THIRD REPORT ON THE LINK BETWEEN OLP AND CONSUMERS AND CITIZENS (WP4)

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The consumers' perception of PDO/PGIs products and the WTO negotiations

The report is organised in two sections:

I. The protection of Geographical names in the WTO
II. The economic arguments for the use of Geographical names

I´ve mainly used the following bibliography:

Bello L. and Gómez J.T. (1996). Las Denominaciones de origen y otras señales de calidad en las estrategias de diferenciación de los productos agroalimentarios. Una propuesta metodológica. Cuadernos Aragoneses de Economía, 6(2): 365-387. (Designations of Origin and other quality cues as strategies of differentiation in agro-food products. A methodological proposal).

Chen J. (1996). A sober second look at appellations of origin: how the United States will crash France´s wine and cheese party. Minnesota Journal of Global Trade, 5(1):29-64

Lucatelli S. (2000). Appellations of Origin and Geographical Indications in OECD member countries: eocnomic and legal implications. OECDE. COM/AGR/APM/TD/WP(2000)15/FINAL. Paris.

The United States Mission to the European Union(2002). Trade Representative Releases. Inventory of Foreign Trade Barriers. http://www.useu.be/Categories/Trade/Apr0202USTRReportForeignTradeBarriers.html. 18/04/2002.

I. The protection of Geographical names in the WTO

The legal benchmark for recognition in third countries

In 1994, the GATT Uruguay Round yielded a specific Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS). This agreement defines broadly what a geographical indication is (...an indication that identify a good as originating in the territory of a member,..., where a given quality, reputation or other characteristic of the good is essentially attributable to its geographical origin); and requires its member states to respect and offer special protection to geographical indications recognised under other Members´ laws, and ensure enforcement procedures to permit effective action against any act of infringement. TRIPS define the requirements for "general protection" and extends "special protection for wines and spirits". Some conflict with the European legislation may arise from 1) the omission of the "human factors" in the definition of a geographical indication; 2) the admissible co-existence with a trade-mark designated as the geographical indication, that was in use either before the TRIPS agreement or before the geographical indication is protected in its country of origin; 3) the lack of protection to the geographic indication when it is identical with the customary name in common language with that product or with a grape variety.

The PDO/PGI as a non-tariff barrier to trade and a barrier to entry into the industry

Non-tariff barriers to trade include non-science based sanitary and phytosanitary standards, customs procedures, government monopolies and lack of transparency in regulations. Hence, the PDO/PGI scheme may be considered as a barrier to trade when it is thought that there is a "separation between territory and human factors" (tradition, heritage and know-how), provided that there is not a "scientific" based linkage; or when the PDO/PGI are mainly considered as an "instrument of the Common Agricultural Policy and Industrial Policy, designed to protect producers and increase their incomes, securing exclusive production rights" (Chao, 1998, p.60-62). For the same reasons, it may also be viewed as an instrument to restrict competition, acting as a barrier to entry into the industry. Nevertheless, when considering the PDO/PGI as a tool of differentiation, the barrier that constitutes a PDO/PGI, either to trade or entry, is similar to any other private brand (Lucatelly, 2000, p.29).

II. The economic arguments for the use of Geographical names

There are two main theoretical approaches that can be used to explain and justify the use of geographical names: Information theory and Shapiro´s model of reputation.

1. Information theory

Information is a valuable resource and not always is fully available for consumers. This leads to asymmetric information: while producers know all the properties of the products, they make, quality in particular, consumers don´t. Three categories of goods are distinguished depending on how information is conveyed to the consumer: "search goods", whose quality can be ascertained before purchase; "experience goods", whose quality is ascertained only after consumption; and "credence goods", whose quality can not be fully determined, even after consumption. Normally, goods share characteristics falling into the three categories.

Under asymmetrical information non-uniform products, with the true quality known only by the producer, are finally sold at the same price. This has consequences on producers, consumers and the performance of markets. From the producer perspective, those who make goods of higher quality will have an incentive to abandon the activity (adverse selection) and those who remain will have an incentive to keep the same price while diminishing quality (moral hazard). Consumers can not optimise their choices: the chosen product might not meet their expectations. In order to weaken this risk, they can behave developing loyalties to a small number of brands and sales outlets that enhance oligopsony power. The performance of the market is damaged: the quality of total supply drops, some consumers will no longer be able to satisfy their preferences; and producers of quality products suffer from unfair competition.

2. Shapiro's model of reputation

The market imperfection derived from asymmetric information can be mitigated through the building up of reputation. There is a dynamic process that involves firm reputation, consumer learning and the seller's choice of product quality. Consumers have expectations about the product quality based on past experience on the purchasing of products by the same firm. Thus, there is a learning process in the formation of quality expectations that finally build the firm's reputation. The firm will invest in building this reputation only if that learning process exists. And only in the long run, when reputation is finally established, the investment will have a return, in the form of a price premium (over marginal cost). Therefore the price premium is an extra cost due to the need of building reputation what in turn is consequence of lack of information. The sooner the consumer learns the true quality of the product, the smaller the over-price will be.

The role of PDO/PGI in relation to the theory of information and the model of reputation:

To solve the problem of market failure, to provide information to the consumer is crucial. And the ways of transmitting this information are labelling and communication tools. In this sense, the PDOs and PGIs (Protected Designation of Origin) and Protected Geographical Indication) can be regarded as a distinctive sign, similar to a trademark. In this respect, they play the same role as any other instrument of product differentiation.

From the research on the link between consumers/citizens and territorial products, we get that, despite the low awareness of the PDO/PGI legislation, the attribute "Origin" has got a remarkable influence on attitudes, motivations and purchasing behaviour of agro-food products in Europe. The territoriality of a product is perceived as a multi-attribute concept, associated to human and natural factors. The product properties are viewed as narrowly linked to the territory, and in some cases consumers are willing to pay a premium for the origin (or PDO/PGI label). That makes the legislation on PDO/PGI an essential tool to protect the consumer expectations and preventing market failure derived from fraudulent information.

The vast majority of agrofood products can be viewed as experience goods, given that most of their characteristics can not be ascertained before consumption. Hence, the consumer needs cues, intrinsic and extrinsic, to infer quality. The PDO/PGI provides intrinsic and extrinsic quality cues, and symbolic signals. It is an intrinsic cue provided the technical specifications on raw materials, methods of production, quality controls, etc.. imposed by the Regulatory Council (body?); an extrinsic cue, given their linkage to territory/origin; and symbolic, due to the human factors (historical, cultural, social implication..) involved by that specific geographic area. Therefore, the PDO/PGI label provides information to the consumer, reducing the asymmetry of information and its pernicious consequences.

Likewise, the PDO/PGI scheme warrants a standard of objective quality, facilitating the homogeneity of the product. The quality expectations that the consumer makes, contribute to build up the reputation of the label, and help again to reduce the lack of information.

The PDO/PGI labelling influences the three categories of characteristics possessed by products according to the theory of information (Bello and Gómez, 1996): search, experience and credence characteristics. First, the PDO/PGI label is strongly linked to some search characteristics, reducing the need for getting information about them (e.g. the fat contents is an attribute valuable at the moment of purchase; if the consumer knows that only a set of brands/designations possess the desired amount of fat, the search for information reduces to that choice set). Second, the PDO/PGI is also associated to specific values of experience attributes (e.g. flavour) and, therefore, it reduces the risk at the time of evaluation of the product properties. Finally, the PDO/PGI confers a guarantee on credence attributes (e.g. nutritional effects, methods of production, ...).

Therefore, the PDO/PGI in its role as signal of quality, reduces the need for search of information by consumer, reducing as a result the pernicious consequences of the asymmetric information on the consumers grounds.

From the producers' perspective, the PDO/PGI mitigates the adverse selection and moral hazard consequences of asymmetric information. The production under this scheme not only enhances quality, but also imposes some standards, granting fair competition amongst firms.