competitiveness over the past 25 years have been based on a wave of mergers and acquisitions designed to rationalise production and to develop brand identities. These companies have tried to refocus on their core business, which is wine. Restructuring measures have had three main aims: (1) to rationalise production and to develop brand identities. These companies have tried to refocus on their core business, which is wine. Restructuring measures have had three main aims: (1) to rationalise production and to develop brand identities. These companies have tried to refocus on their core business, which is wine. Restructuring measures have had three main aims: (1) to
guarantee security of supply by incorporating part of the grape-growing business, by establishing a regular supply base through contracts and by satisfying residual needs through the spot market; (2) to diversify production geographically, either within one country or in various countries, in order to reduce costs, promote the spread of knowledge and skills and develop synergy within the distribution system; (3) to make size pay, not only through economies of scale in processing and distribution but also through a marked increase in bargaining power in relation to suppliers and customers. Central purchasing departments of mass-distribution companies are, in fact, increasingly playing the ‘size card’. In the United States, wholesalers favoured by the ‘three-thirds’ system have been forming concentrations. They are thus in a situation of oligopoly, which enables them to shift the balance of power between suppliers and themselves. Similarly, in the United Kingdom, manufacturers of alcoholic beverages are able to exercise direct control over distribution channels, particularly through their networks of pubs.

The creation of leading brands has been the engine of growth. In the course of recent years, the expansion of the US and Australian markets has been based on marketing campaigns that have created recognised brands. Wine marketing focused on mass consumption has served to broaden the potential consumer base. It has had a ‘snowball effect’ which has strengthened the brand signal in the wine market. Brands are also the basis for licence agreements with local distributors. Accordingly, most brands in the UK and the United States today are controlled by the leading companies of the New World. The brand portfolio is also one of the criteria for participation in the cooperative distribution networks formed between major companies. About 20% of all the restructuring operations involving firms in the wine trade have been set in motion by distribution networks.

- **Forms of governance and financialisation**

The development of the wine-production companies in the new producer countries has helped to bring in funds from the stock markets. These funds have enabled the companies to implement business plans to increase their production potential and to effect increasingly expensive mergers or takeovers. This form of funding, however, is now reaching its limits. In fact, the number of wine firms quoted on the world’s stock exchanges is dwindling, the slump in the financial markets and the overproduction crisis having made value creation difficult for investors. Given the state of the global wine market and the concentration of the industry at the top and bottom of the supply chain, corporate profit margins are being squeezed, and dividends are no longer sufficient to create value for investors. This situation has forced companies to seek new means of creating value, particularly through the repurchase of their own shares.

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80 The supply capacity of wholesale wine buyers has become a key reference criterion for grocery-plus superstores and supermarkets and for the networks of cafe, hotel and restaurant chains.
81 Examples of large multinational companies that have brought their expertise and experience into the marketing of products for mass consumption include the Australian Foster’s Group (which owns the Wolf Blass and Beringer brands), Allied Domecq (which, until the summer of 2005, owned the Spanish brand Bodegas y Bebidas and Montana, the market leader in New Zealand), Pernod Ricard (which owns the Australian brand Jacob’s Creek and has bought the New Zealand brand Montana) and Diageo (the owner of brands such as Blossom Hill and Sterling).
82 These restructuring measures cover a wide range of operations, including licence agreements, cooperation agreements and joint ventures.
84 Between 2000 and July 2006, only about thirty firms applied for listing on the stock exchange.
85 By repurchasing their own shares, wine companies reduce the dispersal of their stockmarket capital and increase their PER (price-earnings ratio, i.e. the ratio between share price and profit per share). In the course of
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In spite of the difficulties experienced by many companies in the global wine market, the sector continues to attract numerous investors, especially funds specialising in investments in wine and venture-capital companies. This phenomenon is fairly commonplace among the wine companies of the new producer countries, but it seems to be spreading today to companies in the countries of Central and Eastern Europe, and is even affecting China and India.  

Financialisation, as an emerging model of governance, is becoming more and more widespread in the global wine sector. Corporate value creation is increasingly guided by the financial criteria dictated by shareholders, who are often remote from the workings of the industry. These strategies, dominated by finance, frequently give rise to tensions between shareholders and the other stakeholders, which can manifest themselves in the closure or relinquishment of vineyards, job cuts and relocations.

A fringed oligopoly is taking shape within the industry today. At its head are 40 or so firms which control 40% of total production volume. The ‘fringes’ of the oligopoly comprise thousands of small and medium-sized businesses. Between the two categories, few enterprises are currently large enough to be bought up by the big wine companies. Accordingly, the development of these big companies through mergers or takeovers will depend on the emergence of new wine enterprises of significant size. Otherwise, if they cannot grow by means of mergers, the large companies will be able to continue their development by planting vineyards in countries where there are no legal constraints, as in the cases of Belvedere in Bulgaria and the Peñaflor Group in Argentina.

One of the main clouds on the horizon for the large wine companies in the new producer countries, which depend on standardised mass production, lies in the capacity of consumers to tell commercial brands from wines with designations of origin and to distinguish between varietal and regional flavours. It is at this level that the stakes are highest in the formulation of proposals to amend the rules governing AOC wines and labelling.

- Proposals for the reform of the wine CMO

On the basis of the preceding analysis, we can propose three types of action to try to improve the competitiveness of wine businesses based in the EU: making business models more dynamic, promoting intangible investments and helping businesses to achieve critical size. The management system in European wine businesses suffers from a lack of organisational skills. Managerial dynamism should be stimulated by: (1) favouring companies that generate projects, are proactive and support innovation; the model of the family business that predominates in southern Europe is an obstacle to corporate competitiveness; (2) encouraging investments in intangible assets, such as brands, marketing, distribution networks, research and development.

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86 One of the major investment funds that specialise in the wine sector is the International Wine Investment Fund (IWIF). This fund played an important role in the development of the Australian wine industry, particularly by purchasing large shareholdings in the leading wine companies, such as BRL Hardy, McGuigan Simeon, Southcorp and Foster’s Group. Its present holdings extend to the international market (Gabriel Meffre and Michel Laroche in France and Vintage Nurseries in the United States). Moreover, the global market leader in the wine industry, Constellation Brands, has announced the intention to launch a programme for the repurchase of its own shares from 2007.

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and new information technology;\(^{87}\) (3) taking measures that enable enterprises to achieve critical size, thereby enabling them to increase their bargaining power and reduce their dependence on players further down the supply chain. The difficulty with this last proposal, however, lies in the definition of the optimum critical size. Besides, given limitations such as excessive indebtedness, the integration of enterprises with different business cultures, and the levels of profitability demanded of companies, which currently affect both the financialised model and the external-growth model, European companies can resort to strategies based on the development of 'horizontal' links such as cooperation agreements, joint ventures or licensing agreements.

4. Fruit and vegetable producer organisations: a model for the wine sector?

The reform of the CMO in 1999 brought official recognition of the role of producer groups and sectoral organisations. It gave them a legal framework but no particular resources. The overall assessment of their activity presented in the Commission document is less than favourable,\(^{88}\) whereas all corporate analyses emphasise their dynamic growth and assert that they are big enough to make inroads into markets. We therefore intend to examine the organisational model of the fruit and vegetable sector in order to identify some principles that can be applied to the wine sector.

- Project-based funding

The aim of the new common organisation of the market in fruit and vegetables, as set out in Regulation (EC) No 2200/96, is to help growers by encouraging them to forge links through alliances in the form of producer organisations, in order to market produce that is more closely matched to the needs of the market in that it is environment-friendly, its origins are traceable, and it meets the desired quality standards. The main instrument of the fruit and vegetables CMO is the creation of an operational fund, to be financed in equal parts by the producer organisation and the European Union (through the EAGGF) for the purpose of redistributing aid from the EAGGF on the basis of a list of eligible measures (see Table 110) recorded in an operational programme.\(^{89}\)

This CMO introduces a new type of rule: (1) previously, that is to say under Regulation (EEC) No 1035/72, the market was essentially administered by means of the system of withdrawals, based on the hypothesis that a reduction in the volume of supplies would serve to raise price levels; (2) now, in order to qualify for aid, the producer organisations, hitherto known as groups of producers, must satisfy precise operational and financial criteria, in particular the ability to match the EAGGF funding. Producers must henceforth form producer organisations, which are

\(^{87}\) E&J Gallo, for example, is one of the companies that invest most in new information technology; it also has a sizeable marketing budget.

\(^{88}\) Commission of the European Communities, Directorate-General for Agriculture and Rural Development, Wine: Common Market Organisation. Working paper, Brussels, February 2006, 78 pp.: ‘However, in reality, the range of activities carried out by producer groups and sectoral organisations represents only a fraction of what they could actually be responsible for under the terms of Regulation (EC) No 1493/1999. Their main problem is that they do not have specific operational instruments, such as in the fruit and vegetable sector, where sectoral organisations actually manage resources. This is because wine is not a standard product like fruit and vegetables. Moreover, some Member States lack interest in the activity of sectoral organizations and do not promote links with them. A number of attempts to take stock of the situation by existing groups in each Member State have failed, which proves the rather marginal role of these groups and organisations in terms of coordination and providing assistance in production and marketing.’ (p. 36)

subject to official recognition and have the task of consolidating and marketing supplies and establishing environment-friendly practices. From a list of options, each producer organisation selects the measures to which it commits itself for a period of three or five years in the framework of an operational programme subsidised by the producer organisation and the European Union, the present rate being 4.1% of the value of marketed production, i.e. turnover, from the producer organisation and 4.1% from the EU, making 8.2%. The consequences of the establishment of the new CMO for fruit and vegetables have been a drastic reduction in withdrawals and export refunds and an upsurge in the expenditure of the operational fund.

- **Main characteristics and development of the CMO**

This new CMO is particularly innovative in that it marks a shift from product-based aid to structural aid, particularly for environment-friendly structures. In this respect, it would be difficult to contest in the WTO framework. It also promotes free enterprise in a sector that is heavily administered and places special emphasis on links between businesses in the form of alliances, a mechanism in common use in other sectors. That is why this particular CMO has been more or less spared by the succession of Agenda 2000 reforms, including those introduced by the Luxembourg agreements.

Nevertheless, the uneven application of the decoupling principle that emerged from the Luxembourg agreements does pose problems, as do the processing subsidies for products like tomatoes or pears. Reforms have been proposed, and the following are among the recommendations made by the seven Member States of southern Europe in a memorandum sent to Mariann Fischer Boel at the end of 2005: (1) allocation of supplementary financial aid to the operational fund to top up existing aid in cases where there are unions of producer organisations; (2) creation of a crisis-management mechanism, involving product withdrawals, advertising and promotion measures and supplementary payments to the operational funds and financed from a budgetary appropriation allocated to the country in question, primarily through a specific dedicated budget; (3) improvement of the conditions applicable to free distribution.

Several phases can be distinguished in the development of the structure of producer organisations: (1) a familiarisation phase, when some groups of producers dropped out and when the organisations learned about the administrative, accounting and organisational practices of each Member State and of the EU; (2) a phase of economic reorganisation, which seems to have continued until 2002-2003, when the crisis of 2003 necessitated administrative restructuring; (3) a post-launch phase (2003-2006), in which the CMO was taking shape and gradually evolving through a succession of improvements.

- **Typology**

As far as the marketing instrument is concerned, it seems that four types of producer organisation can be distinguished (see Figure 111): (1) the individual producer organisation which markets products, either directly or through a business that belongs solely to its members, agricultural cooperatives or other member bodies; (2) the union of producer organisations comprising additive alliances (associations of businesses that develop and market the same product) which try to minimise and sometimes eliminate competition between marketers by means of measures such as bringing sellers together in one physical place, consolidating sales operations in real time by telephone, fax or computer, and merging sales offices into a joint company, in which prices, volumes and client portfolios are shared; (3) partnerships in which the producer organisation operates with a single partner, having chosen to enter into a contract with a trader who markets and possibly also stores and packages the produce (in this case the alliance is made with a business with different but complementary areas of competence); (4) a
structure of the ‘inter-trade’ (interprofessionnel) type, which, though rare, may prove effective in so far as one single property transfer takes place between the producer organisation and the shippers. This transfer effectively corresponds to a wholesaling charge.

- **The main pros and cons of the system of producer organisations**

Among the advantages we can note are: (1) the possibility of recovering more than half, and sometimes a good bit more, of the operational fund, either in the form of investments or in the form of direct aid; (2) the possibility of combining CMO aid with the agricultural guidance premium for product transformation (POA), with aid granted under the joint national/regional plan or with short-term aid measures, export aid or land-management contracts (contrats territoriaux d’exploitation), introduced in 2002, provided that aid awards from different sources are used for different measures; (3) the aid measures that are essential for integrated production; (4) the creation of a counterweight to curb the excessively rapid and massive transfer of the aforementioned forms of aid to retailers and consumers. These aid measures are the main incentive for traders to operate in partnership with producer organisations.

Among the drawbacks, we should emphasise: (1) high management and administration costs, the centralisation of payments, the number and cost of checks and the administrative complexity of the paperwork; (2) the need to possess managerial skills, which increases disparities between organisations, since public aid essentially benefits those who can devise and pursue strategies; (3) the absence of regulation mechanisms with which the structural and cyclical surplus problems could be managed.

- **Are there lessons that can be applied to the wine sector?**

The fruit and vegetable sector differs sharply from the wine sector in two main respects: the great diversity of production processes (species, production cycles and growing conditions) and perishability (few fruit and vegetable products can be stored for a long period in an unprocessed state and never beyond a year). Nevertheless, both sectors face similar challenges: the environment, quality, harvest fluctuations, overproduction crises, price instability and relations with major distribution chains.

The points we would therefore like to take from the foregoing analysis concern the benefits of the structure created by the producer organisations and the way in which the operational fund is managed. What strikes us most about this is the joint involvement of the European funds and the producers’ funds, which implies greater co-responsibility as well as the opportunity to compile a list of eligible measures that can be adapted for use in the wine sector.

A great many of the measures within the four categories could already be transferred to the wine sector, especially those of type 1. In connection with the optimisation of production conditions, we can cite the reduction of inputs (1-12), the monitoring centre for production costs (1-14) or the acceptance of responsibility for storage costs, subject to pursuit of a sound marketing strategy (1-15). In the case of type-2 measures, which relate to the quality of products, we can cite certification (2-2), traceability (2-4) and quality control (2-5). As for the measures of type 3, which are environmental in character, the treatment and management of waste (3-2) and the minimisation of waste can be cited. The type-4 measures, which relate to marketing, are all transferable, but we should stress market research (4-3), the creation of sales offices in countries outside the EU (4-4) and the promotion of brands. **The proposed market organisation comprises a set of measures which are compatible with the rules of the WTO and which, as we have indicated above, ought to be vigorously developed in the wine sector. In short, a**
producer organisation in the wine sector could be the site of downstream reorientation of the resources claimed by both traders and producers. The producer organisation, in the version adapted to the needs of the wine sector, would address producers’ main downstream problems, namely the need for modernisation, association or partnership and marketing, while lending a managerial dimension to its members’ businesses.

Interventions in the market can be made at the more collective level of the Economic Committees, which, besides enforcing the quality rules, can also activate a decentralised system of supply regulation. We can cite the example of the reserve created by Inter Rhône, the trade organisation for wines with the registered Côtes-du-Rhône designation, with a view to stabilising prices. The Economic Committees can also alter their geographical limits and their spheres of competence. This has been the case, in fact, with the creation of production pools in France to administer all categories of wine produced in a given region on the basis of market prospects.

5. Benefits and limits of decoupling in the wine sector

The Commission has opted against scenario 3, which envisaged the application to the wine sector of the general principles of the CAP, particularly decoupling and the single-payment scheme (SPS). The potential advantages were production flexibility, market orientation and WTO-compatibility through green-box classification and the introduction of cross-compliance for all vine-growers. However, ‘in contrast to other sectors, there would be no obvious equitable way of distributing SPS entitlements. On the basis of the available budget, the potential amount of decoupled payment would be very small for a permanent crop and would probably not compensate the loss of market support for many growers’. The cost of adaptation to the market would also be exorbitant, close to that of complete liberalisation of the sector, as mooted in scenario 4.

We share the view of the Commission that it would be impossible to apply these mechanisms generally and uniformly, but, on the basis of the premises underlying reforms implemented in other sectors, we would like to show that it is nevertheless possible to use these mechanisms in a more limited and targeted way.

‘Generalised’ decoupled aid cannot, in fact, respond to a situation where products are differentiated, because the impact of liberalisation or of the abandonment of support provided through distillation schemes would also be differentiated and would thus be a source of unfair redistribution. For example, prestigious wines sold at high prices could sustain a drop in sales and still maintain their price levels. Direct aid in this case would boost incomes that had remained stable. At the other end of the scale, low-priced table wines for which no outlet was found would disappear from the market, and direct aid would only provide a small degree of compensation for the fall in production. The effectiveness of the measure therefore depends on

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91 In the United States, for example, the limits of decoupled aid have been revealed in some sectors where crises caused by underproduction or by falling international prices had prompted the government to introduce new anti-cyclical aid schemes, which are, by their very nature, coupled to production, being higher in years of low farm incomes and tantamount to a secondary form of price support.

92 We performed a comparative calculation for the following two situations of partial balance for each segment of the market that currently benefits from subsidised distillation, assuming that the grubbing-up policy remained unchanged: (1) overall balance with subsidised distillation and (2) overall balance with non-subsidised distillation and decoupled aid (a budgetary amount equivalent to the cost of subsidised distillation). It seems
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the homogeneity of the product and of price levels. This is certainly the case for most of the table wines sent for distillation in the ‘specialised’ regions.

It is possible to conceive of decoupled aid payments that are not based on surface area but on estimated loss. This would remain entirely compatible with the WTO definition of decoupling, provided the amount of aid paid to individual growers was not proportionate to the volume they harvested or even to the area of their holding. Decoupled aid must be payable at a fixed rate, independent of production variables, but the European Commission may choose which growers are eligible for it and the amount they receive. For instance, the Commission may decide to set a higher rate of aid in the regions that would be hit hardest by the end of subsidised distillation. That could be a means of compensating the Spanish and Italian regions which have recently begun to ‘specialise’ in wine intended for the distilleries. One argument in favour of such differentiation of decoupled aid is that the preservation of compensatory aid for years after a reform, as in the case of major crops, tends to make it unpopular and elitist, because it appears like an annuity based on a historic situation rather than being performance-related.

It is also worth noting that the purpose of decoupled aid is not necessarily to cushion the income effects of a reform. It may be awarded on the basis of other criteria, such as farming in regions subject to desertification or in difficult regions.

Lastly, there are numerous forms of uncoupled aid in the WTO’s green box, i.e. aid authorised without restriction, which can be developed in accordance with the principle of the French sustainable-agriculture contract (contrat d’agriculture durable – CAD) or by means of agri-environmental measures, particularly aid for holdings that help to maintain the landscape or rural life, to preserve local know-how, and so on. The development of aid schemes for marketing and labelling seems a particularly interesting option. These schemes would have a beneficial effect both in terms of product transparency for the consumer and in terms of the price obtainable by the grower, and might even help to make European wines more competitive in the global marketplace (see above).

We can therefore affirm that a decoupled aid scheme implemented in a homogeneous region, most products of which were similar in nature and sold at the same price (wine delivered for distillation into potable alcohol would be one example), and meeting the criteria of rural development, environmental conservation, specific types of landscape and the absence of other production options, could be established in the framework of the single-payment scheme without the drawbacks of generalised application. This particular provision was included in the proposal from the Commission for holdings where grubbing-up has taken place. Local or regional decoupling on the basis of specific criteria would thus be a means of solving the problem of socio-economic imbalance in Castilla-La Mancha and southern Italy.

that balance No 2 is higher than balance No 1 for the classical economic reason that, in balance 1, public money pays to maintain the production system at an excessively high level in relation to the market balance, which dissuades the production system from moving into different markets or cutting back its activity. Decoupled aid, in theory, does not have this effect of encouraging producers to persevere in the least profitable sectors (see Document No 100).
Chapter 2: Proposals

1. The facts in outline

1 – Given the opening of the European market to competition from the countries of the New World, undifferentiated blanket control of supply by means of cyclical measures, i.e. distillations, and structural measures, i.e. grubbing-up, applied unilaterally to the European wine sector is no solution, because it opens the door for our competitors to plant and export in greater quantities.

2 – The vagaries of the climate are the cause of harvest fluctuations, which are a source of cyclical and ultimately structural crises. The problem of adjusting segmented markets, however, needs to be resolved both in the producer countries and in the main importing countries, namely the UK, the United States, Canada and Japan.

3 – Global competition is taking place between production systems. In the Old World, widely diverse cultivation systems exist, most producers being specialised and many of them operating on a small scale. Different systems of winemaking also coexist, with private cellars and cooperatives producing wine from their own grapes and other winemakers buying in grapes. The segmentation of the range of products on offer is historically based on divisions into wine-producing regions and on a distinction between those regions that produce table wines and regional wines and those that produce wines with registered designations of origin (QWPSRs). This segmentation is no longer in tune with the main export markets in the English-speaking world, where wines are differentiated by variety, technology and brand name.

In the New World, new vineyards, with high-quality systems of rational irrigation and high yields, produce wine grapes distinguished by the reputation of the grape variety. Most of the grapes are delivered to large winemaking companies, which produce varietal wines tailored to price brackets and customer profiles in the targeted consumer country. These enterprises dominate distribution to the large supermarket chains through their bargaining power and their logistic capacity, the economies of scale and organisation that their size enables them to make, and their marketing budgets. Their range is mostly concentrated in the category of premium wines, where they compete with the producers of European regional wines and generic AOC wines, whose competitiveness is hampered by production constraints, particularly maximum permissible yield levels. In the super-premium and ultra-premium categories, Europe’s AOC wines and QWPSRs are under no serious pressure. The price of these wines is high and even soars on occasion, for example when a new vintage goes on sale.

4 – Europe’s strategic response cannot therefore be anything but paradoxical. Europe is trying, in effect, to maintain and even strengthen the position of its QWPSRs, even though there is competition for their share of the market, while enhancing and developing the competitiveness of premium products by adopting the same commercial weapons and resources that are used by its new competitors. The vineyards producing these types of wine must be able to access all the instruments at the disposal of these competitors, such as technology, irrigation, high yields, changes in the scale of the winemaking and marketing organisations, development of business models, adoption of consumer-driven policies, brand names, and bargaining power in relation to distribution networks.

5 – Europe also has vineyards with an environmental and social role, vineyards whose owners have not tried or are unable to adapt to the needs of the market and whose products yield little return at the floor price paid for the distillation of potable alcohol. There are very few other crops these operators could grow, and such growers serve chiefly to protect the countryside and the local culture and to maintain population levels in rural communities.
2. A variegated proposal

What kind of common organisation of the market can be proposed to deal with these apparently paradoxical situations? To answer that question, let us recapitulate the main intervention mechanisms.

1 – While indiscriminate widespread grubbing-up is ineffective, it is essential to retain a form of grubbing-up that is targeted and differentiated according to strategic objectives that are both economic (grape varieties, yields) and social (grower in difficulty, planned abandonment of activity, absence of successor). Such grubbing-up would therefore be progressive, limited, monitored and evaluated during the course of its implementation. This would allow budgetary savings in relation to scenario 2, thus allowing redeployment towards other measures.

2 – Planting rights should be retained in order to guide policy. However, it should be possible to activate them much more easily by better organising the allocation, exchange and transfer of rights. Implementation of the reserve mechanisms could be evaluated and adjusted to resolve malfunctions. By extension, illicit plantings should be addressed, thanks in particular to the control systems introduced by the new CAP. The management of production potential could be carried out at regional level by a regional ministry, an interprofessional body or an economic committee on the basis of overall market figures with a fixed ceiling and national and European arbitration.

3 – The arrangements for distillation should be reconsidered both in their entirety and for each category. The system of purchase prices could be revised in the interests of budgetary reduction and market orientation. The whole range of manufactured alcohols should be redefined and potential outlets should be developed. The selling price of wine alcohols should be revised upwards. The entire alcohol market should be updated at the level of its various components: potable alcohol, marc alcohol, industrial outlets (carburation), in accordance with environmental (pollution control, marc alcohol as fuel) and energy (tax changes) objectives. Winemaking by-products could attract payments solely for their environmental function. The practices of composting raw marc and of spreading lees need ecological evaluation. The distillation of potable alcohol could see a price reduction, with the latter being compensated by partially decoupled direct aid. The distillation of wine from dual-purpose grapes is no longer on the agenda, having been replaced by plot quota allocations (Zonta Plan). It is therefore abolished. Crisis distillation must be retained but with better implementation. It should be steered at regional level in the light of market balance and be able to assume compulsory dimensions on the basis of differentiated criteria. It should be possible for it to be jointly financed by the interprofessional bodies or economic committees in order to take account of price differentials. It could be aligned with the establishment of qualitative reserves.

4 – Sugaring (chaptalisation, i.e. enrichment with exogenous beet sugar and cane sugar) should be abolished in accordance with the Commission’s proposal. Endogenous enrichment with concentrated and rectified concentrated grape must should be authorised but on a reduced scale, and the subsidy should be abolished. The increase in the cost price of low-price wines in northern producer regions could be partially offset by a subsidy administered within the national envelopes.

5 – The regions involved in the distillation of potable alcohol should be eligible for the single payment scheme and partial decoupling in order to maintain plant cover and should benefit, on the basis of cost studies to be carried out, from a subsidy for summer pruning (‘green harvesting’).
6 – Producer groups and sectoral organisations should be strengthened, reactivated and allocated financial resources in order to develop downstream functions. This change could be inspired by the functions and resources of producer organisations in the fruit and vegetable sector. They should in particular be focused on strategic objectives: mergers, regroupings, associations, partnerships, search for critical size, and commercial development projects such as the creation of labels or promotion campaigns.

7 – The labelling rules do not seem to need to be modified for the reasons stated: room for manoeuvre exists under existing rules. There is no need to do away with references to specific districts for the benefit of table wines without geographical indication. Large geographical areas of reference for regional wines are sufficient for the purposes of this adjustment.

8 – The ban must remain on the import of musts from non-EU countries by virtue of the very definition of wine and in the light of the problems of traceability, risk of fraud and constraints affecting market balance.

3. Budgetary impact

Over the past 14 years, according to the financial reports of the EAGGF,93 average annual expenditure on the wine sector has amounted to a little more than a billion euros (€1 040 m.). These years have included three sharply contrasting periods: the first, from 1993 to 1994, marked the end of the phase of brisk distillation and grubbing-up activity, with annual expenditure running at an average of €1 343 million a year; the second, from 1995 to 2000, was characterised by a relatively balanced market, and an average of only €790 million a year was devoted to the wine sector, and the last period, from 2001 to 2005, coincided with the new CMO and its major restructuring programmes as well as two overproduction crises, which raised the annual average to €1 216 million. The budget for 2005 was very close to that average, and for this reason we shall take it as the reference budget; average figures for particular headings are taken from the preceding report.

Expenditure is divided into two main parts. The first part comprises structural measures, namely permanent abandonment (grubbing-up) and restructuring. The second part comprises market measures, covering export refunds and interventions, the latter subdivided into wine and grape-must storage, distillation and storage of alcohol and aid for grape musts. We shall add a third section for the new measures, comprising ‘downstreaming’ aid for producer organisations, direct aid and national envelopes.

- **Structural measures**

1. The restructuring programme

The restructuring programme is recognised as useful by the Innova study, by all stakeholders and by the Commission, although the Commission expresses the reservation that this budget sometimes funds restructuring measures that would have been implemented in any event.94 We could keep it at €400 million. This substantial budget, however, remains very sharply focused on the top end of the supply chain. We therefore suggest that part of it (25%) be moved further

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‘The restructuring and conversion scheme has enabled producers to upgrade to “quality wine” but could also lead to an increase in production. It may sometimes cover normal renewal, which would defeat its purpose.’ (p. 5)
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downstream in the form of aid to producer organisations. Two arguments support this retargeting: firstly, part of the vineyard area has already been ‘rejuvenated’ under the current programme, which itself followed on from national programmes that were implemented in previous periods; secondly, the conversion of vineyards in Spain should be slowed down by the introduction of direct aid. We would therefore retain a budget of €300 million.

2. The permanent-abandonment programme

The Commission is proposing rigorous grubbing-up of 400 000 hectares of vines over a five-year period with a budget of €2.4 billion. If we base our assessment on an annual average, this decision corresponds to the abandonment of 80 000 hectares a year and a premium of €6 000 per hectare. The annual budget would therefore be €480 million.

We propose that permanent abandonment should not be used as the main market-adjustment variable, but that its use as an intervention mechanism should be governed by strategic, economic and social criteria. The establishment of partial decoupling in the regions we have classed as ‘regions with an environmental, cultural and social objective’ also serves to justify the measure. In such a system, we estimate that between 20 000 and 30 000 hectares would be grubbed up each year. For our assessment we have set this figure at 25 000 hectares, which would entail the allocation of €150 million per annum.

- Market measures

1. Export refunds

The amount devoted to export refunds has been steadily dwindling, and they should disappear under the terms of the WTO agreements. We have not allocated any budgetary funding to them.

2. Wine and grape-must storage

Since this measure is especially effective when market balance is being restored, we have kept its budget constant at about €60 million a year, but we propose that it be transferred to the national appropriations so that the scheme can be managed at the level of the production pools, the regions or the inter-trade organisations.

3. Distillation

We saw above that the development of the budget for the intervention mechanism of distillation depended on several types of decision: the price paid to producers, the nature of the outlets (in simple terms, potable or industrial alcohol), the market selling price and the choice between optional or compulsory application.

Let us formulate the following hypotheses:

- All surplus alcohol is priced at the same rate as fuel alcohol, i.e. €50 per hectolitre of pure spirit.
- Alcohol distilled from winemaking by-products can tolerate a 25% increase in its administered price, raising it to €145 per hectolitre of pure spirit.
- The cost of distillation continues to be assessed at the present rates.
- The processing of by-products of wine lees and grape marcs remains or becomes optional, provided that waste recycling measures (composting and spreading) are proved to be justifiable.
- Regional or national governments may choose to make the distillation of winemaking by-products compulsory, especially in cases where the concentration of production would be a source of pollution that could not be controlled by other methods.
- Producers are no longer paid for winemaking by-products, as the disposal of their waste by
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the distilleries is now regarded as a consideration for the production input; both parties are thus paid in kind.
- We do not take into account the possibility of making part of the marc and lees distillates into brandy or other wine spirits.
- The distilleries receive aid for the waste-removal service they provide to cover the collection of lees and marc and for the related administrative and technical management, i.e. maintaining registers, measuring volumes and quantities, weighing and measuring alcoholic strength.
- The price of potable alcohol is halved, producers being compensated for the income shortfall by means of partially decoupled direct aid.
- Distillation of dual-purpose grape varieties disappears as part of the reorganisation of the production system in Charentes.
- Crisis distillation is maintained at its average level in terms of volume, but the cost of the scheme is transferred to the national envelope.

Amounts under the budget headings would then be as follows:

1) For by-products of winemaking, the volume processed would remain in the order of 1.3 million hectolitres, a price would no longer be paid to the producer, and the cost of processing would be an estimated €42.20 per hectolitre of pure spirit for wine lees and €87.70 per hl of pure spirit for grape marc. We shall base our calculations on an average cost of €65 per hl of pure spirit. If the cost of collection, transport and storage is estimated at €25 per hl of pure spirit, the total cost to be entered in the CMO budget would amount to €40 per hl of pure spirit, i.e. **€52 million** for 1.3 million hectolitres, which is one fifth of the amount allocated in the present budget.

2) For the marc and lees from which spirits (brandies with a registered designation of origin and grappa) are distilled, we estimate that the increase in the price of the alcohol would cover the charges to the CMO budget and that the net budgetary impact would therefore be zero.

3) For potable alcohol, halving the purchase price would reduce it to €125 per hl of pure spirit; the cost of distillation is estimated at €42.20 per hl of pure spirit and the cost of private storage at €12 per hl of pure spirit, making a total cost price of €179.20 per hl of pure spirit. If we set the selling price at €145 per hl of pure spirit, the remainder to be met from the budget would amount to €34.20 per hl of pure spirit, which makes about **€35 million** for a little more than a million hectolitres of pure spirit.

4) In the case of crisis alcohol, estimation is made difficult by the great variability of the volumes of wine to be removed, which depend on the size of the harvest. We propose that the average level of this allocation be maintained but would reassign it to the national envelopes and would reckon with better returns from the industrial outlet. The Commission’s estimate is €202 per hl of pure spirit for a total budget of €180 million, which is based on a volume of 890 000 hl of pure spirit. We have allowed for the higher value attaching to industrial alcohol when it takes the form of fuel alcohol, priced at €50 rather than €10 per hl of pure spirit. On this basis, the total budget can be estimated at **€144.4 million** for the same volume.

4. Aid for the use of concentrated grape musts

As we have indicated, the prohibition of sucrose (chaptalisation) removes the justification for compensatory payments covering the cost differential between the two enrichment methods.
This aid would therefore be abolished, and its budgetary impact would then be zero. Partial compensation for the northern regions can be provided within the national envelopes.

- **The new measures**

All of the expenditure listed above would leave a total of €458 million available if we opted for a stable budget, the customary hypothesis in the context of the CAP. We would allocate this amount to marketing aid for the producer organisations and to direct aid.

1. **The single-payment system**

The single-payment system could be applied in Spain for the 400,000 hectares in Castilla-La Mancha that have not been restructured; the rate could be €300 per hectare to compensate for the price reduction of €120 for wine sent for distillation into potable alcohol, and €80 million could be allocated to Italy for the same reason on the basis of environmental criteria which would have to be defined. The total budget would thus be **€200 million**.

2. ‘Downstreaming’ aid to producer organisations

The reweighting of the budget in favour of producer organisations would therefore include the €100 million saved on restructuring expenditure plus the remaining budgetary balance of €158 million, making a total of **€258 million**.

3. **The national envelopes**

The national envelopes could be topped up by the budget earmarked for crisis distillation, which amounts to **€145 million**, and distributed among Member States on the basis of market criteria; the impact of the increase in the price of white wines from northern Europe could be taken into account in this budget. We would add to it the budget allocated for the storage of wines, which amounts to **€60 million**.

Another option that would not change the bottom line of our calculation would be to assign a significant part of the restructuring budget to the national envelope, leaving Member States and regions the option of making their own decisions on the amounts to be allocated for compensation for the chaptalisation ban, market intervention through storage, the quality reserve or crisis distillation and, lastly, payment of downstreaming aid for producer organisations.
### Table: Budgetary impact of the reform proposal

<table>
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<th>2005 budget in €m.</th>
<th>%</th>
<th>Proposal in €m.</th>
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Part 5: Conclusion

The following are therefore the main differences in relation to the Commission’s proposals:

- Grubbing-up should be more limited, more gradual, more controlled and subject to a voluntarist policy of economic conquest and social management as well as being more economical in terms of the allocated budget.
- Distillation measures should be managed differently; such management should gradually rebalance the market in distilled alcohol, redefine products, update selling prices and take account of environmental, ecological and energy dimensions.
- A proactive strategy should be adopted in the market, based on support for businesses through producer organisations and economic committees, funded through a set of projects, including promotion projects.
- Restructuring should take account of all segments of the market, should not have a Malthusian aim and should be administered at the regional level.
- Environmental support should be given to specialised regions with no other production options by means of partial decoupling in the framework of the single-payments scheme.
- National compensation should be payable for the loss of competitiveness suffered by vineyards where low-priced wines have customarily been produced with the aid of chaptalisation.
- A system should be maintained for managing the consequences of climatic fluctuations by means of storage and crisis distillation; it should be administered at the regional level with compulsory elements and part-funding from national envelopes which takes account of price differentials.
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