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**Cooperation, Competition, and Regulation:  
Constructing Value in French and Italian Wine Markets**

by

Elizabeth Ann Carter

A dissertation submitted in partial satisfaction of the  
requirements for the degree of  
Doctor of Philosophy

in

Political Science

in the

Graduate Division

of the

University of California, Berkeley

Committee in charge:

Professor Steven Vogel, Co-Chair  
Professor John Zysman, Co-Chair  
Associate Professor Marion Fourcade

Fall 2012

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by  
Elizabeth Ann Carter

## Abstract

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Doctor of Philosophy in Political Science

Professor Steven Vogel, Co-chair

Professor John Zysman, Co-chair

In 1976, virtually unknown Californian wine producers shocked the culinary world by beating top French Bordeaux houses at the blind tasting event known as “The Judgment of Paris.” The challenge was repeated in 1986 and 2006, with Californian vintners emerging victorious each time. Yet as producers in other countries increasingly meet or surpass French producers in terms of quality, the price differential between French wines and other wines continues to increase. What enables French producers to maintain market *price* dominance, absent clear *qualitative* dominance?

I demonstrate that French wine producers maintain price dominance because the French government made regulations that defined geographic zones, which drove prices up by (1) limiting supply and (2) locating brand value with grape growers. Quality French producers were able to pressure the government for these market protections because of strong political organization among growers and deep levels of compromise across the supply chain, notably between growers and wine merchants.

Why have some producers secured these market protections, but not others? And why have these regulations worked in France, but achieved mixed results in other contexts? Unlike quality French producers, both the Italian wine market and the French table wine market are characterized by weak levels of vertical supply chain cooperation, which undermines the construction of a protected market space. I argue these different patterns of political organization explain national and sub-national patterns of production and subsequent market outcomes. I then extend my case to the broader luxury market.

This dissertation is dedicated to my mother, Mary Quinn Carter, 1941-1998.

Through her life and especially during her 9-year battle with cancer, she taught me deep lessons about determination, optimism, intellectual curiosity, love, joy, and living each moment to the fullest.

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# **Part I**

## **Introduction**

# Chapter 1

## Cooperation, Competition, and Regulation

### 1.1 Introduction and Overview of the Argument

In 1970, connoisseurs around the globe believed the world of quality winemaking started and ended in the vineyards of Europe—especially the vineyards of France. When international demand for wine exploded during the 1970s and 1980s, we would have expected the market expansion to be captured by European producers. But only some European producers were able to capitalize on this explosion of international demand for wine. High-end French winemakers were among the best positioned, and prices for their wines skyrocketed. Italian producers competed favorably with “New World” wine producers from California, Australia, Chile, New Zealand, and South Africa, but were unable to seriously challenge quality French wine producers for market position. And French producers in the lower-end table wine market, despite clear gains in quality, were unable to compete against New World wine producers. How do producers construct rules to maintain market value? Why have some categories of producers thrived with market expansion, while others have not? These are the puzzles I examine in this dissertation.

My study of the wine sector demonstrates how political cooperation can shape the location of value across the supply chain. Location of value and distribution of risk are not economic givens. Different supply chains favor different economic actors, determined largely by where a brand is located in the production chain. Supply-chain positioning determines who captures economic benefits when the market expands in the short run, and who is left with unsold surplus production in times of sudden economic downturn. The dominant actor in the supply chain is the actor who owns the brand that convinces consumers of quality. These supply chain dynamics impact a firm’s degree of market protection and whether they can transition from a short-run, price-based market approach toward a long-run, quality-driven strategy.

In this dissertation, I demonstrate that patterns of cooperation within the supply chain determine brand location and subsequent production strategy. To prove this argument, I primarily focus on the French and Italian quality wine

markets, but I also offer a secondary discussion of the French table wine market. I demonstrate that the French quality market is corporatist and supply-dominant, with high levels of cooperation across the production chain. In the Italian case, weak supply chain cooperation has resulted in downstream brands and a demand-dominant, flexible model of production, creating a less-protected market space.<sup>1</sup> As for the French table wine market, I define it not as corporatist but as cooperativist, as the sector has high levels of upstream horizontal cooperation but weak levels of vertical cooperation. As a result of this structure, French table wine has a supply-dominant production model that neither leads the market nor responds to it. It creates a protected production model in which supply and demand are only tenuously linked.

In sum, French cooperative institutions insulate wine producers from market fluctuations, while loosely organized Italian producers distinguish themselves by responding to changes in consumer demand. In both cases, these producer institutions and subsequent power dynamics determine which actors dominate the wine production chain, how producers define quality, and how they compete.

**Table 1.1 A Comparison of Wine Market Structures**

	France high-end	France low-end	Italy high-end (DOC) and low end (IGT)
Nature of competition	Quality.	Price.	Hybrid: Price/quality intersection.
Who sets standards	Wine industry	State	Market
Who owns the brand	Growers	Retail Stores	Wine Merchants/ Large Producers/Retail Stores
Organization of the Industry	Corporatist; industry-driven cooperation	Cooperatives; dependent on, yet antagonist with, the state. Wine merchants generally excluded from production chain.	Autarchic; self-governing, ad-hoc volunteerist organization.
Supply or Demand Dominant	Supply-dominant	Supply-dominant	Demand-dominant

Contrary to conventional wisdom, national regulations do not necessarily determine the depth of producer cooperation and patterns of market competition. France and Italy have similar regulatory regimes, yet their wine industries have responded differently to market incentives. These regulatory bodies—*appellation d’origine contrôlée* (AOC) in France, *denominazione di origine controllata* (DOC) in Italy—protect local “traditional best practices” in quality wine regions. These measures link geographic areas with a specific “taste palate,” providing consumers with a geographically based quality guarantee and preventing producers from changing grape variety and adapting new (possibly cost-saving) production practices. This arrangement also severely restricts grape quantities, reducing the potential expansion of market supply. As a result, increased demand has little effect

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<sup>1</sup> The supply chain structure of the Italian quality production (DOC) is parallel to the structure of Italian table wine (notably the “high end” Italian wine category, IGT). This similarity in supply chain structure explains the similar economic outcomes across the two different categories, as I discuss in Chapter 3.

on quantity, but a strong effect on price. Even though French and Italian high-end wine industries both have this type of regulatory structure, French producers command higher prices than Italian producers, and these differences are becoming more pronounced as the market expands (www.wineaustralia.com, 2010).<sup>2</sup>

French wine regulation has helped shelter producers from market fluctuations, such as changes in consumer taste at both the high and low end of the market. I describe this phenomenon as the “supply-driven” or “supply-dominant” approach. For quality producers, the supply-driven approach limits the parameters of price-based competition, enabling producers to shift from differentiating their product based on price-saving measures and competing instead on perceptions of quality. Central to the “supply-dominance” approach is the idea that the producer (not the consumer) should determine what is available on the market, because industry experts are better equipped to lead the market than the mass consumer base.<sup>3</sup> In other words, supply should not follow demand, but demand should follow supply.

In the French quality wine market, supply dominance stems from the producer-defined, government-protected notion of *terroir* (a delimited area with a distinct cultural heritage and geographic characteristics). The *appellation d’origine contrôlée* (AOC) protects *terroir* and “traditional best practices,” limiting producers’ ability to respond to changes in demand. Instead, consumers align their preferences with what producers and the state deem as quality (Teil 2004).<sup>4</sup> Critically, the AOC limits grape production. Thus if demand for wine from a specific region increases, output remains stable, and prices increase. When effective, *terroir* provides growers with a branded monopoly and constricts wine merchants’ production and sourcing options by moving supply chain power away from downstream wine merchants and towards upstream grape growers.<sup>5</sup> For some regions—such as Champagne—prices

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<sup>2</sup> At the same time, a segment of the Italian table wine industry (*indicazione geografica tipica*, or IGT) has achieved a level of market success that eludes their French counterparts, *vin de pays producers* (VDP). The IGT and VDP are both table wines with some link to a large geographic region with minimal production standards (beyond yield limits and sugaring restrictions). IGT and VDP are best understood as parallel regulations to the American Viticultural Areas (AVAs) on which they were modelled: a wine from Napa Valley may be made of any grape of the producer’s choosing; the same holds true in the case of IGT or VDP.

<sup>3</sup> A classic example of “supply-dominant” production is Apple. Steve Jobs aptly demonstrated the notion of supply-driven production when he said: “Consumers do not know what they want; you need to show them” (Isaacson 2011).

<sup>4</sup> Some French AOC markets are more “supply-dominant” than others. For example, Burgundy is more “supply-dominant” than Bordeaux, as demonstrated in Chapter Four. See Coleman 2008 or Laferté 2006 for more information.

<sup>5</sup> *Terroir* has two components: geographic characteristics and traditional best practice. According to this idea, the geographic characteristics of *terroir* provide a distinct taste that cannot be replicated elsewhere, even when using the same grapes and the same production techniques. Local know-how is equally important; the notion is that growers have centuries worth of passed-down knowledge that has enabled them to understand which grapes and production practices are the best expression of their unique *terroir*. As a result of the unique geography and local know-how, only producers in Champagne can produce Champagne, and only in Saint-Émilion can producers make a Saint-Émilion. Critically, this system also prevents newcomers—who are assumed to lack *terroir*—from entering the market.

are more than sixteen times the average price of French table wine (EC-EUROSTAT 2008).

Quality Italian wine, on the other hand, is primarily defined downstream by privately owned brands, which are built largely through the five main Italian wine guides. Wine guides became the primary guarantee of Italian wine quality following the inability of Italian wine regulation to provide salient quality guarantees. Wine guides' rankings are shaped by the evolving tastes of their reader base (Odorici and Corrado 2004). As a result, Italian wine production tends toward demand-dominance, guided by the principle that the "consumer knows best." This distinction between supply-driven and demand-driven markets has important implications for the construction and protection of market value: producers that create demand generate higher value than producers that follow demand. The former launch themselves into a higher-value tier and less crowded market than producers in the latter category.<sup>6</sup>

These arrangements raise two questions: first, why did French quality wine producers institute self-regulation and restricted production choices instead of responding to changes in consumer demand? And how has this resistance to consumer demand actually led to greater market success? The fundamental nature of the price mechanism is such that in a perfectly competitive market, all firms have zero profits in the long run. Thus, a firm's goal is not to maximize short-run profits, but to protect itself from price competition in the long run. Wine is no different, with producers attempting to establish a distinctive market position by creating rents and limiting their potential competition. The form these stable markets take depend on which actors are politically powerful enough to shape certain market institutions, including property rights, governance structures, rules of exchange, and balances of power across the supply chain. I argue that firms pursue strategies that will enable them to create stable shelters from price competition (Fligstein 2002, p. 659).

In the chapters that follow, I demonstrate how timing and politics have led to different institutional configurations, forms of cooperation, and forms of competition in the French and Italian wine industries. My analysis demonstrates the importance of supply-chain cooperation in constructing a degree of market protection from similar competitors, or what I call "bounded competition."

## 1.2 Market Overview: France and Italy Compared

In addition to its central position in gastronomy and culture, wine is a significant source of employment and agricultural revenue in both France and Italy. In 2008, French wine export revenues totaled €7.8 billion and Italy's wine export revenues reached €4 billion ([www.wineaustralia.com](http://www.wineaustralia.com)). There are 110,000 vineyards in France, and 27,000 growers make their own wine (FranceAgriMer 2011). The precise number of vineyards in Italy is unknown, but it is estimated to be one

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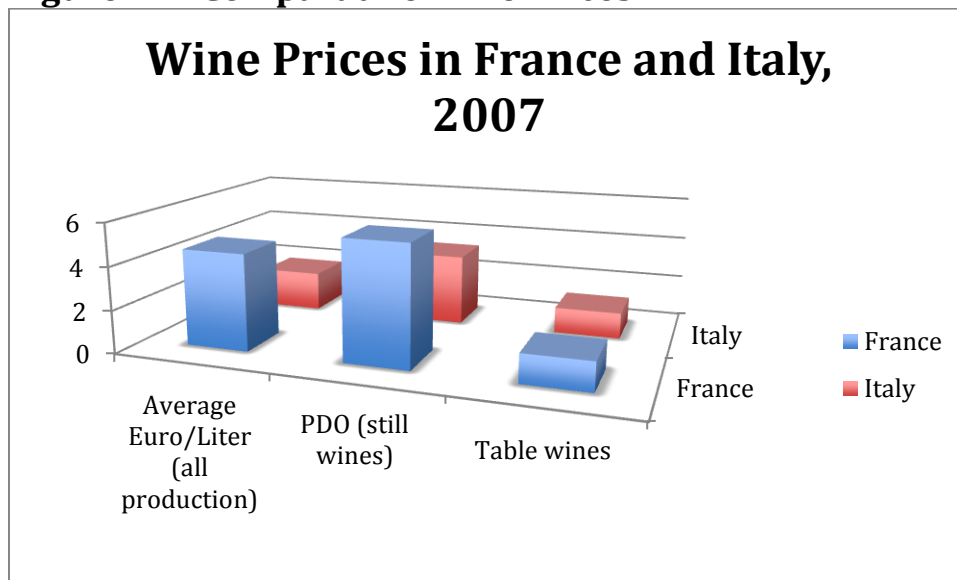
<sup>6</sup> There are five prolific Italian wine guides: *Gambero Rosso's Vini d'Italia*, *I Vini di Veronelli*, *Guida dei Vini Italiani*, *Duemilavina*, and *Guida Vini d'Italia de l'Espresso* (Corrado and Odorici 2009).

million, with 73,000 reported grower-wineries (Seccia, et al. 2008). France and Italy are consistently among the highest-volume global wine producers. In 2010, Italy produced 48 million hectoliters and France produced 46 million hectoliters. France, however, is the top global producer of wine in terms of value: French wines sell for an average of €4.52/liter, where as Italian wines sell for an average of €1.87/liter (EC-EUROSTAT 2008).

The difference in French and Italian wine value is found almost completely in their different PDO (protected designation of origin) wine values. PDO wines require that a minimum of 85 percent of grapes come from a given geographic area, impose yield restrictions, and guarantee producer-determined production rules (including allowable grape varieties). PDO is the European label, at the country level they are France’s AOC wines (*appellation d’origine contrôlée*) and Italy’s DOC and DOCG wines (*denominazione di origine controllata* and *denominazione di origine controllata e garantita*).<sup>7</sup>

The average value for France’s AOC still wines is €5.59/liter to Italy’s DOC/DOCG price of €3.34/liter.<sup>8</sup> French table wines sell at slightly higher prices than Italian table wines: €1.32/liter to Italy’s €1.22. Fifty-eight percent of French wine production is AOC production, while 28 percent of Italian production falls under DOC/DOCG. Regulated producers’ success accounts for the main differences between the French and Italian wine prices (see Figure 1.1).

**Figure 1.1: Comparative Wine Prices**



Euro per liter, based on EU internal and external export data (EC-EUROSTAT 2008). Sparkling wines were omitted due to the strong outlier effect of Champagne, which sells for €21.34/liter.

<sup>7</sup> DOC wine regulation was modeled after the French AOC regulation. It is the legal recognition of traditional wine-making practices. The DOCG was created in 1992, as a DOC with higher regulatory controls. Theoretically DOCs should be granted to high quality Italian wines, and DOCGs should be granted to Italian wines of superior quality.

<sup>8</sup> Sparkling wines are omitted here, but if included, this difference would be even more pronounced: Champagne sells for €21.34/liter, whereas Italian sparkling wines average €2.30/liter.



While 82 percent of French wine value is captured by regulated AOC wine producers, Italy's regulated DOC and DOCG wines capture only 47 percent of Italy's wine market value (ISMEA 2008b, p. 219, data excludes sparkling wines). From a production perspective, only 24.6 percent of Italian grape production is intended for DOC or DOCG production. While there are over 360 DOCs in Italy, many have annual production volumes of zero, as the value gained by the DOC mark is less than the per-bottle fee incurred to apply the DOC sticker (Personal Interview, Corrado and Odorici, July 2010). And DOC production is concentrated: fewer than 100 DOCs account for over 80 percent of DOC output (Corrado and Odorici 2008b). By contrast, French AOC production accounts for 58 percent of the country's wine production (EC-EUROSTAT 2008).

The AOC was constructed to protect French producers from potential market competitors. Even though Italian producers copied this French institutional model with the DOC, a uniquely Italian model of production emerged, one where winemakers compete on flexibility and price-quality intersection. Italian wine producers improved upon quality and established a strong international presence, but they have struggled to break into the French-dominated quality wine market.

### 1.3 Definitions

Before presenting my argument, I need to clarify four important terms: *commoditization*, *upstream production*, *downstream production*, and *in-house production*.

A *commoditized* good is a product that is indistinguishable from immediate market competitors. Examples of market commodities include mass-produced chicken, wine, widgets, etc. The idea is that one product is indistinguishable from another similar product, regardless of where the product is from or who produced it. Commodity producers face higher levels of price elasticity and risk, and compete in something closer to "perfect market competition" vis-à-vis differentiated quality producers.

By *upstream* supply-chain production, I refer to actors who produce primary product inputs. By *downstream* supply-chain production, I refer to actors who purchase upstream product inputs and perform processes necessary to bring this product to market. *In-house* production is when a producer completes both upstream and downstream production within his or her firm. The example of the olive oil sector makes these distinctions more tangible. In this sector, the upstream actor is the olive grower, and a downstream actor is the merchant who buys olives, converts them into olive oil, bottles it, and brands it. A second downstream actor—and one that is "further downstream"—is the retailer, who is the final link between the product and the consumer. "In-house" olive oil production refers to the grower who presses and blends his own oil, bottles and brands it.<sup>9</sup>

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<sup>9</sup> The actual tasks performed along the supply chain vary greatly by sector and in the case of wine, by region: a grower may also convert her grapes into wine, and then sell the wine to merchants. This does not change one's position as upstream or downstream, and the precise production function is

**Figure 1.2 Supply Chain: Upstream to Downstream Production (Left to Right)**



## **1.4 The Argument: The Politics of Luxury**

I argue that differences in location of supply chain value are principally explained by three factors: divergent patterns of cooperation and competition, the relative power of different supply chain actors, and state strength. Let us consider each in turn.

### **1.4.1 Patterns of Producer Cooperation**

Patterns of producer cooperation vary greatly between our case studies, and these patterns determine the location of value in the supply chain. The French quality wine sector follows a corporatist organizational structure. In Italian wine production, the sector's organizational structure is corporatist by law, but voluntaristic in practice. In our minor case study of French table wine, the market structure is what I call "cooperatist." For quality French wine producers, value is located upstream with growers. For less cooperative Italian producers, brands and value are located downstream with large wine merchants or retail chains. And for French table wine cooperatives, value is captured primarily with retail outlets.

The key to understanding the French quality wine market begins by categorizing French quality wine organizations as corporatist.<sup>10</sup> Here, I borrow from Wyn Grant's definition of corporatism as a "system of interest representation in which the constituent units are organized into a limited number of singular, compulsory, non-competitive, hierarchically ordered and functionally differentiated categories, recognized or licensed by the state and granted a deliberate representational monopoly within their respective categories in exchange for observing certain controls on the selection of leaders and articulation of demands and support" (Grant 1985, p. 25).

There are two principal institutions that support this corporatist arrangement in the French quality wine market. First, there is the interprofessional

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less central to my argument than where one's location in the supply chain. Note that this supply chain structure applies to non-agricultural sectors as well, as I discuss in my concluding chapter.

<sup>10</sup>While quality wine organizations are "corporatist," table wine producers are organized into cooperatives. The structure of the French cooperatives is explored in Chapter Two.

council, a hierarchical regional decision-making body that splits power evenly between growers and merchants in a protected wine-producing region.<sup>11</sup> The council decides upon the regulation for the designated area and enforces quality monitoring.<sup>12</sup> Secondly, there is the quasi-governmental INAO (*Institut national de l'origine et de la qualité*),<sup>13</sup> which determines who can receive the *appellation d'origine contrôlée* (AOC) recognition and assists local groups in constructing and codifying traditional best production practices.

French AOC interprofessional organizations resemble the successful corporatist boards that Schonfield describes in *Modern Capitalism*. Two groups of unequal power (in his case, labor and capital) come together to make long-term decisions. In some cases, this negotiated compromise can improve the economic position of both sets of actors. As in the German case that Schonfield describes, the French state is not actively guiding the decision-making process. Instead, their protection of the inter-industry agreements is critical to the success of the sector.<sup>14</sup> This is consistent with Fligstein's idea that actors will compromise in order to secure their ultimate objective of long-run market stability.

Corporatist organization is critical to the success of French wine producers. Codified "best practice" production agreements protect against price-based competition and guarantee a minimum level of production quality. Merchants and growers work together to define the terms of quality, tradition, and typical taste, and then use state regulation (the AOC) to protect these definitions and to limit production output. These cooperative institutions insure firms' stability by limiting supply and creating high barriers to entry. Strong local cooperation between different actors enables firms to consider long-term production strategies and prioritize long-term value added over short-run cost reduction. As Schoenfield noted, corporatist German labor defends its interests and pushes for a long-term market perspective through participation in the boardroom. Similarly, French grape growers increase long-term market stability and help redefine quality by splitting power with the merchants on the interprofessional council. Here, they obtain a type of monopolistic protection over a defined geographic area, while merchants can

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<sup>11</sup> Examples of interprofessional councils include the CIVC (*Conseil Interprofessionnel du Vin de Champagne*), the CIVB (*Conseil Interprofessionnel du Vin de Bordeaux*), the CIVL (*Conseil Interprofessionnel du Vin de Languedoc*), etc. Small appellations are subsumed into the larger regional interprofessional council, i.e., the Margaux appellation is subsumed into the CIVB; they would not have their own interprofessional council.

<sup>12</sup> As of 2011, the European Union requires quality audits to be completed by a private auditing firm of the interprofession's choice.

<sup>13</sup> The INAO consists of industry experts (generally from the interprofessional councils), a range of technical experts (including geologists and enologists), and representatives from the Ministry of Agriculture. Though the INAO falls under the jurisdiction of the Ministry of Agriculture, they are technically a neutral "quasi-governmental" body whose mandate is to assist producers organize for protective organization. The INAO is funded by both the producers they protect and by the Ministry of Agriculture. The INAO sees their mission to protect and support quality French agricultural production, and they are the voice for French quality production both in the Ministry of Agriculture and, by extension, at the EU level.

<sup>14</sup> In the German case, a main function of the state was creating a stable macroeconomic climate and keeping inflation low; in the French case, it is protecting trademarks and enabling the quasi-governmental INAO to legitimate the decisions of the local interprofessional organizations.

influence the growing conditions for the grapes they want to use in their winemaking. This causes quality to increase for a limited production quantity (bounded by geography and production yields), leading to higher profit margins for growers and merchants.<sup>15</sup>

Corporatism, as Grant suggested, has the potential to change the balance of political power in favor of the weaker groups in a capitalist market society (Grant 1985, p. 25). He notes that sectoral-level corporatism, or “meso-corporatism,” is especially prevalent in agriculture, linking farmers, food processors, and the state. Farmers need to associate in order to exert market influence, and food processors (and sometimes distributors) agree to corporatist arrangements in an attempt to obtain protection from the collective strength of farmers and their supportive agricultural departments in government (Coleman et al. 2004, pp. 211, 214-215). Grant and Coleman argue that the interests of food processors tend to be overshadowed by farming interests (pp. 214-215), and policy tends to emphasize farmer stability rather than productive efficiency.

We see this dynamic in the case of quality French wine production. Wine merchants agreed to give organized grape growers a geographically determined monopoly over a limited grape supply for two reasons: first, to secure some form of protection from the politically powerful grower groups, and second, to preempt the state from intervening and writing the market rules. As growers began cooperating with wine merchants (*négociants*), they ensured that high grape quality and adherence to traditional production became profitable for actors throughout the production chain. For example, Champagne grape growers have a monopoly over Champagne grape production, enabling them to earn as much as €5.50 per kilo. Champagne *négociants* pay more for their wine grapes than any other *négociant*. But instead of making Champagne uncompetitive, the quantity of Champagne is severely constricted, leading buyers to bid up prices in the luxury market: Champagne sells for €21.34 per liter, four times the amount of other regulated French wines (EC-EUROSTAT, 2007 prices). The regulation protects farmers, but wine merchants benefit as well, as both parties were instrumental in shaping regulatory policy to protect their own economic interests.

While French quality production is characterized by corporatist organization, French table wine production empowers the grower but omits the merchant. The politics of radicalized southern French table wine grape growers led to the institutionalization of concentrated grower power. These growers organized into local cooperatives and the state gave into their demands of a livable price for their production. Various price supports from the central government provided growers with enough economic protection to keep radical political uprisings in check and isolate producers from shifts in consumer demand. However, the incentives for

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<sup>15</sup> In certain regions, AOC quality regulation provides growers with a type of monopoly position; for example, all grapes used in the AOC “Champagne” must be bought from growers that grow in the Champagne region. The AOC designation is supposed to recognize “traditional best practice,” but it acts as a *de facto* quality guarantee and limits wine quality from a given region, enabling protected wine producers to command higher prices for their wines. It also divides decision-making evenly between two typically antagonist groups—growers and merchants—behind one common objective: increasing value of the common brand.

quality production were weak, as growers would receive a set price for a quantity of grape regardless of quality. These circumstances led French table wine producers to produce more cheap wine than the shrinking market could absorb.

Tying grape prices to quantity rather than quality had two additional effects for the French table wine market. First, it caused nearly all wine cooperatives to produce a more or less interchangeable wine. So while the cooperatives cut the merchant out of their supply chain, they passed supply chain power on to retail outlets, who could choose from hundreds of interchangeable producers. Secondly, it caused producers to try to produce at or near the maximum output level. Over time, the wine market became flooded, interchangeable producers became commodified, and the two institutions that were intended to protect producers—cooperatives and the state—undeniably contributed to locking producers into a low-price, low-quality cycle.<sup>16</sup> Not only were French table wine producers unable to give regulated producers a run for their money, but the French market developed into a highly bifurcated system, with little room for movement from one category to the other (regardless of the actual quality potential of a given plot of land).

Italian production, similarly, located production value downstream with large merchants and retail chains. Italy's fragmented wine producers and the country's initial regulatory failures prevented protective regulation from altering power relationships between actors in the wine production process. Instead of working through the state to improve their market power, Italian producers relied on individual innovation and market feedback to improve their market position. Italian wine regulation such as the DOC never moved value upstream, because the country's grape growers never became a strong, politically cohesive unit.

Critically, the differences in the location of supply-chain power shapes the different styles of wine French and Italian producers create. The wine blog *The Zinquisition* summarized these differences between French (*terroir*-driven) wines and Italian (style-driven) wines: "*Terroir*-driven wines are often associated with wines of a "natural" style... with limited human intervention. Style-driven wines are wines where a winemaker strives to create a wine of a certain style.... These wines are also thought by critics to reveal less of their *terroir* as those subtleties are masked by the (human) intervention (*The Zinquisition*, December 2005, as cited in (Corrado and Odorici 2009, p. 115).

The perception of the *terroir* wines as rare, special, and unique helps drive the French wines into a higher price point than their Italian competitors. In Italy, producers hesitated to cooperate with each other and consumers did not view *terroir* as a sufficient quality guarantee. Value became located with the person who transforms the grape, rather than with the geographic area. Brands are then associated with the individual winery, not with the broader geographic area. Additionally, knowledge can be transferred and replicated, whereas *terroir* cannot. As a result, Italian wines compete with other "New World" wine exporters—such as

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<sup>16</sup> French table wine producers have tried to move toward quality beginning in the 1980s. This strategy has been difficult both due to the stigma southern wines face among consumers and a production mentality that equates production volume (as opposed to production quality) with grape prices (Personal Interviews with producers in the Languedoc, 2009 and 2010).

Chile, the United States, Australia, and South Africa—despite the fact that Italians have millennia of wine production behind them. And many French quality producers compete in an uncrowded market space.

The famous “Judgment of Paris”—when California wines beat out French wines in a blind taste-test in 1976—demonstrated how wine quality can be difficult to judge, even for professionals.<sup>17</sup> Because of the sheer number of regions and brands—and the difficulty of discerning quality—quality guarantees take on an acute importance in the wine market. Through the corporatist interprofessional organizations, French producers are able to define and protect shared quality brands via the state. Unlike regulation, wine guides build enologists and brands, as opposed to protecting geographic areas.

### **1.4.2 Power of Different Supply Chain Actors**

According to Gary Gereffi’s analysis of global industrial supply chains, there are two types of commodity chains: producer-driven and buyer-driven. Producer-driven systems are characterized by high barriers to entry for the inputs of production. In contrast, buyer-driven commodity chains are highly competitive and controlled further down the production chain by branded manufacturers and retailers (Gereffi 1999).

These commodity chains parallel my descriptions of the French wine industry’s supply-driven system and the Italian wine industry’s demand-driven system. On the one hand, French regulatory institutions limit supply and put value in the hands of the few economic actors with legal access to the shared geographic brand (i.e., growers within the protected appellation). On the other hand, Italian wine brands rely more on the expertise and name of the winemaker than on the traditional best practice of growers. Additionally, quality wine in Italy is often produced outside of the protective DOC regulation (via the IGT table wine category). French quality wine exemplifies a producer-driven production chain: by equating quality with “intrinsic” geographic traits and centuries of refined production know-how, they create high barriers to entry for production inputs. For quality Italian producers, however, the fact that value depends on enological know-how (i.e., grape blending, aging, oxidizing, etc.) and not *terroir* means there are lower barriers to entry and a more competitive market.

### **1.4.3 State Strength**

By applying the idea of corporatism to the structure of the French wine market (Keeler 1987), I demonstrate how the goals of producers came to be the goals of the state. Corporatist institutions, such as the interprofessional councils, are non-competitive, hierarchical representative organizations that are autonomous in their origins. These organizations develop a symbiotic relationship with the state though

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<sup>17</sup> French wine experts judged the 1976 “Tasting of Paris.” For more information, see the “The Judgment of Paris” (Taber 2006) or movie *Bottleshock* (2008).

an osmotic process, and the state becomes reliant on the active consent of recognized interest organizations for its legitimacy (Grant 1985, p. 10).

The French state is presented in most political science literature as a “strong” state with a strong administration, as contrasted with Germany (federal), Britain (weak administration) and Italy (extensive state bureaucracy with limited efficacy). If this is the case, why is the “strong” French state unable to resist the demands of the wine lobby, but the “weak” Italian state is successful in implementing difficult reforms—the same reforms the strong French state has tried (and failed) to implement?<sup>18</sup> This image of France as a strong state and Italy as a weak state fails to capture complex political realities. In what respect is a state “strong” or “weak”? And who is defining it as strong or weak?

Peter Evans’ notion of “embedded autonomy” provides an explanation of how a strong state can be captured by industry interests. According to Evans, states are not insulated from society, but are embedded in a “concrete set of social ties that binds the state to society and provides institutionalized channels for the continual negotiation and renegotiation of goals and policies” (Evans 1995). Because states are collective but not autonomous actors, they are vested with multitudes of interests. According to Evans, embeddedness implies “a concrete set of connections that link the state intimately and aggressively to particular social groups with whom the state shares a joint project of transformation.” (p. 59) Evans’ framework elucidates why the “strong” French state appears to be captured by economic interests: economic interests within the state are tied to non-state economic actors in the shared goal of market protection.

Evans argues that embedded autonomy can enhance the ability of the state to develop a “constructed comparative advantage” (p. 82). This combination of traits strengthens the state’s capacity to acquire the information needed to effectively regulate the sector, while keeping the state sufficiently isolated to maintain some autonomy: “a coherent, cohesive state apparatus with close, institutionalized links to an economic elite would be more effective at producing industrial transformation than other kinds of state-society relations” (p. 225).

Evans’ typology enables us not only to make sense of the successful French regulatory case, but it may also shed light on the limited success of Italian quality wine regulation. The Italian state bureaucracy is “embedded”—there are strong ties between the state and some groups within civil society (especially elite groups). However, the Italian bureaucracy lacks the autonomy associated with the Weberian state, and the state is perceived to be vulnerable to manipulation by the elite (Ginsbourg, 1995). Throughout most of the twentieth century, the Italian bureaucracy appears to be closer to the idea of clientelistic state. It lacks bureaucratic autonomy and hence the capacity to develop a “constructed comparative advantage.” The “strong” structure of the French state, meanwhile, enables the Ministry of Agriculture to deny granting regulatory protection to some organized producer groups. The French government’s autonomy in this respect

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<sup>18</sup> Such as creating DOCG, the higher-quality, “guaranteed” DOC—a reform that the INAO tried and failed to implement in France. See (Smith, et al. 2007).

increases the power, legitimacy, and value of its regulation in a manner that does not occur in the Italian case.

In the French case, we see organized *vignerons* shaping consumer preferences via the Ministry of Agriculture. Producers determine “traditional best practice,” the INAO accepts or rejects the product as AOC, and the product receives protection from the Ministry of Agriculture. This state-backed guarantee then shapes how consumers define quality. French consumers seek the official mark of state quality before they buy their wine—but this quality has not been defined *by* the state. It has been defined by producers *through* the state. Producers get what they want—a degree of market protection afforded by a national quality label. And consumers buy what they want—a regulated wine, guaranteed to be produced according to agreed upon production standards. This model is effective insofar as consumers have the perception of choice and producers can sustain otherwise economically unviable small firms, all without direct government economic price supports (as we tend to see in other agricultural markets).

A state that has the ability to enforce standards and impose sanctions will be more effective in providing a legitimate quality guarantee than a state that is perceived to lack legitimate enforcement capacity. As I discuss in Chapter Two, the French state has played a significant role in regulating the quality production dating from the seventeenth century (Shonfield 1965, p. 79). During this time, quality was determined by the Sun King (Louis XIV), regulated by his finance minister Colbert, and the king’s taste would be replicated by his court and through the social hierarchy. Consumers demonstrated their sophistication by converging on the king’s definition of quality (Elias 1978). Conversely, the young Italian state (Italy was united only in 1861) had no history of regulating quality. Quality was hierarchical, defined by the local courts (Personal Interview, Laura Gori, February 2008), but a centralized, national quality hierarchy never emerged. As a result, quality knowledge is deep in Italy, but it is not centralized. It is taught at the local level.

Italian and French citizens have different perceptions of the state, the market, and the links between them. In France, the market is frequently viewed as tool that can be abused by the powerful to the detriment of the general will. In Italy, many citizens hold the opposite perspective. Italian wine producers described market as a neutral mechanism, accessible to all and determining prices by production value rather than the magnitude of political power<sup>19</sup> (producer interviews 2008, 2009, 201). Success in the market, then, is seen as a noble end in itself for Italian winemakers, which further orients their production toward responding to changes in demand and maximizing market performance. French winemakers, conversely, described the quality risks associated with a free market (Personal Interview, Sociologist Antoine Hennion March 2008; Personal Interview

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<sup>19</sup> Relatedly, an interviewee explained to me that the reason scandal-plagued Silvio Berlusconi had won three Italian presidential elections was due not only to the weak, fragmented Italian left, but also to Berlusconi’s success as a businessman. “He represents meritocracy and hard work. He has broken the old social order. He is the successful outsider” (interview with an Italian wine merchant, July 2010).



Paul Pontallier, General Manager Chateau Margaux February 2008; Personal Interview Wine Merchant Eric Texier, July 2011). These views on the relative merits of the free market reflect the experiences of the two countries: French producers strove to protect their initial price advantage, and Italian producers aimed to break into their market space.

## 1.5 Luxury Markets and Bounded Competition

Luxury markets (including wine markets) are examples of how producers politically construct the rules for value, or what Lucien Karpik calls, “the authenticity regime” (2010). These markets are distinguished by limited supply, hierarchical and elite-defined notions of quality, and prices that vastly exceed production costs. They rely heavily on politically constructed market signals to indicate quality, signals that can include shared geographic brands, firm brands, and expert reviews.

This approach requires an understanding of the relationship between market restriction and value-added production. There is an assumption in liberal economics that when buyers and sellers are atomized and information is perfectly distributed, the market will operate efficiently. If actors can easily be replaced (hired and fired), upstream producers will have their choice of downstream merchants, merchants will have their choice of producers, and consumers will have the freedom to buy the product that offers the price and quality they desire. This structure, it is assumed, gives rise to a highly efficient market mechanism. The notion of an actor’s market power tends to be omitted (or is assumed to be balanced perfectly between different actors).

Such a market model is appealing in theory. But a recurring critique of the “atomized actors lead to efficient market outcomes” assumption is the following: too much competition may actually be *detrimental* to the creation of value-added markets. Some authors have already described the potential tension between the notion of market efficiency (competition) and of “market slack” (Hirschman 1970) or market “monopolists” (Schumpeter 1942, Kim and Mauborgne 2005, Brooks 2012). In *Exit, Voice, and Loyalty*, Albert Hirschman demonstrates how having too many market exit options can be detrimental to a firm. Easy market exit can rob the firm of the feedback it needs to respond to the consumer preferences and improve performance. If firms were truly operating near Pareto efficiency (where profits are equal to zero), a minor market disturbance could cause the firm to go under. A degree of “market slack”—or market inefficiency—allows firms to adapt to changing consumer preferences. If there is enough market slack, firms can invest in the development of new products, improve production, take risks, anticipate market demand, and look to protect long-term market interests.

Schumpeter takes this argument a step further, arguing that monopolies are better for the economy than perfectly competitive firms, as they provide greater stability and thus provide a foundation for long-range economic strategies. He differentiates monopolies from cartels—which deliberately stifle competition—and notes that monopolies provide a level of short-term market protection: “there are superior methods available to the monopolist which either are not available to a

crowd of competitors or not available to them so readily” (1942, p. 101). He concludes his discussion on monopolies by noting their importance to a healthy economy: “(Monopolies have) come to be the most powerful engine of our progress and in particular of the long-run expansion of total output not only in spite of, but to a considerable extent through, this strategy which looks so restrictive when viewed in the individual case” (1942, p. 106).

Market inefficiencies, then, can be beneficial for firms and for consumers. *New York Times* columnist David Brooks has recently explored this idea. He argues that in the contemporary American economic culture, “competition has trumped value creation” to the detriment of long-run microeconomic (firm-level) success (Brooks, April 2012). Elaborating on the ideas of entrepreneur Peter Thiel (the co-founder of PayPal and an early financial backer of Facebook), Brooks notes that instead of creating value, potential entrepreneurs tend to confuse being “slightly better than everybody else in a crowded and established field” with value creation. Value creation is something different: it is creating a new market and dominating it. The rewards, he argues, are not just bigger for the monopolists, but often bigger for society too.

Kim and Mauborgne also argue for the benefits of monopolistic competition in their *Blue Ocean Strategy* (2006), where they offer the metaphors of the red and blue oceans to explain two different market strategies. The red ocean scenario represents a highly competitive marketplace bloodied “red” by the spoils of prior predators. Producers in the red ocean try to outperform market competition by grabbing a greater share of existing demand, but market space becomes crowded and potential profits and growth are reduced (Kim and Mauborgne 2006). The authors argue that market dominance can be achieved instead by finding the “blue ocean”—that is, creating one’s own market space instead following the path others have already established. Blue ocean producers look like the entrepreneurs described by Brooks and Thiel—they create a novel form of supply, compete by establishing a degree of monopolistic protection, and have a potential opportunity for growth and profits.

Behind the idea of “monopolistic value creation” is the notion that firms should aim for unoccupied market space, where they can secure long-run market stability and a degree of market slack. French AOC regulation provides a clear example of how producers can create demand instead of responding to it and how “inefficient production” can benefit upstream producers, consumers, and even wine merchants. For other successful, high value-added sectors—including luxury producers—a degree of upstream supply-chain power is key to constructing a degree of market protection. Critical to this upstream supply-chain power is creating the perception of unrivaled quality and restricting market supply.

“Bounded competition”—or a degree of market protection situated in a broader competitive marketplace—enables firms to achieve a stable market niche that protects the firm from price competition in the long run (Fligstein 2002). Competition can lead to efficient production and low prices, but too much competition can lead to commodification, a transferring of market risk to the most vulnerable production actors, and a collapse of market options for consumers. On the other hand, cooperation can decrease transaction costs, increase trust between

actors, and contribute to the long-run health of a company or sector.<sup>20</sup> It can help develop a sufficient economic cushion to fund research and development, enable creative risks, and facilitate innovation. At its worst, cooperation can produce monopolies or oligopolies and protect inefficient producers. Ideally, producers strike the balance described by Schumpeter: enough market protection to provide a buffer from intense price-based competition, but enough exposure to product substitutes that encourages innovation and quality production. The idea of upstream supply protection is central to building and maintaining value in competitive, integrated markets.

In a state of “bounded competition,” actors cooperate across and within the supply chain, while at the same time competing in a broader competitive market. The three cases of this dissertation each demonstrate different mixes of cooperation and competition, which create different market winners and losers. The French low end of the market has high levels of upstream cooperation, which isolates producers from demand and leads to a commodified product, ultimately causing growers to struggle to differentiate their wine from market competition. The Italian market has low levels of upstream cooperation, which benefits downstream actors by weakening shared geographic brands and the price of grapes. The high end of French wine production has united upstream and downstream producers, leading to a production model that deliberately decreases output and provides enhanced market protection, providing producers across the supply chain with the potential for profit.

Competition and cooperation, however, never occur in a politically neutral space. Market organization rests upon formal and informal institutions, institutions that favor some market actors over others. As a result, successful models of bounded competition in one context will not necessarily produce the same results in other national contexts. The ability of bounded competition to create market slack is closely related to economic actors to cooperate effectively throughout the supply chain. This cooperation takes a degree of local trust and national institutional legitimacy. For these reasons, producers with low levels of social trust and national institutional legitimacy may struggle to construct shared brands and implement a successful model of high value-added “bounded competition.”

French wine producers, as the first to arrive in the luxury market, have succeeded in establishing a form of bounded competition. They responded to an increase in market competition by constructing a new definition of quality Laferté (2006). This “authenticity regime” valorized their product and kept potential competitors out of their market space. According to economic sociologist Lucien Karpik, six characteristics define the authenticity regime, and each is clearly observable in the fine wine market. These include:

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<sup>20</sup> Production cooperation can take a myriad of forms: local community cooperation (from horizontal networks in Third Italy or Silicon Valley, to geographically specified agricultural producers), intra-firm cooperation (some examples of corporatism, some cooperatives), and supply chain cooperation (another form of formal or informal corporatism). Upstream producer cooperation is one way that firms can construct shared brands and protect their market niche.

1) a large diversity of product names and tastes as well as consumers' tastes or logics of action, along with the threats rising from an opaque market; 2) the central position occupied by substantial impersonal judgment devices acting through competitive struggles and whose credible knowledge will orient consumers' action all the more because they possess a high degree of symbolic authority; 3) the active presence of trust/belief, which is all the more necessary for consumer choice and market continuity because knowledge should be credible; 4) varied forms of adjustment, which express the various forms of encounter between the tastes proposed by the devices, the tastes of the products, and the forms of consumer commitment; 5) a pervasive model or originality that reveals its presence within financial constraints, mainly by the primacy of quality competition over price competition and by the relative adequacy of the regime components; and finally 6) the diversity of the effectiveness of the coordination regime according to the effectiveness of the judgment devices, consumer confidence, and forms of commitment. (Karpik 2010, p. 147)

French grape growers were able to define this authenticity regime in terms of *terroir*—or the traditional best expression of a delimited geographic area—due to their political organization and the regulatory legitimacy of the state. As later market entrants, Italian wine producers could not benefit from bounded competition and were looking to increase their market share. This reality, combined with the ways Italy's patterns of social and political organization differed from those in France, led Italian wine producers to construct an alternative authenticity regime. Instead of bounded competition, Italy's authenticity regime relied on market signals and individually owned brands.

## 1.6 Outline

Chapter Two provides an overview of economic history and institutional development in the French wine market. Chapter Three examines the role of politics in the construction of the Italian wine market. Chapter Four compares the market consequences of the different wine regimes. In Chapter Five, I widen the scope of my analysis and apply my findings regarding supply chain cooperation, brand location, and the role of regulation to the broader French and Italian luxury markets.

## **Part II**

## **France**

# Chapter 2

## The Politics of Wine Regulation: “Cooperativism” and Corporatism

### 2.1 Chapter Overview

The political process of market construction determines where value is located in the production chain and how economic risk is distributed. In the wine production supply chain, determining the location of value is the key to understanding regulatory protection, producer strategy, and subsequent market outcomes in the industry. Producers create brands to avert direct competition, and long-term competitive advantages are highly correlated with where the brand is located in the production chain. In the French quality wine market, brands and quality standards are located upstream with grape growers. These growers work in partnership with other supply chain actors and their agreements are protected by government regulation. At the low end of the market, wine cooperatives emerged to protect growers from the perceived unfair production practices of remote wine merchants. But the effect of the cooperatives was the production of vast amounts of undifferentiated, commodity wine. As a result, downstream retail chains dominate the table wine supply chain.

These specific circumstances emerged when French grape growers were recovering from severe economic fluctuations in the late nineteenth and early twentieth centuries. Many French producers blamed this widespread economic hardship on the “free market”—a market the French state had protected quality manufacturers (such as textile producers) from since the seventeenth century. Others framed the economic crisis through the prism of the French Revolution, positing the mass of French rural growers against the few powerful, wealthy wine merchants. Unlike their Italian counterparts, organized political actors in France repeatedly demonstrated they could fundamentally alter national-level politics.<sup>21</sup>

Small-scale growers were able to construct new rules of the game in the early twentieth century and capture value due to both their political cohesion and their ability to tie their economic plight to of the cherished national goal of preserving

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<sup>21</sup> The best example of this exercise of power came during the French Revolution in 1789, and this political power was repeatedly demonstrated through the many nineteenth century French regime changes prior to the Third Republic (1871).

“French exceptionalism” and “*la France profonde*.” French exceptionalism is the idea that French culture—including cuisine, fashion, and certain ideas—is distinctively French, of superior quality, and deserving of market protection. *La France profonde* is the idea of traditional, unique French agricultural identities. Under this notion of protecting French cultural tradition from market competition, grape producers organized and pushed for the creation of cooperative local institutions under the protection of the Ministry of Agriculture. The ministry responded positively to this cultural framing of the problem and recognized the growers’ political strength by creating regulations that supported growers’ interests over the interests of French wine merchants and the free market.

Under these conditions, different market-inhibiting institutions emerged at the different ends of the French wine market. At the high end, these institutions linked the formerly adversarial wine merchants (or “*négociants*”) and grape growers through a local organization that split power evenly between the two groups, providing them both with proprietary access to a shared brand. Firms in the supply chain that would normally be competitors became interdependent and created stable markets. At the low end of the market, growers essentially replaced the *négociants* with wine cooperatives, choosing to produce and distribute wine themselves.

If we want to understand why the French still dominate the quality wine market, we need to explore how and why French producers organized to protect their market space. Across the French wine market, growers pursued price stability, creating a bifurcated market trajectory. At one end of the market, an institutionalized form of cooperation led to high value-added production, protected by government-regulated geographic brands. At the other end of the market, institutionalized compromises locked in a manner of production where price was detached from both production quality and customer demand. This regulation took two very different forms in the high and low ends of the market: the *appellation d’origine contrôlée* (AOC) for quality wine, and the *statut de la viticulture* for table wine (*vin ordinaire*, or *vin de table*). The AOC would eventually be instituted in over 400 French wine-producing regions and in the production of other quality agricultural products. Today, it provides the basis for the European Union’s quality agricultural policy (including wine). The *statut* (1931) would eventually provide the foundation for wine policy within the European Union’s Common Agricultural Policy (1972-present). Additionally, French wine policy has shaped the market terrain on which subsequent market entrants compete. Therefore, the significance of French wine regulation has reached far beyond its original design.

The institutions that emerged from the political struggles to create these regulations altered the location of value in the wine production supply chain and subsequent production incentives. At the low end of the market, price-stabilizing regulation led to commoditized wine production and institutionalized a disjuncture between price and quality. This left Southern growers with little leverage, as the consolidated French table-wine retail markets had many sellers and few buyers.

At the high end of the market, however, the new regulations led to a model of production where shared geographic brands (such as Burgundy, Bordeaux and Champagne) empowered grape growers. Quality French wine is protected upstream

through the government-protected notion of *terroir*, or delimited area with a distinct cultural heritage and geographic characteristics. *Terroir* provides growers with a monopoly and constricts wine merchants' production and sourcing options. The AOC is a geographically based regulation regime that protects local "traditional best practice" in quality wine regions, thereby protecting an image of *La France profonde*. It provides producers with a shared brand and consumers with a level of guaranteed quality, but prevents producers from adapting their product to meet changes in consumer demand. These growers had a monopoly over the grapes that *négociants* needed to create a regulated regional brand of wine. This system also prevents newcomers—who are assumed to lack *terroir* and "traditional best practice"—from entering the market.

With both the high-end AOC and the low-end *statut*, producers constructed a market approach where consumers should adapt to supply (as opposed to the other way around). These two differing wine production structures had clear implications for the location of value in the supply chain. At the high end of the French market, the new rules moved the value of production from wine merchants towards grape growers. At the low end, the elimination of large-scale wine merchants moved production value further downstream, to the retail store.

In this chapter, I explore the economic and political pressures that brought about these two different forms of market protection in France: quality wine regulation and table wine regulation. I begin with a brief overview of the significance of the French wine sector. Next, I discuss the role of the state in constructing quality regulation and in shaping consumer preferences. I then describe the implosion of the French wine market in the second half of the nineteenth century. Finally, the chapter looks at political upheaval in the Languedoc and Champagne to demonstrate how local cooperation shaped French wine regulation.

## 2.2 Significance of the French Wine Sector

Agricultural production is central to the French economy: agribusiness accounts for €150 billion in annual revenue, making it largest sector in French industry (2009). The French agricultural sector includes 10,568 businesses and provides 412,500 jobs (2008). Ninety percent of France's Small and Medium Enterprises (SMEs) (under 250 employees) and 70 percent of its Very Small Enterprises (VSE) (under 20 employees) are in the agribusiness sector.<sup>22</sup> France is the top agricultural producer in Europe, accounting for 18 percent of all EU production (SOPEXA 2009), 2008 data). Globally, France is the fourth-largest exporter of agricultural and agribusiness products.

Wine is a critical component of French agribusiness: French wine value accounts for 15 percent of the country's total agricultural production value (Agreste 2012). Wine from the *appellation d'origine contrôlée* (AOC) regime, which governs the country's high-end wine production, constitutes 58 percent of all French wine

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<sup>22</sup> Data from Sopexa 2009.



production volume and 84 percent of total French wine value (2004-2006, (FranceAgriMer 2011). The wine sector is also responsible for a significant number of French agricultural jobs: as of 2000, there are over 110,000 French vineyards (FranceAgriMer 2011). The majority of output comes from smaller French farms (with less than twenty hectares).<sup>23</sup> The French wine industry, then, plays a significant role in maintaining small French farms.

French agribusiness and wine are not only central to the French economy, but also to the global French brand. France is the top tourist destination in the world—hosting 79.5 million tourists in 2011 alone (note that the population of France is only 65 million) (World Tourism Barometer rankings, 2012). Promoting France as a cultural leader—in wine, agriculture, design, and art—is critical to building the French brand. The folklore of a culturally exceptional France—including the notion that France has a particularly strong connection to the land its inhabitants—is not only important for France’s perception abroad, but also for the French national identity. Even though 75 percent of the French population lives in urban centers, their notion of a more pastoral *France profonde* remains central to French cultural self-identity. As Bruce Crumley describes it:

*La France profonde*, an almost untranslatable term, conjures up the idea that the "real" France is rural France, found in the landscape that shifts constantly from plain to mountain and back again, and which produces here a cuisine based on butter, but just over there, one that relies on oil... (Crumley 2010).

Graham Robb elaborates on this sentiment:

Maybe it's their love of the *terroir* and the wonderful food it produces, or maybe it's because there's just so much rural land out there beckoning to them, but the French have integrated the countryside into their collective consciousness and identity in a very distinctive way (Graham Robb, as quoted in Crumley 2010).

The idea of the small French farmer, and especially the small French *vingneron*, is central to the notion of *la France profonde*. Additionally, the idea of unique, *terroir*-driven wines of an “intrinsic” quality appeals to the sentiment of French exceptionalism. And according to France's Chambers of Agriculture, fondness for the people, places, and quality foods rooted in the French *terroir* generates around \$25 billion annually in tourism-related income (Crumley 2010).

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<sup>23</sup> In some regions, the majority of wine output is produced by very small farms—in Champagne, over half of the region’s production comes from farms of five hectares or less, and in the Languedoc, the figure is 45 percent.

## 2.3 The French State: A History of Quality Regulation and Quality Consumption

Quality French wine producers had strong incentives to organize for state protection of geographically based production distinctions. The French state had, after all, held the unique position of defining and protecting quality dating at least as far back as the seventeenth century. At that time, two French economic policy objectives emerged and legitimized the state's role as a luxury-goods regulator: the explicit pursuit of quality over price and the emergence of quality as narrowly defined by the top of the social hierarchy (Shonfield 1965, Elias 1978). Scholars have argued that the emphasis on quality over price resulted from France's strictly hierarchical class structure, the elite's consumption habits, and specific economic policies pursued intermittently since the reign of Louis XIV (1643-1715).

Highest quality production was a paramount objective during the Louis XIV's reign, and it was seen to be at odds with a priced-based marketplace. Finance Minister Jean-Baptiste Colbert believed that quality would always be the decisive factor in trade and that competitiveness in price was a "subsidiary matter" (Clark 1929).<sup>24</sup> According to this argument, something as important as maintaining quality and tradition in a "culturally important" sector should not be left to the vicissitudes of the market. Instead, the state should steer the economy where it can best serve the national interest. Figures like Colbert believed that the national interest is not necessarily found in price-based competition, but in a more long-term strategy. This strategy is designed to enable French producers to compete by creating a higher-quality product that sustains a degree of producer independence from the market while protecting French culture, tradition, and know-how. As Shonfield notes: "If the guarantee of quality is thought to be invariably more important than achieving a low price, the argument for state regulation of the productive process, even at the cost of some loss of competitive power, is compelling" (Shonfield 1965: 79).

Historically, the French state has played a central role not only in protecting quality production, but also in defining hierarchical patterns of quality consumption. The idea that quality is objectively determined and hierarchical is inextricably linked with early French social and economic order. During Louis XIV's reign, the most privileged noblesse competed with one another for proximity to the king and participated in hierarchical patterns of consumption at the royal court (Elias 1978). The cultural hegemony of the court reached into the middle ranks of society through

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<sup>24</sup> The French taste for quality that flourished at Louis XIV's court was contemporaneous with a strong finance minister who subscribed to a mercantilist view of the economy. For mercantilists, trade is a zero-sum game and the amount of bullion a country possesses is a precise measure of the state's power. Thus for Colbert, the high sums that were sent to foreign craftsmen to appease the luxurious tastes of the court at Versailles was money that was strengthening foreign states at the expense of France. To keep the money French nobles spent on luxury goods within France, Colbert created state-run factories to manufacture luxury goods (Clark 1929)

this “civilizing process.”<sup>25</sup> Thus, tastes were centralized and fundamentally linked to the state’s (here, the king’s) assertion of quality.

The history of consumers aligning their tastes with élite preferences is deeply embedded within French culture. Taste in France was not an individual matter; it was a means of showing refinement by adapting taste to “known” ideas of quality. As such, aligning personal taste with centralized definitions of quality emanating from Paris was not unusual; rather, it was how consumers had been taught to demonstrate their level of cultural sophistication (Personal Interview, INRA Sociologist Genevieve Teil, November 2007). This history proved critical in shaping how wine producers framed their requests for assistance to the French Ministry of Agriculture in the early twentieth century. Instead of market protection, producers asked for quality protection, and appealed to a romanticized idea of French cultural dominance. The idea that price-based competition undermines quality is at the core of French quality wine regulation.<sup>26</sup>

The French state’s demonstrated capacity to regulate, create, and protect markets was critical in establishing the notion that the state has a legitimate role in defining, protecting, and guaranteeing quality production.<sup>27</sup> As Alexis de Tocqueville observed, the relationship between elitism, centralization, and corporatism

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<sup>25</sup> The “civilizing process” refers to the hierarchical standards of taste that emerged through Louis XIV’s court. The king’s tastes “were eventually internalized not only by the genteel classes but also by the bourgeoisie, who became wholly assimilated to courtly norms” (Elias 1978).

<sup>26</sup> In the high value-added market, a firm’s market strategies will vary on account of timing. Early market entrants look to protect first mover advantages, which necessarily include a degree of government protection (such as trademark, copyright, and patent protection). Later market entrants look to break into this market space, attempting to differentiate their product on the margin, frequently by offering a “similar” product at a lower price. An example of this dynamic can be found in a comparison of the mid-nineteenth century French and British high value-added clothing sector. Luxury production in Paris in the middle of the seventeenth century set the standard for the rest of Europe (DeJean 2006). But what French artisans could create, foreign competitors could mass-produce at a lower price—a phenomenon that occurred in the world of French fashion as early as the nineteenth century. For instance, as soon as haute couture pioneer Charles Frederick Worth’s Paris fashion designs were released, British manufacturers began replicating these creations at a lower price for the mass market. This historical competition between French design and lower-cost British production led to the creation of fashion seasons. By changing design frequently, French clothing producers were limiting the competition’s ability to enter their market space. Innovative design is, by definition, supply-led. It is a leap of creativity that pushes production forward. Design breakthroughs benefit the designer and the firm, but the returns from innovation last only as long as the firm can remain protected from copies. Firms can do this through brand protection, continuous innovation, or by imbuing the brand with a certain intangible quality. Whenever British manufacturers came out with copies of the latest French styles in the late nineteenth-century market, new styles would already be coming out of Paris. These experiences fed the perception that competition eroded initial French market advantages, especially in quality markets.

<sup>27</sup> The French state’s first foray into officially recognizing quality wine production came in 1855, with its classification and selection of top Bordeaux wines for the World’s Fair in Paris. When provided with the opportunity to present the best Bordeaux wines to the world at this 1851 event, French officials based wine rankings on prices and brand names. The notion of *terroir* was not prominent in this classification (which still provides the foundation of wine hierarchy in Bordeaux). A premier *cru* was based on the house, not on property, so when a house changed their landholdings, the land that was guaranteed as “highest quality” changed as well. This classification remains intact and has undergone very few changes over the past century and a half.

characterized the *ancien régime's* status hierarchy leading up to the French Revolution. This hierarchical social system parallels the structure and function of the AOC wine regulation. Under the *ancien régime's* corporatism, the monarch gained power by carefully doling out tasks and functions to the nobility and to *les charges*<sup>28</sup>. The nobility served as an intermediary between the monarch and his subjects. As previously noted, the tastes of the monarch were replicated by the nobility, which in turn were replicated by the lower classes (Elias 1978). Intermediary bodies like *les charges* and the nobility were tightly tied to *ancien régime* notions of elitism and hierarchy, making corporatism one of the main targets of French revolutionaries. At the same time, corporatism was a familiar structure for French organizations looking for market protection. It is a recurring theme throughout French economic history for producers to organize and for the state to grant them a kind of monopolistic protection. Sometimes these institutions display dominance over the state (corporatism), and sometimes the state dominates the producers (*dirigisme*).

French wine today is marked by these two different state-market dynamics. The quality wine market is corporatist (with strong producer organizations) and the table wine market is marked by *dirigisme* (producers' dependence on the state). There is an undeniable connection between the existence of capital, local political organization, and the development of quality production in France. Corporatist wine organizations emerged in historically wealthy French regions—regions that had been favored by the king and had a flourishing pre-revolutionary nobility, including Burgundy, the Loire, Champagne, and Bordeaux<sup>29</sup>. These quality wine regions had access to wealthy consumers, such as local elites or foreign markets. Southern France, conversely, was historically economically backwards, as it was lacking in nobles and successful examples of corporatist protection. Southern France is the part of the country that is the greatest distance from Paris, and it is the region that still struggles to define itself as a quality wine producer, despite the emergence of some exceptional regional producers.<sup>30</sup>

Wine policy locked in old patterns of organization and production in both northern and southern France. In northern France, this pattern consisted of

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<sup>28</sup> *Les charges* are ennobled local functionaries.

<sup>29</sup> Bordeaux was less favored by French monarchs and more favored by foreign markets. Still Bordeaux had a strong presence of *noblesse de robe*, wealthy bourgeoisie who purchased their titles.

<sup>30</sup> Italian market development paralleled the French case. Quality wine production developed in Piedmont, at the behest of French aristocracy who married into the house of Savoy. Upon developing the Piedmontese *terroir*, Piedmont's wines were exported to elites in other northern Italian regions (Personal Interview, Aldo Vacca, July 2011). In other Italian regions—such as Tuscany and Sicily—quality wine production emerged only much later with local landed elite, really taking root in Tuscany only in the 1960s and in Sicily in the 1990s. These local elites had greater access to capital, greater training in marketing, the ability to hire wine experts (or to acquire their own expertise via training), and access to political and economic networks. Southern Italy is economically underdeveloped in comparison to northern and central Italy, and the region remains a laggard in quality wine production. For example, southern Italy represents 51 percent of Italian wine production, but only 28 percent of its regulated grapes. Only 13.7 percent of southern Italian grapes receive DOC or DOCG protection, as compared with 36 percent of northern Italian grapes (ISTAT 2007).

hierarchy, distinction, and state protection. In southern France, this pattern was characterized by dependence on the state for economic development, which did not stop people from blaming the state for the region's continued poverty. And as French households increased in wealth throughout the twentieth century, consumers moved toward purchasing the more expensive, elite wines and away from purchasing the low-cost, low-quality, and stigmatized Southern wines.

French wine regulation is one clear example of a French attempt to protect, brand, and sell a romanticized idea of the French cultural heritage. This image shapes domestic consumption (*à la France profonde*) and market competition among producers. Like other luxury sectors, the French wine "authenticity regime" (the AOC) links quality with something intangible. This provides a high level of protection against would-be market competitors, as Karpik explains: "The French fine-wines market concentrates the main characteristics of the authenticity regime: large numbers of products carrying a rich symbolism, numerous judgment devices, primacy of quality competition, relatively balanced competitive forces, critical pluralism, promotion of customer confidence, activity and autonomy and fairly strong consumer commitment" (Karpik 2010, p. 144). The construction and protection of this "intangible quality" of the authenticity regime drives success in the French quality wine market. French consumers embraced the authenticity regime as defined by French producers and the state.

The AOC authenticity regime as defined by northern French wine producers ossified a regional division between those at the top of quality hierarchy (in the North) and those at the bottom (in the South). Still today, over 50 percent of French table wine is produced in the Languedoc, and 78 percent the region's wine is *vin de table* (including *vin de pays*, table wine with a geographic indicator). Languedoc-Roussillon was the largest regional wine producer in France in 2009, at over 12 million hectoliters of wine, but 9.4 million of this amount came from table wine production. The price differential between table wine and regulated AOC wine is significant: table wines sell at €1.32/liter compared to €5.59/liter for AOC still wines. In 2006's Languedoc, three-quarters of the region's farmers are engaged in viticulture, and the average Languedoc farmer earns only 27.1 percent of what farmers in other French regions make (Agreste 2007).

## **2. 4 Changing Supply Chain Dynamics, 1860-1900**

The question is, then, how were some French wine producers able to construct national rules for value? To answer this question, we need to consider these producers' incentives to cooperate and organize for state protection, as well as the state's incentives for supporting a constrained market over a free market. Our story starts in the latter half of the nineteenth century, when transportation costs plummeted and the size of the French wine market increased. One might think this development would be a boon for French grape growers, but that was not the case. Across the country, growers found themselves unable to compete with producers in more remote markets: Bordeaux and Orléans could not compete with low-cost

producers in the Midi, Midi producers could not compete with lower-cost producers in Italy and Algeria, and Champagne producers could not compete with lower-cost producers in the Aube. Wine consumption grew with the expansion of the working class; yet by the dawn of the twentieth century, producers in France's principal wine-growing regions were not breaking even.

The central question became what to do about the millions of small, seemingly inefficient grape growers. The increase in table wine demand, driven by the new working class in Paris, had led many farmers to specialize in wine production, especially in the historically poor Midi (also known as the Languedoc). But this increase in specialization and decrease in transportation costs had an array of adverse effects, including increasing producers' dependency on one crop, deepening price fluctuations and economic insecurity, and increasing contact between different regions. One consequence of increased contact was that after phylloxera arrived in the Midi in the late 1850s, the vine-killing lotus spread throughout the entire country, decimating northern French wine regions in the 1880s. The limited supply of grapes throughout the long phylloxera infestation—coupled with inexpensive transportation costs and a robust domestic demand for table wine—led merchants to seek out alternative grape suppliers and new methods for “stretching” wine. Merchants began to source grapes from Italy, Algeria, and, importantly, from other regions within France. Additionally, merchants found ways of lengthening the wine supply they had by adding water, sugar, and various fillers (Simpson 2011).

But the lasting impact of the phylloxera plague was to concentrate supply-chain power in the hands of *négociants*. Prior to the phylloxera crisis and the introduction of railroads, merchants and growers were mutually dependent.<sup>31</sup> During the crisis, the pendulum swung in the direction of growers, who had a scarce—and expensive—product, causing producers to dub this crisis period as the *Age de l'Or* (Golden Age).<sup>32</sup> When the phylloxera pest was eradicated, French growers faced a glut of domestic grapes and merchants had an array of supply options.<sup>33</sup> Therefore, the power in the supply chain had moved from a relatively

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<sup>31</sup> The role of the *négoce*, or wine merchant, is to buy grapes, must, or wine from grape growers and convert these products into a finished wine. They sometimes bottle and label the wine; and they link the wine with wine brokers (in Bordeaux), stores, restaurants, and other buyers. The specific relationship between the *négociants* and growers varies greatly by region

<sup>32</sup> These early years of market specialization and increased access to new markets were known in the Midi as the “*Age d'Or*” and lasted from 1860 to 1875. By 1875, French wine exports were thriving and domestic consumption skyrocketed, so despite a 75 percent increase in grape production in just ten years, growers were experiencing market success. Most growers in the Languedoc were small and sold unfinished wines (such as grapes or wine must) to remotely located *négociants* (wine merchants). With this vast market expansion, both growers and merchants were able to maintain healthy margins.

<sup>33</sup> In 1903, official wine production in the thirty-five communities in Hérault totaled 1,004,915 hectoliters, but these communities sold 2,284,848 hectoliters, the difference supposedly coming from fraudulent wines (Simpson 2004). The price of table wines was driven by alcohol content, and sugar increased the alcohol level of a wine. The use of sugar during the *Age d'Or* (1860–1875) was relatively restrained, due both to the low cost of high-sugar grapes and the high rate of sugar taxation. With the wine crisis, though, the government decreased the tax rate on sugar, and sugar became an important ingredient in the alcoholic concoctions that were sold in Paris as “wine.”

stable equilibrium between growers and merchants, toward the growers during the phylloxera crisis, and then squarely toward the merchants after the crisis.<sup>34</sup>

These two factors—alternative sourcing supplies for *négociants*, and increased production volumes once the pest was eradicated—spelled disaster for grape growers across France. As the supply of Languedoc’s grapes increased and their prices fell, the level of grape imports did not adjust back to pre-crisis levels (Simpson 2011). At the same time, Northern *négociants* increasingly substituted cheap wine from the Languedoc into wines with some geographic name recognition, most notably in Bordeaux. From the Northern grower’s point of view, the *négociant* was undermining the brand that quality producers had developed in these regions and was unwilling to pay “authentic” producers for their product, depressing grape prices. According to growers, this weakened the market for quality wine, since a consumer buying “Bordeaux” or “Champagne” would have no guarantee regarding the content of the bottle.

In reality, the problem Northern growers faced was a bit more nuanced than presented by this story (which is the story told by government officials and producers in quality wine-producing regions). Specifically, it is true that some *négociants* were misusing place names. While most high-quality production came from branded houses in a few select regions, producers who did not sell to these branded houses could still potentially take advantage of the geographic place name. They were not necessarily quality producers but, with a quasi-protected market due to high transportation costs, they had not traditionally faced steep cost curves. In the middle of the nineteenth century, that began to change.

For example, Champagne producers in the Marne struggled to compete with producers from the neighboring Aube. Aube’s vineyards had been planted more recently and were denser, prone to greater industrialized production, and therefore much cheaper than grapes from the Marne. Grapes were bought from the Aube and sold in wine labeled “Champagne.” Champagne’s Marne producers argued that Aube producers were not authentic Champagne producers, that their wine was of a lesser quality, and that selling Aube wine labeled as Champagne constituted fraud (Kladstrup and Kladstrup 2006). Similar competition between regional producers emerged elsewhere in France. Just as producers in the Marne were pushed into price-based competition with producers from the Aube, producers in Bordeaux were pushed into price-based competition with producers from the Midi.

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Specifically, the wine industry used eight million kilograms of sugar in 1885, the year the tax on sugar was reduced by 60 percent. The following year, the quantity the industry used increased to 26 million kilograms. In 1899, when harvest volumes doubled the 1885 harvest yields, the volume of sugar the industry used reached 39 million kilograms (Colman 2008, p 16). While growers blamed the *négociants* for overuse of sugar, in practice many growers used sugar before selling the wine to the *négoce*.

<sup>34</sup> At the same time, however, the phylloxera pest undermined French wine market stability, and its effects were particularly severe for Southern growers. It emerged sometime in the Languedoc between 1858 and 1863, and due to its early arrival and the density of local vineyards, the relatively poor Southern region was the worst hit by the crisis. It is estimated that 75 percent of all French vineyards were destroyed in the crisis, and upwards of 83 percent of vineyards in parts of the Midi (Loubère 1978).

Notably, both producers in the North and producers in the South faced similar problems and adopted similar solutions. The similar problem was *négociants'* increasing power and growers' decreasing power as the supply options of the former increased at the cost of the latter. Northern and Southern producers both framed the problem as one of "fraud" and authenticity: for producers in the Languedoc, "fraud" meant wine additives, for Northern producers, it meant misuse of geographically based brands. For both groups, the solution to the problem was greater upstream (grower) control as a means to guarantee product authenticity. In this way, quality regulation was not framed around the idea of market protection *per se*, but rather about consumer protection.

To solve these problems, producers aimed to restore the previous market advantages. The regulatory regimes institutionalized certain political and economic constructs that were in place prior to the Third Republic. The wealthier, historically noble Northern regions integrated different supply chain actors into a production hierarchy, and sold this to "aspirational" consumers.<sup>35</sup> The historically poorer South institutionalized a flat social hierarchy—the cooperative—produced a generic, inexpensive, common wine, and sold this to French farmers and the working class. French wine regulatory regimes ossified two distinct social structures and two different product markets, catering to a shrinking economic class that bases purchases on price (the rural and working poor), and a growing class that determines purchases based on perception of quality and status (the upper class and bourgeoisie).

## **2.5 Maneuvering Through Crisis and Towards Regulation in the Early Twentieth Century**

To understand the divergent trajectories followed by these two groups of wine producers, we need to understand how groups organized under the AOC and *statut de la viticulture* regimes and which interests were articulated and protected. The interests protected by the AOC reflect the objective of high price by creating an "inimitable" quality—interests that do not actively respond to changes in demand, but do reflect a degree of market influence. The AOC was founded through a compromise among an array of actors: large and small growers, wine merchants, industry professionals, and the Ministry of Agriculture. The interests protected by the table wine regulation, meanwhile, reflected the interest of grape growers who wanted stable, state-guaranteed prices for their grape production. Compromise and negotiation was limited in the construction of table wine regulation. Over the long run, these different forms of cooperative structures created a high-end regulatory model that had room to compromise and evolve, and a table wine regulatory model that was prone to a repetitive pattern of breakdown, political protest, and state intervention.

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<sup>35</sup> In the luxury sector, the "aspirational" consumer refers to the consumer who "aspires" to be a part of the brand dream. This may be a consumer who cannot afford a top wine, but can afford a second wine from a top producer.



*Appellation d'origine contrôlée* (AOC) regulation developed in Champagne; the *statut de la viticulture* developed in the Languedoc ("The Midi"). While these two regions were opposites in terms of quality production, they shared a production structure dissimilar to other French wine-producing regions. This distinctive structure proved critical in facilitating active political organizations that pressed for market protection. In both Champagne and the Languedoc, grape growers tended to sell their grapes, wine must, and wine to *négociants*, who would blend the wine and brand it. In other regions, *négociant-éleveurs*, or growers who also bottled and branded their own wine, played a stronger role.<sup>36</sup> The effect of the strict division of labor within Champagne's and the Languedoc's production structure was twofold. First, when grape prices decreased, growers placed blame on *négociants* for "dishonest winemaking." Secondly, the division caused a type of class consciousness to develop in these two regions, as growers united against *négociants*. These divisions had an especially significant impact on producers, who established a strong and organized political identity and, ultimately, won concessions from the state.

In both Champagne and the Languedoc, the first decades of the twentieth century were economically and politically tumultuous. The shift in supply chain power that began in the last decades of the nineteenth century did not abate; prices for grapes remained abysmally low. In the Languedoc, growers lost money on crops every year except for one between 1900 and 1907 (Loubère 1978). Champagne growers were also battered by four consecutive years of low prices from 1906 to 1910 (Kladstrup and Kladstrup 2006).<sup>37</sup> In both cases, growers blamed *négociants*, and called on the state for greater market protection.

There are three political developments that arose in both Champagne and the Languedoc that proved critical to the emergence of regulatory protection of the wine sector: The first is the establishment of new forms of producer cooperation, the second is the rise of mass political demonstrations against the state and *négociants* (1907 in the Languedoc and 1911 in Champagne), and the third is the resulting power dynamic between the state and wine producers. In both Champagne and the Languedoc, these developments were critical in consolidating the political power of small producers and redefining the relationship between producers and the state.

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<sup>36</sup> In other regions, notably Burgundy, there was a strong tradition of *négociant-éleveurs*, growers who brought their own wine directly to market, without (or with minimal use of) a wine merchant. Bordeaux had its own unique market structure which varied by market segment: a system of growers, merchants, and courtiers (brokers) at the high end of the market, and *négociant-éleveurs*, growers, and *négociants* for those outside of the luxury market.

<sup>37</sup> Low crop prices in Champagne during this period are seen as the result of poor crop yields, as opposed to the overproduction problem that depressed prices in the Languedoc. Still, both regions placed blame on wine merchants.

## 2.6 Politics in the Languedoc: New Forms of Cooperation, Production, and Regulation

While French farmers had generally been a bastion of conservatism, the first decades of the twentieth century saw independent Midi farmers become increasingly socialist and communist (earning them the nickname, “*le Midi Rouge*”). Government legislation aimed at encouraging workers’ associations (1884) and consumer protection (1905) encouraged formal cooperation and regional and sectoral solutions to common problems (Martin 1996, Simpson 2004). Also, there was a strong sense of shared regional identity among Southern wine producers. Even today, Languedocians still feel a deep-seated sense of being frowned upon by Paris and of being “outsiders” in a national system that favors Northern industry and agriculture (Personal interview, INAO Montpellier 2009; Personal Interviews, grape growers and academics, 2010). At the onset of the twentieth century, cooperation in the Languedoc was strengthened to the extent that Northern outsiders were squarely blamed for the economic problems of the Midi region: Languedoc producers believed that remotely-located *négociants* and a state that failed to protect Southern growers from “fraudulent” merchants were responsible for the plummeting wine prices. The blame was *not* aimed at the Midi producers for producing more table wine than the market could absorb.

The growing importance of wine cooperatives also played a central role in strengthening cooperation, organizational capacity, shared identification, and leftist ideology in the Languedoc. The impression that wine merchants were to blame for the economic difficulties facing small Southern farmers strengthened the distrust of the “free” unregulated market and fed the growing Southern socialist impulse. The cooperative leadership became highly integrated with the local *Parti Socialiste*. The cooperatives provided strong linkages between rural peasants, local politics, and national politics, especially as prominent local cooperative leaders moved to the national legislative stage. Cooperative leaders came to prominence through the growers’ unions and the Socialist network: “you could not be president of the cooperative if you are not Socialist” (Personal Interview, Wine Merchant Eric Texier, July 2011). The first cooperative appeared in the Midi in 1901; by 1939, they accounted for 70 percent of all wine produced in the region and strengthened its political cohesion. Before long, every small winegrowing village would have its own cooperative, and these cooperatives became the loci of political organization (McFalls 1992).

The goal of the grower-run cooperatives was twofold. First, small growers were now able to take advantage of economies of scale and to share costs in the capital equipment that was becoming standard for commercial wine production. Second, they enabled growers to move from growing grapes through to delivery of wine in retail outlets without having to interact with *négociants*. Instead of competing with cheaper Algerian growers to sell their wine to *négociants*, the growers became their own *négociants*. The idea was that growers could simultaneously take a greater share of the profits that wine merchants normally

captured and solve the problem of wine fraud by bypassing the guilty party completely.

While the cooperatives consolidated the Socialists' political power, they also kept farms small and supported production quantity over quality. A main problem with cooperatives was that it was difficult for them to differentiate quality, and they generally paid for grapes based on weight (and alcohol content). Since grape quality and quantity are inversely related, this development kept the vast majority of production in the South low-cost, low-quality market segment. Cooperatives were able to decrease shared capital costs and consolidate political power, but they were unable to stabilize the price of French table wine due to chronic overproduction. This caused producers to further pressure the state to intervene and stabilize wine supply, without, they hoped, asking the cooperatives to decrease their output.

Deep political cohesion among these cooperatives was instrumental in bringing about “the greatest political demonstrations in France since the Revolution” in Languedoc in 1907 (Loubère 1978).<sup>38</sup> Protestors called upon the state to do more to stabilize the market. Initially, protestors' goals were twofold: to further limit wine lengthening, while placing little or no restrictions on growers' production.<sup>39</sup> The result of the protests was also twofold: it increased government involvement in regulating wine production, and convinced both the growers and the government in Paris of the political explosiveness of the Languedoc. It also furthered consolidated Languedoc's farmers in their status as small-scale, radicalized, and politicized producers—distrustful of the state and the market, yet expecting the state to protect them from the market. Finally, there was little negotiation between the *Ministre des frauds* (technically the overseer of the powerful Confédération Générale des Vignerons (CGV), which allowed growers to bring fraud charges to the local tribunals), the *Ministre de l'agriculture*, and Southern producers. The state largely met the demands of the small farmer socialist cooperatives. *Négociants* and large landholders were essentially absent from the agenda-setting process. In the long run, the lack of political compromise with

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<sup>38</sup> Economic pressures that had been building up over decades finally exploded over four months during the spring and summer of 1907. As many as 500,000 to 800,000 protestors took to the streets to demand the state play a greater role in stabilizing the wine market. When the crisis reached its peak, six people were killed by the French army, and one French battalion defected to the side of the protestors. It seemed to some at the time that the southern French region would leave the Republic. Unlike the majority of protests where French citizens protested state action (or state inaction), these protests in southern France united different economic actors (from grape growers to shopkeepers) across the four regions of southern France (the Gard, Hérault, Aude, and Lozère) against common enemies in Paris (the state and “dishonest merchants”).

<sup>39</sup> Part of the refusal to limit grape production was based on the grower's optimism that the table wine market could rebound to its glory days. They were unable to concede that the *Age d'Or* was behind them and that production volumes needed to be curbed. Instead, they demanded—successfully—that the state restrict wine-lengthening practices but leave the growers' production volumes untouched. In immediate response to the crisis, the Ministry of Agriculture provided a legal definition of wine for the first time, implemented controls on *chaptalisation* (adding sugar to wine), began to collect information regarding wine harvest yields, and started imposing controls on wine distribution (Colman 2008). Growers were also able to launch formal fraud investigations through the powerful Confédération Générale des Vignerons (CGV), which allowed growers to bring fraud charges to the local tribunals.

*négociants* and large landholders would come back to haunt the Languedoc. The political institutions in southern France protected only one set of actors (small growers).<sup>40</sup> In addition, the protection that followed the protests did little to stabilize the market for French grapes, as it failed to address the structural problems of overproduction. There was a brief respite from economic pressure during the war, but beginning in the 1920s, trouble in the wine sector began to re-emerge and growers were now willing to consider production controls.

In 1935, the *statut de la viticulture* was implemented as a comprehensive solution to the South's wine problem.<sup>41</sup> The *statut* had three objectives: to decrease the size of vineyards dedicated to table wine production, to stabilize prices by controlling supply, and to provide a *prix social* (a wine price that was sufficient for a family to retain its land) (Loubère 1990, p. 129).<sup>42</sup> Thus, the *statut* essentially bought the political peace of thousands of radical, organized agricultural workers by providing them with a stable price for their grapes, but at the cost of institutionalizing a market divide between supply and demand and deepening local divisions. Through the mechanisms of price and quality control, the state essentially protected wine growers from the shifts in supply. While they could, at great expense, stabilize supply, they had few tools to stabilize demand. Because producers were isolated from changes in demand, a critical disjuncture arose between what customers wanted to drink (quality) and what producers provided (generic wine, priced only by volume and alcohol content). The increasing divergence between

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<sup>40</sup> Evidence of the power of the small *vigneron* is found in the fact that the *statut* did not apply to any of the 1.66 million small wine farmers—it only applied to large producers. And the power of the small *vignerons* hastened the failure of the policy: small *vignerons* accounted for 40 percent of total table wine production. As the state attempted to withhold and distill wine in order to achieve the *prix social*, its ability to do this was weakened when 40 percent of the market—the small *vignerons*—could dump their wine at any time. Large producers found the *statut* sufficiently punitive that, once the *appellation d'origine contrôlée* was introduced in 1935, producers began moving under this regulation only to avoid the table wine production restrictions (Loubère 1990), further deepening ideological divisions in the region. At the same time, it prevented small producers from consolidating their landholdings and it maintained a model of production that was increasingly at odds with the model of consumption emerging in the country (Touzard 2000, Clavel 2008).

<sup>41</sup> The leaders of the local cooperatives filled the ranks of the *Assemblée Générale* during the Third Republic, causing French wine policy for Southern farmers to be much more favorable towards small farmers than large landowners. Specifically, the 1.6 million small-farming grape growers in the Midi found their leader in Socialist deputy Edouard Barthe, a small *vigneron* who had established the *Ligue des Petits et Moyens Viticulteurs* in 1930. According to French wine historian Leo Loubère, Barthe “was the kind of socialist who defended small family property, seeing in large capitalist estates the true perpetrators of fraud” (p. 128). Through his activity in parliament, he sought to limit the development of large-scale industrial wine production and to protect small family farms (Loubère 1990, p. 129). He worked through the powerful wine lobby in the Chamber and Sénat, which consisted of a diverse group of supporters, including conservatives who wished to keep peasant army conscripts and deputies who were seeking to limit migration from poor rural areas to depressed urban areas. Barthe benefitted from the simultaneous political action demanded by grape producers, as well as the political strength of his constituents, who had remained hostile to the state. The state was looking to appease these powerful political organizations (Loubère 1990, p. 131).

<sup>42</sup> To do this, state policies included paying producers to voluntarily uproot their vineyards, taxing producers whose harvests and yields surpassed specific limits per hectare, controlling alcoholic-percentage limits, and keeping surplus wine off the market.

supply and demand was absorbed by the state. This achieved social peace in southern France, but as supply and demand diverged, the price of this peace steadily increased.

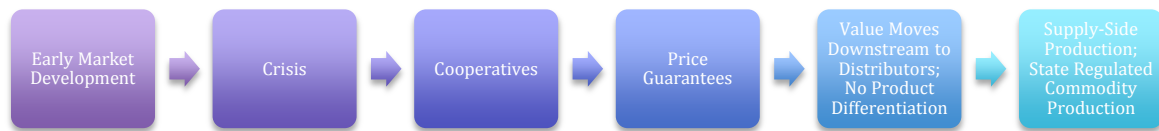
An inflexible political and economic structure relegated southern French producers to economic dependency and serious long-term market problems. Some of the organizational solutions to the table wine market's problems ended up damaging the market's long-term viability.<sup>43</sup> For example, one reason the cooperatives were established was to remove the *négociant* from the supply chain. But taking the *négociant* out of the production picture did not relocate the locus of value back to the growers. The hundreds of Southern wine cooperatives were producing low-quality "plonk" that was generally indistinguishable from one cooperative to the next. The power that *négociants* once had to select from among competing, substitutable goods now moved to the retail level. As a result, retail stores could now choose from among competing cooperatives and dictate the terms of production. Value was still not captured upstream by growers; it was captured downstream by the retail outlets (see figure 2.1). The retail outlets tried to compete on store brand and price-quality intersection. The cooperatives did not have a brand, producers were replaceable, and their collective power was strong against the state but weak within the market. As a result, 79 percent of Languedoc's growers sell to cooperatives, large wholesalers, and large distributors, and Languedoc's producers only €1.67 per liter (as compared to the average AOC price of €5.59 per liter).

Small French table wine producers succeeded in securing their political and economic objectives—stable prices, no fraudulent wine production, and no unfair pricing by *négociants*. Instead of solving their market problem, however, producers became dependent upon the state, out of touch with consumer signals, and developed a stigmatized brand (the name "Languedoc" became synonymous with "bad wine"). The radicalism and organization that enabled table wine producers to define the French government's regulation of their product prevented them from adopting the compromises and flexibility to develop into competitive producers. Producers were completely removed from quality incentives and as a result, their products were perfectly substitutable, weakening cooperative producers' market position. The cooperatives, like other examples of French *dirigisme*, became characterized by simultaneous political strength and political dependence. The interprofessional councils from quality wine making regions, meanwhile, stood in stark contrast to cooperatives in terms of their organizational structure and market outcomes, as I describe in the next section.

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<sup>43</sup> Also, in future negotiations, a pattern manifested itself in Southern wine politics: massive political demonstrations, followed by the state capitulating to the growers' demands. Finally, when political interests began to diverge in the 1970s and the 1980s (due to an influx of new growers with different economic and political objectives, and the movement of regulatory authority from France to the EU), the politics of the Languedoc fragmented. Unable to be politically flexible, the political unity of the region broke. Compared to other French wine-producing regions, the Languedoc moved from the most politically cohesive to the most politically fragmented (Personal Interview, Jean-Marc Touzard, June 2009, June 2010).

**Figure 2.1: Politics of Supply Chain Value for French Table Wine**



## **2.7 Champagne and the Politics of the Appellation d’Origine Contrôlée, 1900-1935**

French wine regulation is the result of crisis, cooperation, and institutional innovation. Quality wine producers attempted to increase wine value by tying quality to geography and limiting production outputs. While growers in the Midi responded to their economic crises by excluding the *négociant* from the production chain, producers in Champagne united growers and merchants together into a power-sharing cooperative body and created a limited-quantity, state-guaranteed shared geographic brand.

While Champagne growers were at the opposite end of the quality spectrum from the Languedoc producers, the two regions shared a strict demarcation between growers and merchants. As with grape producers throughout France, the extension of the railways in France enhanced the market power of wine merchants to the detriment of the *vignerons* (small growers), increasing *négociants’* ability to source grapes from a multitude of growers. But whereas producers in table wine producing regions accused *négociants* of selling “fake wine” doctored with additives, quality wine producers accused dishonest *négociants* of labeling cheaper extra-territorial wine as Champagne.

Chronically low grape prices and the perception of widespread misuse of place names angered growers in Champagne, especially small landholders who produced wine of an average quality. This frustration finally came to a boiling point in the spring of 1911. Taking a cue from the Southern protestors, twenty thousand

protestors in Champagne took to the streets in Epernay in March and April 1911, protesting low grape prices and inadequate government market intervention. At one point, the rioting growers destroyed *négociants'* houses in a show of contempt for their labeling practices, and 15,000 troops were called in from Paris to maintain peace. The growers called for greater regulation protecting local wine customs and strict delimitation of wine-growing regions. The strong state military presence in the region, followed by a robust harvest in 1911, helped create the semblance of peace. The violence in 1911, however, demonstrated the potential power of collective action to growers, local merchants, and the state. The massive destruction to the Champagne vineyards during World War I essentially took the issue out of the national debate until the vineyards began to rebound in the early 1920s. In the interwar period, the growers' *syndicats* began to negotiate production restrictions with local merchants in order to gain control over the Champagne name (Kladstrup and Kladstrup 2006).

In obtaining favorable regulations, producers in Champagne relied on their political power and, critically, framed price-based competition as an assault on French exceptionalism. To vote against the protection of small producers was to vote against protecting the legacy of French cultural production. French growers appealed to the idea that the free market is at odds with quality production, and that luxury production and "the intangible" must be protected in order to prevent "free-riding." The idea is that downstream agents are driven by price, while suppliers are driven by product differentiation. Therefore, in order to protect product differentiation from price-based competition (and possible commodification), upstream producers should be protected.

Champagne's solution to the problem of low prices and the backlash over the misuse of place names was to bring the *négociants* and growers into one organization, the interprofessional council (*conseil interprofessionnel*), where the two groups split power evenly.<sup>44</sup> *Négociants* were willing to cooperate with local growers in the hopes of exercising greater quality control over the farmer's grape-growing practices. Together, producers and *négociants* set rules of production, called the *cahier des charges*. The *cahier des charges* restricted the area from which *négociants* could purchase grapes, and in return it held growers to certain quality standards.<sup>45</sup> *Négociants* could only buy grapes from producers inside the geographic boundary, produced by the agreed upon production standards. The wines produced according to the agreed-upon rules of production could be branded with the shared geographic brand. The government protected the agreement and prevented others from using these place names. The interprofessional council unites growers and merchants behind one common objective: increasing value of the common brand.

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<sup>44</sup> Champagne's growers and merchants had been organized into cooperative institutions intermittently since the mid-nineteenth century.

<sup>45</sup> These practices include permitted grape varieties, plant density, plant height, yield, harvesting, alcohol content, fermentation, taste, color, and labeling. For the most part, the regulation that limited grape growing practices did not hold *négociants* to certain standards of production. This issue became significant toward the end of the twentieth century, when *négociants* increased their use of other product-enhancing tools available to them, including yeast selection, reverse osmosis, barrel types, and oak chip flavoring.

These institutions insure firms' stability by limiting supply and creating high barriers to entry, enabling firms to consider long-term production strategies and prioritize long-term value over short-run cost reduction.

The outcome of these cooperative institutions is a corporatist production structure.<sup>46</sup> The corporatist arrangement is supported by the interprofessional council and the quasi-governmental INAO (*Institut national de l'origine et de la qualité*). The INAO consists of industry experts (generally from the interprofessional councils), technical experts (including geologists and enologists), and representatives from the Ministry of Agriculture. Beginning in 1935, the interprofessional councils have worked with the support of the INAO to create production standards to secure geographically protected *appellation d'origine contrôlée* (AOC) recognition.

The INAO determines who can receive AOC recognition, and assists local groups in constructing and protecting traditional best production practices. Even though the INAO falls under the jurisdiction of the Ministry of Agriculture, it is technically a neutral "quasi-governmental" body<sup>47</sup> whose mandate is to help producers organize for protective organization. Though the French Ministry of Agriculture oversees the INAO, the ministry generally accepts the INAO committee's "expert" recommendations. In the few instances where the Ministry of Agriculture has opposed the INAO, the battle rarely leads to policy changes at the producer level (Smith, et al. 2007); Personal Interview with Jacques de Maillard, February 2008). The INAO sees its mission to protect and support quality French agricultural production, and they are the voice for French quality production both in the Ministry of Agriculture and, by extension, at the EU level.

The AOC sits atop the country's wine regulatory hierarchy. This regulation not only guarantees the origin of a product, but also guarantees that a wine has been produced in accordance with "traditional best practice," as defined and regulated by local producers.<sup>48</sup> Under the AOC, the interprofessional council's rules are then reviewed by the INAO and codified into nationally protected legislation. In addition to sharing best practice, the production standards enable all producers to achieve a similarity (*typicité*) in taste, so the consumer buying a regulated AOC wine will have a sense of what the wine will taste like even if they do not know the producer. In effect, these geographic names function as a shared brand. As mentioned at the onset of this chapter, AOC production accounts for 58 percent of total French wine production, 84 percent of all French wine value, and is a critical factor in explaining

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<sup>46</sup> Here I apply Wyn Grant's definition of corporatism, a "system of interest representation in which the constituent units are organized into a limited number of singular, compulsory, non-competitive, hierarchically ordered and functionally differentiated categories, recognized or licensed by the state and granted a deliberate representational monopoly within their respective categories in exchange for observing certain controls on the selection of leaders and articulation of demands and support" (Grant 1985, p. 25).

<sup>47</sup> The INAO is funded by both the producers they protect and by the Ministry of Agriculture.

<sup>48</sup> The European Union took over enforcement of quality control over products of origin in August 2009. According to Article 47, producers will no longer be able to guarantee authenticity of the wine produced within their locality, but instead are required to hire an independent auditing firm to conduct the quality tests.



why French wine sells for more than twice the per-unit price of its nearest competitor (www.wineaustralia.com, 2010).

While the AOC is guaranteed by the state, it only guarantees that wine was produced according to a specific process. While the AOC technically guarantees origin and “traditional production,” quality protection is implied.<sup>49</sup> But the producers, through their involvement in the INAO, determine which practices are “traditional best practice”. The idea that the free market undermines quality production was critical in producers receiving the power from the state to self-regulate. The AOC represents a type of protectionist framing that yields positive results because it protects quality production, which is a “cultural good” in itself. Furthermore, its success has provided a luxury market niche from which less regulated producers are excluded. The AOC, then, appears to represent an example of decreased short-run efficiency but increased quality and value-added—just as Colbert, Louis XIV’s finance minister, envisioned for quality regulation to function in France. The history of the state as the guarantor of quality played a significant role in making the AOC a goal for producers, and for its success in shifting French consumption patterns.

The INAO’s power, meanwhile, is to determine whether an area has a distinct wine heritage and to extend protection to this region. They cannot rewrite the rules of production or declassify a wine (unless producers break the rules that they have made for themselves). As a result, France’s 452 protected wine appellations are not state creations; rather, they represent producers employing state regulation to distinguish their local wine as high quality. Due to France’s traditional state-centric, hierarchical definitions of quality, wine drinkers look to align their tastes with “national definitions of quality,” which are actually producer-defined. Producers, then, effectively use the state’s reputation as quality guarantor and regulator as a means to create market protection.

The ultimate effect of the AOC regulation, then, is the following: to bind the *négociants* to only produce a wine like Champagne from grapes grown by a limited number of vineyards, and to provide *négociants* with a guaranteed product though dictating the terms of production to growers. While this structure theoretically makes both actors better off, it generally benefits growers more than *négociants*—Champagne’s growers earn €5.50 per grape kilo, but still *négociants* receive an astonishing €21.34 per liter of wine. If the AOC brand is successful, growers essentially have a monopoly over the key production input. *Négociants* can benefit from a unique product (which is perceived as irreproducible) and have an opportunity to build a luxury “heritage” brand based on a geographic name and their own reputation. But the effect of the regulation is to shift the bulk of the value—and the locus of market power—from an unlimited number of wine merchants to a limited number of growers.

The AOC quality regulation is effective because it appears to be a legitimate and valid means to shape consumer choices. As of 2006, French consumers said

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<sup>49</sup> As one interview subject said: “If the practices didn’t result in quality, the practices would have changed. Traditional low-quality is a contradiction in terms. So traditional practice is de facto local quality production” (Personal Interview, Bernard Martin of INAO Narbonne, July 2010).

appellation origin was the most important factor when purchasing a wine, above both grape variety and brand (d'Hauteville 2007). With consumers buying based on shared geographic brands, growers, merchants, and *négociant-éleveurs* (growers who are also merchants) can remain small and profitable (figure 2.2).

**Figure 2.2 Politics of Supply Chain Value for the *Appellation d'Origine Contrôlée***



Ultimately, the benefits of the AOC are significant: it allows for the survival of small producers without state subsidies, and it appears to increase consumers' choices. There are, however, a few disadvantages to the model. First, it is not a growth-based model. Its value is in its restriction. This places limits on *négociants* and growers who wish to expand production. The idea of AOC also prevents table wine producers from becoming quality producers: the definition of "insiders" is dependent upon a group of "outsiders" (especially when market insiders is associated not with "quality" in itself but multi-generational "traditional best practice"). Finally, it is an elitist model of production, based on French hierarchical notions of sophistication and refinement, where French consumers show their refinement and cultural sophistication through knowledge of the complicated French wine hierarchy. But consumers in third countries—especially the Anglo-Saxon countries that have experienced the most rapid growth in wine consumption—often eschew top-down, state-determined notions of quality. Similarly, the French model of wine regulation, with its hundreds of protected appellations and regionally specific appellation hierarchies, is obscure to consumers who are accustomed to purchasing wines based on grape variety (which, until recently, were banned from French AOC labels). Finally, AOC production prevents adaptation to market trends. This may benefit the AOC producers as it keeps producers in a unique, quasi-protected market space, but as consumer palates change (generally toward fruit-forward, oaky wines) AOC producers are largely excluded from this area of market growth.

Despite these limits, cooperation appears to “work” at the high end of the market for growers, merchants, and consumers. The innovative forms of cooperation created a protected market space for producers and, thus, greater product diversity in the market (as producers are not forced into short-run commodity production). These innovative forms of cooperation were critical to protecting France’s first-mover status in the wine market, by guaranteeing quality and limiting supply.

## **2.8 Conclusion**

Some scholars have made new arguments regarding the interest of firms—specifically, that firms’ main goal is not to create short-run market gains, but to create stable markets over the long term (Fligstein 2001). Firms employ government protection in an attempt to limit market competition, construct a protected brand, and stabilize market demand. In both of my cases in this chapter—French table wine and French quality wine—we observe a struggle between different actors in the supply chain to create a stable market. Different actors in the production chain have different goals: growers want to create a production monopoly on their grapes. Wine merchants, meanwhile, want to minimize their market risk and exposure by maintaining flexibility. Yet all actors in the supply chain want to benefit from a restricted brand (or find another means to protect against price-based competition).

Markets are systems of power, where firms employ strategies to reproduce their dominant position (Fligstein 2001). This process is political. Prior to the formation of alliances between different actors, power struggles must be resolved, including how the alliance’s institutions are organized and how power is divided. The resolution of these problems varies greatly between our different cases. In Champagne, the birthplace of French AOC regulation, politically powerful growers secured even power sharing with economically dominant merchants. In the Languedoc, the birthplace of French table wine regulation, politically powerful French grape growers organized into cooperatives, removing merchants, one of the main market players, from the supply chain (and in the long run, moving production value further down the supply chain, with retail stores). The different locations of value and different supply chain politics are the product of how power was institutionalized in these different cases—in moving from crisis, to politics, to market institutions.

# **Part III**

## **Italy**

# Chapter 3

## Italian Wine Politics

### 3.1 Chapter Summary

Italian consumers and producers remain distrustful of government regulation. They consider the state too weak to resist clientelism, and view the convergence of economic protectionism and elite interest in Italy as evidence of patron networks. Consequently, Italian consumers put more faith in known quantities—i.e., local quantities—than in the broader market. They do not trust the state to guarantee quality, despite some serious state actions designed to build its legitimacy.<sup>50</sup> The fact that the Italian government used wine regulation as a tool of quality development beginning in 1963—sometimes protecting weaker quality wines and subpar production practices—undeniably weakened popular perceptions of the Ministry of Agriculture’s legitimacy to define wine quality. The ministry’s position was further weakened when some table wine producers began to outsell government-protected *denominazione di origine controllata* (DOC)<sup>51</sup> producers.

Rather than relying on a government or wine industry quality guarantee, Italians buy beyond local wines based on the endorsement of one of the country’s five main commercial wine guides. These wine guides emerged in the 1980s as the Italian government’s quality regulation regime failed to guarantee quality. One quality winemaker in Emilia-Romagna, summarizing the state of the Italian wine market, said: “Regulation is less important than wine experts. People don’t trust the government mark.” There are specific examples of regulatory failure in the Italian wine market, including that the prolific, expensive Italian wines in the 1970s were table wines, produced by a small group of former Chianti winemakers who created a new style of wines that came to be known as “Super Tuscans.” Additionally, 26 Italians died in March 1986 from drinking contaminated domestic wine in what came to be known as “the methanol scandal.” This episode caused a crisis among Italian wine consumers, who viewed the government’s willingness to allow

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<sup>50</sup> For example, in response to a prolific case of wine fraud in Brunello (2008) the Ministry of Agriculture made wine auditors criminally responsible for the approval of fraudulent grape growing that takes place under their watch. The charge brings with it a mandatory term sentence. Italy is the only country in the European Union to have this standard.

<sup>51</sup> The DOC is quality wine produced according to “traditional best practice”, produced in limited quantities and guaranteed via the Ministry of Agriculture. It is the Italian equivalent of the French AOC.

potentially lethal amounts of methanol in Italian wine as a major regulatory failure (Personal Interview, Winemaker Francesco Lambertini, July 2010; Personal Interview, Economist Maurizio Canavari, July 2010; Personal Interview, Economists Vincenzo Odorici and Raffaele Corrado, July 2010). Wine guides emerged because the government mark failed to provide a legitimate quality guarantee in the eyes of Italian consumers.<sup>52</sup>

In this chapter, I demonstrate that the weakness of Italian wine regulation stems from weak levels of trust among local producers and among producers, consumers, and the state. The compromise and cooperation that characterized quality French wine regulation (Chapter 2) never emerged in Italy. Instead, political division, economic division, and accusations of political patronage limited levels of negotiated compromise. Italian wines' market gains came not through cooperation and protection, as in the French case, but rather through production innovation by a few market leaders. Brand value, therefore, was located primarily with these specific market leaders, and not with the geographically based *terroir* that French winemakers and consumers prize. Economic actors who tested the agreed-upon rules of production in the Italian wine industry were often rewarded with strong market payoffs, further weakening the validity of the state's regulatory protection. Innovation often came when winemakers used grape blends that were not state-protected, weakening protected local growers' potentially monopolistic position over their DOC grapes. Consequently, wine value came to be located with individually owned brands. Small, regulated producers achieved market success only later when they copied successful local production leaders' winemaking styles.

This scenario raises the following questions: What are the market consequences of are some actors in the Italian winemaking sector advantaged over others, due to social position, economic standing, and political connections? If so, what effect does a perceived power asymmetry have on local politics and economic competition in the Italian wine market?

### 3.2 Overview of the Italian Wine Market

The Italian wine sector is central to the country's economy and the global Italian brand. It is the country's second-largest agricultural sector in terms of value (after dairy) with annual export revenues of €4 billion. There are 73,000 reported wineries and an estimated one million Italian grape farmers, with more than two-thirds of Italian grapes grown on farms of five hectares or less (ISTAT 2007, Seccia, et al. 2008). In addition to the direct economic effects of the wine market, the proliferation of Italian wines in international markets has helped build the broader Italian global brand, leading to spillover benefits in other sectors, especially

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<sup>52</sup> According to the wine guide analysis conducted by Corrado and Odorici, wine guides' scores generally do not reinforce the national regulatory hierarchy: "Instead, the wine guides appear to have emerged to guarantee quality after the government mark failed to provide the perception of a legitimate quality guarantee" (Corrado and Odorici 2009).

agricultural production and tourism (Personal Interview, *Conorzio* President, April 2008).

While the annual volume of Italian wine production (48 million hectares) is comparable to the annual volume of French wine production (46 million hectares), the value of the Italian wine sector is significantly less. France's wine export revenue is €7.8 billion, compared to Italy's €4 billion (2008 data, [www.wineaustralia.com](http://www.wineaustralia.com)). The value of table wine is nearly the same in the two countries, but regulated AOC French wine commands a higher price (€5.59/liter) than its Italian DOC counterpart (€3.34) (EC-EUROSTAT 2008).

The Italian quality market is smaller in scope than its French counterpart. While 82 percent of French wine value is captured by more regulated, higher-end *appellation d'origine contrôlée* (AOC) wine producers, the value of the Italian table wine market exceeds the value of more regulated, higher-end Italian *denominazione di origine controllata* (DOC) and *denominazione di origine controllata garantita* (DOCG) wines (ISMEA 2008, p. 219).<sup>53</sup> From a production perspective, only 25 percent of Italian grape production is intended for DOC or DOCG production. While there are over 360 protected DOC geographic areas, many of these have annual production volumes of zero, as the value gained by the DOC mark is less than the per-bottle fee incurred to apply the DOC sticker (Personal Interview, Corrado and Odorici, July 2010). And DOC production is concentrated in a few hands, as fewer than 100 DOCs account for over 80 percent of DOC output (Corrado and Odorici, 2009).

Most Italian wineries and cooperatives are vertically integrated and have a tiny market share, but larger firms are not vertically integrated (Seccia et al., 2008, p. 2). Despite the high number of small wineries in Italy, the market remains very concentrated. The nine largest firms in the country hold nearly a third (32 percent) of the overall Italian wine market. This raises the question of whether large firms may have a degree of "oligopsony market power" when setting grape prices for farmers (Seccia et al., 2008, p. 2). Though Italian grape prices are not available, my interview subjects across the supply chain in both France and Italy emphasized that French producers receive higher prices for their grapes than Italian producers.

### 3.3 Italian Wine Consumption Patterns

One significant difference between French AOC and Italian DOC wine markets is the divergent behavior of domestic consumers. DOC and DOCG wines accounted for only 25 percent of Italy's total domestic wine consumption in 2001; the parallel figure for French consumption during the same year was over 50 percent (Odorici and Corrado 2004, p. 115). According to a survey of French wine consumers, appellation of origin (AOC) is the most important factor driving their purchasing decisions

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<sup>53</sup> DOC wine regulation was modeled after France's AOC regulation. It is the legal recognition of traditional winemaking practices. The DOC serves to prevent other extraterritorial actors from wrongly appropriating Italian places names. The DOCG was created in 1992, as a DOC with even higher regulatory controls. The idea is that DOCs are granted to high-quality Italian wines and DOCGs are granted to Italian wines of the highest quality.

(d'Hauteville 2007). Italian consumption patterns, however, follow a different social cue. Instead of purchasing based on *terroir*, Italians exhibit a strong market preference for local wines. According to the Italian government's national wine report (2008):

In each region, consumers display a strong preference for local wines. So the best-selling geographic wine in each region are wines from that region, for example, Barolo in Piedmont, Valpolicella in Veneto, Lambrusco in Emilia Romagna, Chianti in Tuscany, Primitivo di Manduria in Puglia, Nero d'Avola in Sicily, and so on. Italian stores tend to carry major wines from all Italian wine regions, but consumers still exhibit a strong preference for regional wines.<sup>54</sup>

While French consumers' tastes converged on centrally defined notions of quality, Italians' notions of quality have historically been deeply local and taught at the family level. At the same time, Italy and France are countries with profound levels of regional diversity, and wine production retains a deeply regional identity in each country. In France, the state emerged as a guarantor of quality as early as the seventeenth century. A strong state and a rigid, hierarchical class system were critical to the constructing the shared idea that taste is objective, learned, and defined by the elite. French consumers subscribed to a nationally defined idea of "quality"—defined by local elites and protected through national-level regulation.

Italian construction of taste, however, has remained a deeply local affair. The Italian state is very young (united in 1861), and Italian identity remains more closely tied to region than to nation. As Massimo d'Azeglio famously wrote after the uniting of Italy: "We have made Italy. We must now make Italians." An economist at the Collegio Carlo Alberto in Turin articulated this idea particularly well: "There is one time when we feel 'Italian': during the World Cup." Even today, in most Italian regions, younger generations speak Italian, while older generations speak the local dialect, and people who are working age speak both (Personal Interview, Rome, July 2011). Italians that migrated from southern Italy to northern Italy more than 30 years ago are still referred to within some villages as "foreigners" (Personal Interview, Montepulciano, July 2009). And unlike France, national quality regulation, and a nationally-centralized taste hierarchy, has no historical precedence in the Italian context. Italian consumers, like Italian producers, value the quality products of their region, not nationally-guaranteed quality products.

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<sup>54</sup> *Nelle preferenze dei consumatori resta un forte localismo. Il vino più venduto in ogni regione è quello che caratterizza la vitivinicoltura della stessa o, al limite, di una regione limitrofa. Nell'ambito delle bottiglie da 75 cl troviamo così il Barolo in Piemonte, il Valpolicella Classico in Veneto, il Lambrusco dell'Emilia in Emilia Romagna, il Chianti in Toscana (ma anche nel Lazio), il Primitivo di Manduria in Puglia, il Nero d'Avola in Sicilia, e così via. Il fenomeno si verifica nonostante, a differenza di quanto accadeva nel passato, l'assortimento nei punti vendita preveda comunque i prodotti più caratteristici di tutte le regioni italiane. Filiere Vino, Volume 2, 2008. Document not paginated).*



### 3.4 Creating Quality Markets? The Birth of Italian Wine Regulation

Italy's Ministry of Agriculture constructed the DOC in 1963, at a time when Italy was industrializing rapidly and most Italians still drank mass-produced wine (Clavel 2008). Italy's postwar economy was premised on expansion, exportation, and market adaptation. The flow of workers from rural farms to northern urban centers, increasing since the Fascist era, expanded rapidly throughout the 1950s and into the 1960s. The market economy began replacing the barter economy across most of the country. Italy was lifting people out of poverty at the highest rate in the country's history. During this time, grape growers and wine merchants were not experiencing market contraction—if anything, their production benefited from market expansion (though the gains from this growth were not necessarily captured evenly by merchants and growers). Under these circumstances, there was no incentive for one group of wine sector actors to make serious concessions to the other; there were no “hard times” during this period that caused actors to act to protect themselves from the market. The need to stabilize fluctuating grape prices—the main driver behind French regulation in the early twentieth century—was less relevant to the Italian wine market in the postwar period.

Despite these differences, the goal of Italy's 1963 DOC regulation was to increase the price and quality of Italian wine, as the AOC had done for French producers. The regulation attempted to do this by restricting the quantity of protected grapes, codifying traditional best practices, protecting shared geographic names from being expropriated, and increasing levels of cooperation between local producers. To accomplish these ends, the DOC created several institutions in the Italian wine market that directly copied the French AOC model. For instance, the Italian *comitato nazionale della vita del vino* mirrored the public-private, French *Institute national de l'origine et de la qualité* (INAO). The *comitato* is comprised of industry experts who are independent, but formally under the Ministry of Agriculture. The DOC's *consorzio* was the equivalent of the French interprofessional council, made up of local growers and merchants creating shared production standards. Like France's interprofessional councils, the Italian *consorzio* split voting power evenly between growers and merchants, at least for the DOC's first three decades. The *disciplinario*, meanwhile, is the Italian version of the AOC's *cahier des charges*: a written document of the attributes of a protected wine (including appellation boundaries, maximum yields, and allowable grape varieties). Additionally, the Italians had a regional intermediary organization, the *stato regione conferenza*, whose function paralleled France's regional INAO units. On paper, then, Italian quality regulation was identical to French quality regulation; in practice, however, these regulatory regimes were dissimilar.

Italy has not traditionally been associated with quality wine production,<sup>55</sup> as one of my interview subjects explained, “Italy has a long tradition of wine-producing, but not of quality wine production. This emerged only over the last 30

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<sup>55</sup> There was an emergence of a small quality wine market in Piedmont in the late nineteenth century. However, this nascent market collapsed under the Mussolini regime and Piedmont began to rediscover quality production only in the postwar period (Personal Interview, Aldo Vacca, July 2011).

years” (Personal Interview, Vincenzo Zampi, Professor of Economics at *Università degli Studi di Firenze*, July 2010). In light of these circumstances, the DOC implemented production rules to create value rather than to protect value (Personal Interview, Zampi, July 2010; Personal Interview, assistant to a member of the *comitato nazionale delle vino*, July 2010). While the French wine regulatory regime was a bottom-up construction intended to enhance and protect quality wine production, one objective of the Italian wine regulation was to improve upon existing production practices, as one observer explained: “We made DOC instructions to improve production practices. The point was to learn how to make good wine, and to sell the wine at a good price. There were not any quality Italian wines at that time that were at risk of being imitated” (Personal Interview, Vincenzo Zampi, July 2010). In this sense, the goal of Italy’s *Ministero d’agricoltura* was market building, not market protection.

This aspect of Italian wine regulation had two important consequences. First, it created local organizations to serve as an economic development tool, but these organizations were created without the parallel construction of a common political identity and without negotiated compromise. The oscillations of the French market in the early twentieth century had caused French growers to organize in response to merchants and the state. Local Italian growers united through local production organizations that paralleled the French organizations, but they were less politically cohesive than their French counterparts. Secondly, Italian grape growers did not hold any political power when regulations were implemented because their grapes were not in demand. Italian grape growers would thus remain weak under the new regulations, and political power followed the preferences of more powerful economic actors.

### **3.5 Innovation, Market Flexibility and the Emergence of Quality Wine Production**

In Italy, neither producers nor the market have recognized the DOC-protected means of production as a genuine measure of quality. While the French wine market had time to evolve, respond to market signals, and determine the best expression of *terroir*, Italian production was protected before the market had provided enough feedback regarding traditional best practice techniques. As a result, the DOC regulation often institutionalized subpar winemaking practices. According Vincenzo Zampi:

How the rules were set up, Italian winemakers had to do something wrong to create quality wines...When you realize what the market wants, and it’s different from the *disciplinano*... it’s a very difficult situation. The problem was the rule. What was institutionalized wasn’t best practice. For example, in Brunello, the initial *disciplinario* was crazy. They required four years in the cask. That is expensive and it destroys the wine. It’s not the best practice—totally against best practice. [Wine producer] Biondi Santi said that this wine practice was bad, and he was right on. This regulation has now changed to three years in cask. But the first *disciplinario* also said that you can use 20 percent of other grapes. Now, there are only sangiovese grapes in Brunello. But sangiovese is produced across Italy, so it is in no way unique to Tuscany.

The traditional best winemaking practices that the DOC protected were neither traditional nor were they best practices. Producers who wished to improve upon the protected winemaking practices faced two choices. One was to leave the state-protected DOC appellation and create high-end table wines. A few large Chianti estates, including Antinori and Sassissima, famously chose this option when they began experimenting with different grape varieties and eventually created the luxury “Super Tuscan” table wines. Other producers stayed within the protected DOC denomination, but committed fraud by breaking production rules to appeal to the palate of prolific wine reviewers. The most prominent example of this phenomenon came in the 2008 fraud involving Brunello wines (“Brunellopoli”), when five top producers in Montalcino were accused of adding illegal grape varieties to their Brunello wines. Some of the accused winemakers protested these charges, others did not. The scandal caused all Brunello imports to the United States to be banned temporarily, and the scandal unquestionably weakened the legitimacy of the Italian wine regulatory regime, both domestically and internationally.<sup>56</sup>

Due to the mismatch between Italian production rules and international market demand—which favors French grapes and winemaking styles—there remains an incentive for Italian producers to innovate in order to strengthen their market position. Consequently, producers experiment based on a desire to improve quality and marketability rather than a desire to decrease prices. According to wine blogger and enologist Franco Ziliani, “The rules are broken to tailor-make the wines for the American public. To reach a bigger audience. Not to save on price, but to sell.”<sup>57</sup>

There are two ways Italian producers can alter production to meet evolving market trends: changing the grape or changing how the grape is transformed. The examples of the Brunello problem and of the development of the Super Tuscan focused on changing the “traditional” grape blend. The *disciplinario* (codified rules of production) primarily concerns itself with tying a geographic brand with a particular grape variety (or varieties) and specific cultivation techniques. Winemaking standards—including barrel type, length of time on the skin, etc.—tend to vary between different producers, partly because these techniques are less strictly defined in the *disciplinario*. As a result, cases of wine fraud in Italy tend to be associated with the usage of specific types of grapes. Implementing new

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<sup>56</sup> For more information, see <http://www.nytimes.com/2009/08/12/dining/12brun.html>.

<sup>57</sup> Professor Zampi echoed the opinion that Italian producers were breaking production rules in order to make better wines. Italian producers, he explained, were trying to create the best wines possible in an antiquated regulatory market. By breaking production rules, producers created better wines, wines that, in the case of Brunello, were banned from the American market when the fraud was exposed. Zampi pointed out the contradiction in the situation: “Americans said ‘our problem is that you told lies. The problem is the lie. It is against our values’. At the same time, it is the Americans that *told us* (Italian producers) what to make. You told us what you wanted to drink, and so we made it for you!”

winemaking procedures may produce schisms within the *consorzio*,<sup>58</sup> but rarely lead to a producer leaving the denomination.<sup>59</sup>

Both of these innovation choices place innovation and “quality improvement” downstream with winemakers. Quality is not defined and protected by a region’s grape quality, as it is in the French case. Instead, it is up to the expert at an individual winery to find a way to improve upon the initial wine product. This arrangement weakens the position of the grape grower: unlike in the French case, the grower is not indispensable. This is especially true when winemakers decide to change grape types beyond what the *disciplinario* production rules stipulate. Additionally, product experimentation has the effect of weakening a shared brand.

The effects of wine fraud are felt most acutely by grape growers and small producers, and these actors would benefit the most from a strong shared geographic brand. When taste and color varies from one producer to another, the shared brand is weakened. Grape fraud adversely impacts growers within the DOC boundaries. If merchants are looking to blend in a grape that is not produced by local growers, the local growers’ market power diminishes as their monopolistic hold on production inputs is lessened.

Ziliani described a significant indicator of wine fraud, vine grafting. Italian growers have become adept at vine grafting, cutting down the time for a vineyard to change from one type of grape to another to just one year.<sup>60</sup> When this occurs in a DOC region (as it does in some Tuscan DOC regions), it frequently signals wine fraud, as growers replace an approved grape variety with a “market-approved” grape variety.

Ziliani explained a second way wine fraud occurs: grapes are imported from California, or shipped from one part of Italy to another, regulated region. The proof, he said, is that the imported wine passes through Italian ports, import taxes are paid, and the wines mysteriously disappear—they are never formally accounted for again. In addition, he has interviewed Southern growers who specifically disclosed which Northern DOC producers buy their grapes. Thus, there is some level of illegal wine blending, either to change grape compositions or increase yields of particular wines. If a DOC winemaker using grapes from other areas, his behavior undermines the economic position of the protected growers, and likely exacerbates local political divides.

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<sup>58</sup> See *No Barrique No Berlusconi* (Negro, et al. 2006) for more about the divide between “new world” and traditional winemaking styles in Barolo and Barbaresco.

<sup>59</sup> The emergence of Super Tuscan wine is one famous example of the most successful producers leaving the DOC; a more recent, prolific example is Angelo Gaja declassifying his DOCG Barolo and Barbaresco in 1996 to Nebbiolo Langue in order to add the Barbera grape.

<sup>60</sup> Wine grafting is perceived to limit the expression of *terroir*.

Ziliani describes another way that banned grape varieties find their way into protected DOC wines:

Some growers plant one grape on the outside and another on the inside. Happened in two of the most prolific wine regions in Italy, one in Tuscany and another in Piedmont. In one case, pieces of land that were certified to produce nebbiolo were actually physically merlot. A trick. So when you go and harvest that piece of land, it is officially nebbiolo. So all of your paperwork is fine. But that piece of land should be marked with a less prestigious DOC, not as a famous DOCG if it has these different varieties inside. So the trick starts with the vines, not with the cellar. When people tasted this, it was clear that this was not nebbiolo. The taste was different. But (leading wine critic) Mr. Parker liked this new style wine and gave it an award....<sup>61</sup>

### 3.6 Wealth, Power, and Wine Production

Some producers' movement toward new wine styles has exacerbated local political divisions in several regions. Producers that moved toward new winemaking styles were not the smaller, poorer family farms; they were the larger estates and wealthier producers. Larger producers generally made wine from both their own grapes and from purchased grapes. These producers had the finances to take production risks, hire enologists, and buy new barrel types. They also often had networks to promote their wine—including international, professional, press, and political contacts. And these networks tended to overlap—one study demonstrated that producers who hired professional wine consultants were more likely to receive a positive review in an Italian wine guide (Corrado and Odorici, 2008). This could be seen as evidence of a type of patronage; or it could be evidence of the importance of social networks in the Italian market.<sup>62</sup>

Wealthier Italian wine producers who wish to build their brand enjoy clear advantages, and these advantages may be perceived by less powerful producers as evidence of a type of “insider network.” In any event, larger producers who had the means to innovate were more likely to experiment with new winemaking styles and find market success, sometimes changing the regulation as a result. As successful wine producer Francesco Lambertini told me, “In Italy, the market does not follow the law. The law follows the market” (July 2011). The correlation between power, market success, and regulatory adaptation strikes many grape growers as another example of an anti-meritocratic network. As a result, local innovation has not enhanced local political cohesion, but has diminished it.

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<sup>61</sup> Personal Interview, Franco Ziliani, July 2010. As a result of the grape fraud, the Italian Ministry of Agriculture tightened regulations over vineyards (now every parcel of land is inspected at least once every four years). In addition, submitting a fraudulent wine audit has become criminalized (Personal Interview, with a member of the *Comitato Nazionale delle Vini*, July 2010). This change was designed to increase trust in the DOC system.

<sup>62</sup> For example, a wine consultant may have social and professional contacts at certain wine guides. Alternatively, a wine consultant or enologist may serve as a type of brand guarantee, increasing a wine's visibility and placing it on wine reviewers' radar.

There were three important consequences to wealthier Italian producers' rule-breaking innovations. First, despite the fact that winemakers tended to break DOC production rules in order to improve the perception of product quality (as opposed to minimize costs), different production philosophies deepened divides between wealthier landowners and poorer, small farmers. Both sides described this divide differently: smaller farmers cited political corruption and production fraud committed by famous local producers; famous local producers (and wine lobbyists) lamented the lack of trust, cooperation, and anti-market attitudes represented by "the rural mentality" (or "farmer mentality") of smaller producers. Secondly, these circumstances led to a "market leader" approach to innovation and brand creation in the Italian wine market instead of a cooperative approach. A market leader approach occurs when a producer or a few producers successfully create a new quality wine—such as the aforementioned Super Tuscan examples, Gaja in Barbaresco and Banfi in Montalcino. These producers initially took great risks and found a high payoff in the market. As their wines became more expensive and were priced out of the market, other local actors copied their production strategy and attempted to become a lower-cost alternative to the innovative producer. Thirdly, this type of innovation creates imbalance within and across the DOCs. Instead of a DOC serving as a broad guarantee of quality or consistency, brand leaders and wine guides provide the quality guarantee. A DOC is not good enough by itself; it has value when it follows a brand leader.

### **3.7 Local Political Fragmentation: Political Patronage or Endemic Mistrust?**

As discussed in Chapter 2, French wine regulation emerged as a political response to perceptions of unequal economic power and class divides between growers and merchants. Italian political divisions, meanwhile, arose between what I will call wine's "market insiders" and "market outsiders." Market insiders were most frequently larger landholding grower-merchants, who grew some of their own grapes, bought grapes from other growers, and then made and bottled their own wines. Market outsiders tended to be growers. This is critical to the political identity of wine producers: French producers identified themselves by their position in the supply chain (Loubère 1990) and were monoculturalists prior to the 1935 AOC wine regulation. But Italian grape growers produced many agricultural products simultaneously (Personal Interview, Aldo Vacca, July 2011); as a result, they did not identify themselves specifically as "grape growers." Political identity among French wine market actors has a strong national aspect and is shaped by production function. Political identity among Italian wine market actors, on the other hand, is local and defined by socioeconomic networks.

Italian wine producers frame their situation in terms of economic ideas and opportunities, which differs from how French quality *vingnerons* describe their situation. Specifically, several Italian interview subjects repeated the idea that some grape growers suffered from a "farmer mentality" (or a "peasant mentality"), were free riders with no sense of how markets work, and had only a limited interest in

making quality wines (Personal Interview, quality winemaker in Emilia-Romagna, July 2010; Wine Promoter, Sicily, July 2010; Economist, Florence, July 2010; Wine Merchant, Emilia-Romagna, July 2010). Those outside of the group of branded elite Italian winemakers tend to criticize the “insiders” by pointing to examples of political patronage and corruption, especially in securing DOC or DOCG protection. On both sides, the effect of these divides is to perpetuate weak local institutions: less successful farmers distrust successful farmers, and successful farmers have little interest in cooperating with less market-oriented, “backwards producers.”<sup>63</sup>

One successful large-scale wine merchant in Emilia–Romagna, said the major problem with Italian DOC wine lies with the growers:

How do you build an Italian quality market when you don't have know-how, and you have farmers who have only made grapes; made grapes for quantity and not quality, and are family-run, with no paid employees? They have traditions, but not the ones that are working on the market, and virtually no sense of marketing, branding, or responding to the market changes. The high-end of the market was driven by competition to create a wine of a high quality. Rural wine farmers goals were short-run and aimed at cost minimization.

Other examples of this “farmer mentality” included Southern farmers’ inability to capitalize on European Union subsidies and their resistance to wage-based economic arrangements. A marketing agent at a Sicilian wine promotion agency described how Sicilian farmers received EU funds to develop wine cellars and cultivate direct sales, but refused to spend the funds to hire employees to man the phones or work on the sales floor. And as of 2011, 62.5 percent of all Italian agricultural work units (AWU) are outside of the wage-based economy (2011 data, Eurostat). According to the Sicilian wine promoter, if a task at an Sicilian vineyard requires paid labor, it simply doesn't happen. As a result, he said, “Wine producers have beautiful cellars that are not used. Producers were given capital, but still have an aversion to a wage-based economy” (Personal Interview, Wine Promoter, Palermo Sicily, July 2010).

A local agricultural leader in Puglia told me a similar story. This man was in charge of using European Union funds to publicize and promote a regional brand identity through trade fairs and grocery store displays. This *consorzio* president organized producers of an array of village products—olive oil, wine, cheese, pasta—with one producer of each product represented in this particular *consorzio*. Yet despite the fact that EU funding made this promotion nearly free for participating producers, there was a deep amount of distrust among *consorzio* members. Notably, there was a pervasive sense of competition, despite the fact that producers in the organization made complementary products (Personal Interview, Lazio, March 2008). Lack of trust inhibited cooperation and proved a significant, durable obstacle to building a shared geographic quality brand.

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<sup>63</sup> Indeed, these two negative characterizations of the Italian wine market—that successful producers are corrupt and failed producers lacked market sophistication—came up repeatedly even beyond producers. Government officials, academics, wine writers, and other observers made these criticisms, though this characterization tended to be applied to central and southern Italy and not to Piedmont. Also note that this same divide came up (infrequently) in my interviews with French producers and government officials when describing production politics in the Languedoc region.

While many wine experts found rural ideas to be the main problem facing the Italian wine sector, other experts (including growers, writers, academics, market leaders, and agro-tourism promoters) cited an endemic system of corruption and patronage in national and local wine politics as the problem.<sup>64</sup> One could argue that this idea is further evidence of weak levels of trust among those outside of the elite. For example, an action that a farmer may deem to be corruption may seem to another actor to be a savvy marketing strategy. And what a farmer may perceive as “honestly following local norms and standards” may seem like “anti-market” activities to an export-oriented producer.<sup>65</sup>

Indeed, just as Italian winemaking elites provided substantial evidence of what they called “farmer mentality” among smaller producers, accusations of corruption in Italian wine politics abounded from grape growers, academics, journalists, and wine merchants. Franco Ziliani provided concrete examples of powerful producers receiving appointments to the *comitato* and granting themselves DOCGs. More broadly, there is a pervasive idea that the government grants DOC distinctions based on political patronage. This notion reflects the national consensus on twentieth century Italian politics, where politicians consolidate local support by granting political favors to their constituents (examples include offering state-funded employment or contracts for state-sponsored projects).

DOCs are granted by an expert para-public committee, the *comitato nazionale della vita del vino*, which parallels the French national *Institute national d'origine et de la qualité* (INAO) committee. However, the only person I encountered who attempted to argue that the *comitato* was fair and apolitical was himself a member of the *comitato*. No other actors I spoke to in the Italian wine industry shared this opinion. Instead, producers and wine writers perceive the *comitato* as a means for local leaders to deliver economic protection to their local constituencies. “In Italy we have a political committee who decides, instead of technicians” (Ziliani, Personal Interview, July 2009). Even the assistant to the *comitato* member who defended the organization said (after his boss left the room) that, “Yes, giving the DOC is a bit political.” The assistant also said that *comitato* members were primarily beholden to regional interests over national interests (interview July 2010). Zampi, the economist at University of Florence, echoed this view: “Agriculture and politics are intertwined. Favors. You want to protect your constituents” (July 19, 2010). A top winemaker in Emilia-Romagna told me about the political nature of the DOC in a more oblique manner: “Soon the EU will grant DOC status... this reduces the ability of political actors to improve their local standing by securing DOCs for their

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<sup>64</sup> Several interviewees expressed both perspectives at the same time: that the powerful were corrupt and the less powerful lacked marketing savvy.

<sup>65</sup> What the Italian elite refer to as a “rural mentality”, I would compare to a type of conservatism, similar to the rural conservatism observable today in parts of the United States. Some characteristics of rural conservatism include a distrust of the government, a distrust of the elite, and a resistance to changes to the traditional way of rural life. The conservative impulse is so deeply engrained in parts of Italy—especially rural areas—that this lack of trust surely contributes to the weakness of the DOC regulation, and to the Italian preference for local (known, familiar) products.



constituents... it is perceived it will be more difficult to secure DOC protection at the European level.” As University of Bologna economists Rafael Corrado and Vincenza Odorici summarize: “Instead of [distinctions like DOC and DOCG] being a selection of ‘the best among the good wines,’ based on actual quality, fame and diffusion, denominations became a tool of local institutions for promotion of their territories and productions” (Corrado and Odorici 2008b, p. 8). According to all these different sources, Italians perceive the DOC as intertwined with local politics.

In addition to the perception that the DOC is a means for political actors to win local constituents’ support, there is a perception that more powerful producers are able to secure “custom-made” DOCs or DOCGs. Enologist and wine blogger France Ziliani provided me with specific examples of powerful (large, market-oriented) producers who were forced out of existing DOCs after their production innovations strayed too far from traditional best practice. But after being excluded from their initial DOC, a new DOC was tailor-made to fit their new wine style. Ziliani provided specific examples of this phenomenon in both Tuscany and Piedmont.

Ziliani provided another example of the relationship between political influence and regulatory protection. Specifically, he described an instance where the CEO of one of the largest Tuscan wine firms secured a national political appointment through which he controlled which areas could be upgraded to DOCG. Soon after his political appointment, he granted DOCG to a region where he was a dominant producer, despite the fact that “this region was clearly not worthy of a DOCG status” (Personal Interview, Franco Ziliani, July 2011). This sort of development strengthens the perception that the DOC is driven more by political linkages and less by wine quality.

The insider/outsider divide in the Italian wine industry has become institutionalized into local Italian *consorzii*. Prior to 1992, *consorzio* votes were distributed 50 percent to growers and 50 percent to merchants—regardless of production volumes. Using this structure, actors would decide (or alter) production rules, including allowable grape varieties and production yields. Critically, these votes determined the leaders of the *consorzio*, including members of the tasting panel. This distribution of voting power was based on the French interprofessional structure under that country’s AOC regulations. After 1992, however, the voting structure within Italy’s *consorzii* shifted. Votes are now determined by production volume, regardless of position in the supply chain. This change was made at the behest of the *Ministero d’agricoltura* in an effort to increase the competitiveness of Italian wine.<sup>66</sup>

The change in *consorzii* voting procedures shifts local decision-making power toward large, export-oriented producers in regions where ownership is concentrated. For example, large export-oriented producers may prefer to adapt their local wine variety to the currently popular “New World” wine style. In practice, this means favoring international grape varieties over local varieties, enhancing

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<sup>66</sup> According to the *Filiera Vino* Report published by ISMEA (*Istituto di Servizi per il Mercato Agricolo Alimentare*), a main weakness of the Italian wine sector is the excessive fragmentation and the small size of Italian wine firms—as noted above, 69 percent of Italian wine is grown on farms of five hectares or less.

wine colors, increasing the taste of oak, etc. Changing the distribution of votes in *consorzii* has enabled large-scale producers to pursue these types of strategies, further orienting Italian wine toward an international style.

Even when powerful producers are unable to formally change the *disciplinario* production rules, they have been able to push the taste and color of Italian wines toward a more international style. In one major Italian wine-exporting region, large producers used their power to put themselves on a DOC's "blind" wine tasting panel, which must taste a wine sample before the wine can receive the DOC stamp. A key player in breaking the Brunello fraud scandal, Franco Ziliani, described how large producers used their voting influence to "stack the deck" in the tasting panel. Once they dominated the panel, they used their voice to push the taste of Brunello in a particular direction:

You need to present samples of your wine. If the style of Brunello they have in mind is merlot, and you have made your wine with sangiovese, the *consorzio* will tell you "you need to do something with this" because it is not marketable. The *consorzio* is very political—[the people] who judge the wine in the "blind tasting" are the same people who make the wine. They like their style of wine. In Montalcino, it happened more than once, the best producers were 100 percent sangiovese from Montalcino. They played by the book. And the wine was boycotted from the test panel because there was too much sangiovese. This was not the official reason. They find other reasons. But fake Brunellos passed without any problems.

The concentration of political power in the Italian wine sector both changes the taste of wine and inhibits the voice of small producers. According to my interviews, local power asymmetries weaken local cooperation because vulnerable actors fear retribution (Personal Interview, Agro-Tourism Operator in Emilia-Romagna, July 2010; Personal Interview, Franco Ziliani, 2010).<sup>67</sup> When asked why so many producers kept quiet though they knew about the wine fraud, Franco Ziliani explained:

In Montalcino, the majority of producers respect the rules. At the same time, they justify what the big producers are doing. They justify this for many reasons. One is that everyone is a little bit guilty. With so many rules, everyone is guilty of having broken a few rules. Small producers don't feel that they are powerful enough to stand up to the large producers. The most important producers know the secrets of the small producers. So their hands are dirty and this is known.<sup>68</sup>

I was also told an array of stories from other sources, which suggested either evidence of corruption or evidence of a lack of social trust. One interview subject described the political consequences that befell a local, self-made producer upon

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<sup>67</sup> This idea was also put forward by Leo Loubère in his historical account of Italian wine politics in *The Red and the White*. He described the particularly apolitical nature of southern Italian grape growers, where asymmetries of power and fear of political retribution are most acute (1978).

<sup>68</sup> Retribution affected Ziliani himself after he broke the Brunello scandal: he was kicked off the board of a major Italian wine journal after he broke the story in 2008.

confronting more a politically powerful local wine figure.<sup>69</sup> Not infrequently, people noted the role of organized crime (the Mafia) or conservative Catholic social groups (such as Opus Dei) in local wine politics, notably in their role in shaping political networks and thus impacting market access.<sup>70</sup> I was not in a position to judge the accuracy of these statements or stories, but regardless of their accuracy, many local actors perceive insider networks as providing differential levels of political access. And this perception of unequal opportunities demonstrates a cleavage between local elites and other local producers.

Undeniably, in any sociopolitical hierarchy, some actors have access to opportunities that other producers do not. In the Italian wine sector, these advantages are sometimes economic: some producers can afford to hire enologists, winemakers, and build cellars, and other producers cannot. But the perception is that economically powerful producers operate under a different set of rules than the rules that inhibit other producers, weakening trust in “neutral” political institutions. The local division comes not from an inequity in opportunities—though this exists—but from a perception of differential political access.

Italian wine production is more market-driven than French wine production, in part due to Italians’ low levels of trust in their country’s regulatory politics. This is true from the point of view of consumers, which we will explore below in our discussion of wine guides. But it is also true of producers, who equate quality production with economic success and high prices. This outlook contrasts sharply with the views I heard in my interviews with French quality producers in Bordeaux, where quality is defined by the experts, independent of market success (Personal Interview, Eric Texier, August 2011; Personal Interview, Paul Pontallier, Chateau Margaux; Personal Interview, Geneviève Teil, November 2007). One Italian interview subject told me that the market was an accessible path for a producer to build a better life in a manner that did not rely on political dealings. He said that while he disliked President Silvio Berlusconi, Berlusconi won the presidency twice because he embodied this new type of “self-made” Italian entrepreneur: “He made his own money. He did not come up from inside of the system. He represents the possibility of moving beyond the old system of politics” (Personal Interview Agro-Tourism Firm Owner, Emilia-Romagna, July 2010). As a result, some Italian producers turn a blind eye toward political “problems” so long as they maintain the ability to achieve

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<sup>69</sup> This producer, who I spoke with, was effectively excluded from market participation and political participation; I was asked not to describe the details of the confrontation in order to prevent any further retribution.

<sup>70</sup> In this same central Italian wine region, I was told very specific stories in a hushed voice of the linkages between local politics, church politics, and “visibility” in the wine market. According to one agro-tourism operator, the fact that the most prolific local quality wine producer was powerful in the church, the university, and in an array of local organizations is a evidence of an Italian system that privileges those already in a position of power and limits true social mobility. One prolific, politically active quality producer I interviewed, meanwhile, said he had an advantage because of his training in business and marketing. As a result he was able to bring a market perspective to wine production, hiring the best winemaker, employing top enologists, obtaining top scores for his wine, and building a successful brand. Both of these perspectives are technically correct: this man is politically powerful and he is a successful businessman. But is this evidence of corruption/abuse of power? Or is it evidence of a savvy businessman?

a level of market success: “There was a magical moment when everything was selling and everybody was making money. Any bottle which said Brunello would sell for \$50. People say America has to have wines like this, America buys wines like this, so what’s the problem? Everyone was ignoring or playing blind. The press, the importers, the *consorzio*.” (Ziliani, July 2010)

While local divisions can have negative consequences on the value of a shared brand, the willingness of some producers to take production risks can benefit other local producers. Aldo Vacca, director of the prestigious wine cooperative in Barbaresco, described how all Barbaresco producers were helped by the rise of regional winemaker Angelo Gaja. Gaja innovated and created spectacular wines, and his internationally recognized wines had two effects: they priced Gaja out of the market, and they created a stronger association between Barbaresco and quality wine production. As a result, smaller producers copied Gaja’s winemaking style, and, through new brand recognition of the Barbaresco name, these other producers benefited from an increase in prices.<sup>71</sup> Thus a shared brand has emerged, but one that follows market trends and builds upon the market success of individual producers, rather than a brand that derives from state protection.

This “rising tide lifting other boats” model has characterized most famous Italian wine regions, including Montalcino, Tuscany, and Sicily, to name a few. When a few producers break production rules, the innovation provides a risk and an opportunity for other producers in the same appellation. Small producers suffer a risk as innovative producers, each seeking to improve upon the rules, broaden the common taste so that it is unclear which taste is represented by the protective regulation. At the same time, if one producer succeeds, others can copy his methods and try to gain market share.

### **3.8 Exit the State, Enter the Market: The Significance of Italian Wine Guides**

Economics Professor Zampi explained that the political nature of the DOC protection was a main reason why it protected subpar winemaking practices from the beginning: “When you want to create a new area, you need to allow people to experiment, learn, and find the best quality. Instead, politicians are in a rush to give a value-added to their constituents.” An arrangement like the DOC has three significant consequences. First, it may slow down the process of innovation (at least among some producers). Second, it may stigmatize the shared local geographic brand, if the region is associated with a low-quality wine. Third, the protection of lower-quality wines weakens the value of other DOCs, as the government mark no longer signifies an effective quality guarantee.

Wine guides appeared in Italy during the early 1980s in order to meet consumers’ need for guidance at a time when table wines sometimes out-priced DOC wines (Corrado and Odorici 2009, p. 114). Because of the inability of the

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<sup>71</sup> This phenomenon is most pronounced in regions where consumers attribute quality with region of origin—i.e., this occurs in the United States, Germany, and Switzerland, but not in emerging markets such as China and India (Personal Interview, Aldo Vacca, July 2011).

codification system to identify wine quality perfectly, the verdict of wine critics has assumed a crucial role in determining the commercial fortunes of a top wine and their winery (Corrado and Odorici 2004, p. 157). With weak regulation in the Italian wine industry, the wineries' best strategy is to push for product differentiation and construct an individually owned brand, in order to stand out from the myriad of anonymous wines. Under this strategy, wine guides and wine experts clearly play a crucial brokerage role between increasingly diversified producers and increasingly variety-seeking consumers (Corrado and Odorici 2004, p 156).

Research indicates that good reviews drive wine prices (Roberts and Reagans, 2007). Sometimes, wine reviews reinforce existing ranking hierarchies (see Hay's analysis of Robert Parker's impact on the Bordeaux wine market, 2007). But wine rankings from Italian guides do not enforce the regulatory wine hierarchy (Corrado and Odorici, 2008). Instead, Italian wine guides "provide orientation to consumers, and at the same time reflect a logic of quality that is closer to the taste of the general public than to the traditionalists' logic.... Their selection and review policies reward the wines that better fit the taste of the general public" (Corrado and Odorici 2009, p. 115).

In order to help create market-driven wines, many producers employ traveling winemakers. Most traveling winemakers consult for several wineries simultaneously (the most prolific in 2007 consulted for over 60 different wineries), and the winemaker's reputation serves as a type of brand guarantee: "The affiliation of a winemaker is more easily observed than a difference in quality.... Prominent winemakers serve as indicators of the unobserved quality of the producers that employ them" (Corrado and Odorici 2009, p. 115). Wineries that employ professional winemakers are more likely to be positively reviewed by wine guides than wineries who do not employ professional winemakers (Corrado and Odorici). Indeed, the data in Corrado and Odorici (2009) suggests that independent winemakers engaged in a modern approach to winemaking by relying on professional networks rather than on the advocacy of tradition. They overcame resistance to modern winemaking approaches with the help of the wine guides that tended to reward products that are more consistent with the taste of the general public rather than with the dictates of tradition (2009, p. 122). Wine guides orient the market away from growers and toward producers and place further emphasis on downstream production practices:

*Terroir*-driven wines are often associated with wines of a "natural" style. By "natural," proponents mean wines with limited human intervention. That is, no additions of acid, tannins, concentrate, etc. Thus, the *terroir* (as it related to the effects of climate anyway) remains unmasked. Style-driven wines are wines where a winemaker strive to create a wine of a certain style—typically a "New World" or riper style. Wines of this type are more likely to have less variation between vintages, utilize technology and post-harvest additions like those described above. These wines are also thought by critics to reveal less of their *terroir* as those subtleties are masked by the intervention (The Zinquisition, 20 December 2005, as cited in Corrado and Odorici, 2009 p 115).

These “new style” wines are technically strong, but they rarely break into the luxury market space dominated by French producers. Why? Because luxury consumers perceive the French products as unique and without substitutes. By placing quality in a non-transferrable local attribute (the *terroir*) and limiting production quantities, French wine is perceived to be rare. The dynamic of constrained supply and growing demand placed some French wines squarely in the luxury market, where price reflects scarcity rather than quality or value-added. French quality is perceived to be above concerns of market demand. The Italian wine strategy of wine guides and wine experts, on the other hand, places brand downstream and orients production to changing consumer tastes. Elite Italian wine producers define quality, but define it by anticipating market demand. As a result, Italian wines have competed in a more crowded, less protected market space. As Aldo Vacca, wine historian and president of the Barbaresco wine cooperative, described in July 2011:

The traditional market is more unique. It has more of a market. It is more intriguing, more complex, you don't have all of this fruit but eventually you have layers of complexity... (Some producers have) started to realize what I always thought—if we want to sell our wines, we need to give a unique product. So maybe not wines that are fashionable at the moment, maybe not the most popular, but different. Otherwise, everyone is in the same market space.

### 3.9 Market Structure

When the value of an individual brand leads to an increase in interest in a broader wine region, it tends to increase wine prices for other regional farmers. For example, Gaja's star caused prices of other Barbaresco wines to rise. The increase in wine prices in turn increases the price of grapes. Italian grape growers respond to this by building their own winemaking facilities, and wine merchants respond by growing their own grapes. The idea here is that growers are trying to cut into the profit enjoyed by wine producers, and producers are trying to stabilize grape prices. (Personal Interview, Aldo Vacca of the Barbaresco Wine Cooperative, July 2011).<sup>72</sup> This response reflects the weak linkages across local supply chains—wineries “want to guarantee quality, as these are perceived to not be sufficiently controlled by the DOC” (Personal Interview, Winemaker Francesco Lambertini, July 2010). So even as a regional brand becomes more recognized, the cooperation between market actors remains limited. For many small quality producers, the supply chain is entirely contained within the family firm. As a result, production tends to shift in-house as the market expands. This trend differs from the French case, where growers and merchants sometimes remain separate despite increased market demand (Champagne is the best example of this).

Thus small producers tend to be vertically integrated, and large producers are not. Though grape prices are not available, the fragmented nature of the

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<sup>72</sup> In some regions, producers transform their grapes into wine via cooperatives, which has the same effect of keeping value with the grower.

protection of atomized Italian grape growers theoretically enables large producers to exercise oligopsony power when setting grape prices (Seccia et al., 2008, p. 2). In Seccia et al.'s paper "Market Power and Price Competition in the Italian Wine Market," the authors calculate the market concentration index of the Italian wine market, noting that "a certain degree of market concentration appears in almost half of the Italian wine market, despite the large number of firms." The Italian wine sector is fragmented, to the advantage of large producers and distributors. In

What does the concentration of Italian wine producers mean for the future of the Italian quality wine market? According to economic sociologist Lucien Karpik, large firms—which he calls "megafirms"—may have the power to reshape the market, reconceptualize luxury symbols, and break the stranglehold of top French firms. He argues that French wine is protected by limiting market supply, a notion he calls "the market of singularities." Potential market competitors, he says, need to reframe how luxury is constructed and compete through product differentiation as opposed to protection:

The barrier of the belief in the superiority of appellation has already been partially breached abroad. Is it going to hold more successfully in France? And elsewhere? No one knows. But we do know that the competitors are megafirms with enough technical and financial resources to eventually succeed in dismantling their opponents' symbolic systems, even those with a long history. And we also know that trust/belief does not always follow the model of slow erosion over time. In all events, there is a theoretical consequence to the comparison: one world based on differentiation and the other on singularization. One should be addressed by mainstream economics and the other by the economics of singularities. (Karpik 2010, p. 146).

According to Karpik, the extent to which Italian wine is successful in the luxury market will depend upon whether they can not beat France at her own game—the game of defining luxury. According to Karpik's line of reasoning, the downstream consolidation of Italian wine firms could enhance Italy's position as a luxury wine producers.<sup>73</sup> Given the fragmented structure of the Italian wine industry, an successful Italian redefinition of luxury would rely on innovative wine styles rather than terroir—not because Italy lacks terroir but because weak levels of cooperation place value-added on downstream processes (winemaking, bottling, distribution, branding, product placement). Currently, Italy makes style-driven wines for a market that defines luxury as singular and *terroir* driven. As a result, most Italian wineries are locked out of a French defined, French dominated luxury sector.

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<sup>73</sup> Karpik's quote captures how Italians compete vis-à-vis their French counterparts: there are nine Italian "megafirms", though only one is able to push prices significantly over marginal costs (Seccia et al, 2008). The Italian market is attempting to compete on brands and product differentiation.

### 3.10 Conclusions

Different responses to the production rules in the Italian wine industry have amplified cleavages within producer organizations. First, a durable divide emerged between larger, export-oriented producers and smaller producers. This divide became institutionalized through voting procedures in local producer organizations (*consorzii*), which provided votes based on quality outputs instead of position in the supply chain. This is both a cause and a consequence of weaker levels of trust and cooperation among local actors. Cooperation across the supply chain remained weak; producers who were interested in either building a quality product, or in receiving a fair price for their grapes, began bringing the entire wine production chain in house. Secondly, as producers breaking Italy's DOC rules created better wine (at least as judged by the market), it created ambivalence about following production rules in a manner that was sometimes detrimental to small producers and local growers. Finally, grape growers in Italy did not establish hegemony over taste definition as growers had done in France: quality in Italy was not located with the land, as the quality of wine from an area could be hugely variable. Instead, value accrued to the winemaker who transformed the wine and the producer who owned the individual brand.

The definition of quality remained downstream with those who transformed the wine and bought the grapes, and formalized quality guarantees between aggregated growers and buyers remained weak. Quality producers either put an emphasis on grape transformation or they moved to grow their own grapes. Demand for regulated grapes increased in Italy only after a few winemaking leaders began to establish individually owned brands. It was not cooperation that caused the Italian market to gain recognition as quality; it was individualism, competition, and a slight disregard of codified production norms.

The French strategy of protective geographic regulation for wines was to increase prices by restricting the quantity of French grapes (both directly by limiting production within the protected region, and more broadly by preventing other producers from making "Champagne," "Burgundy," etc., with other grapes). This difference in strategy reflects the fact that the French were trying to protect market share, the organizational power of French growers, and the perceived legitimacy of the state in regulating quality. In the Italian case, quality wines developed in areas with lower levels of a shared political identity, lower levels of trust, and differential access to capital. As a result, producers competed in an *ad hoc* cooperative manner, creating quality wines based on technical improvements and by responding to market signals. The Italian wine sector has become more market-oriented and more competitive. Italy successfully moved from a backwards wine producer to a formidable market competitor, but one that remains outside of the protected French luxury market space.



## **Part IV**

# **Wine Sector Data**

# Chapter 4

## French and Italian Wine in Comparative Perspective

### 4.1 Chapter Summary

The goal of this chapter is to compare the different supply chain dynamics in the French and Italian wine sectors. In Chapters Two and Three, I explored patterns of cooperation within these two cases. In the French case, supply chain organization ranged from high levels of cooperation and compromise (Champagne) to patterns of merchant exclusion (Languedoc). In Italy, meanwhile, persistent political divides prevented the emergence of political cooperation and market protection throughout the country's wine industry.

I begin this chapter with a brief comparison of the French and Italian wine data. Next, I compare data across different French wine-producing regions. Variables I explore in the intra-France analysis include farm size, prices, and distribution strategy. Following our investigation into the French case, I analyze the same variables in Italian wine-producing regions. The data demonstrates clear differences between the French and Italian wine industries across all three variables, differences that are consistent with my broader argument about the importance of supply chain dynamics. Ultimately, upstream power in a negotiated context (as exists in the French wine industry) is associated with protected markets, while concentrated downstream power (as exists in the Italian wine industry) is associated with price-based competition.

### 4.2 Overview of French and Italian Wine Market Data

There are 110,000 vineyards in France, and 27,000 of these growers make their own wines. The precise number of vineyards in Italy is unknown, but it is estimated to be one million, including 73,000 grower-wineries (FranceAgriMer 2011); (Seccia, et al., 2010). French wines sell for an average of €4.52/liter, whereas Italian wines average €1.87/liter (excluding Champagne and other sparkling wines, EC-EUROSTAT 2008). This average price difference can be traced to differences between the countries' top wines: French top-rated (AOC) wines sell for €5.59/liter

on average, compared to Italy's top-rated (DOC-DOCG) wines, which sell for €3.39/liter (Table 4.1)

**Table 4.1: Price per Unit of Wine Across Regulated PDO Categories (euro/hectoliter), 2007**

	Protected Designation of Origin wines <sup>74</sup>
France	5.59
Italy	3.39

On the other hand, Italian table wine competes favorably with French table wine: French producers receive only marginally higher prices than Italian producers for table wines that are marketed without government-protected geographic labels—and sometimes less, depending on the measure used.<sup>75</sup>

**Table 4.2: Wine Prices by Table Wine Categories (euro/ettogrado), 2007**

	Protected Geographic Indication (PGI) red <sup>76</sup>	PGI white	Table wine red	Table wine white
France	3.52	4.81	2.84	3.94
Italy	3.87	6.48	3.05	3.35

Conversely, Italian producers' *indicazione geografica tipica* (IGT) table wine earns up to 35 percent more than French wine in segments of the Protected Geographic Origin (PGI)<sup>77</sup> market (2007). French table wine producers are not able to capitalize

<sup>74</sup> PDO, or protected designation of origin, is the European Union's term for AOC and DOC-DOCG wines. Units across PDO and table wine categories are not comparable here, as PDO wines are measured in volume and table wines are measured according to alcoholic grade. Data from EC-Eurostat, 2008, data excludes sparkling wines.

<sup>75</sup> When using euro per liter, French table wines are prices marginally higher than Italian table wines. When prices are measured in euro per *ettogrado*, Italian table wines prices are higher. *Ettogrado* is the price per alcoholic degree, by liter of wine. Italian wines tend to have higher levels of alcohol (a result of more sugar in grapes from warmer climates). Historically, both French and Italian table wine cooperatives used alcohol level to determine wine prices. Italy's ISMEA (the statistical branch of the *Ministero dell'agricoltura*) measures table wine prices in *ettogrado*.

<sup>76</sup> PGI, or protected geographic indication, is the European Union's term for IGT and VDP (*vin de pays*) wines. Units here are price per *ettogrado*, which measures the cost of a liter of wine, with weight given to variation in alcoholic context. Note that earlier table wine data in this chapter and in Chapter One was provided in euro per hectoliter. Data here is provided in euro per *ettogrado* because this categorical data is not available in (or compatible with) euro per liter.

<sup>77</sup> The PGI market includes IGT wines and, historically, France's *vin de pays* (VDP) wine. However, currently the French Ministry of Agriculture is in the process of categorizing VDP from PGI to Protected Designation of Origin (PDO), as PDO requires the agricultural product is grown in a given

on France's wine reputation, whereas some Italian producers have thrived in this competitive market segment.

As Table 4.2 demonstrates, Italian table wine prices are higher than French prices for three of the four table wine groups.<sup>78</sup> These figures demonstrate that the Italian model competes favorably in the mass market. The French protectionist model is effective in competing in more protected market segments. The pages that follow investigate the causes underlying these different outcomes.

### 4.3 Summary of French Wine Sector Data

Because of their histories of politically strong growers, the regions of Champagne and Languedoc must be at the center of any analysis of French wine politics.

Table 4.3 indicates a high level of upstream cooperation among wine-industry actors in Languedoc and in Champagne, as anticipated based on my Chapter Two analysis. Both regions are dominated by small farms, which indicate a level of price protection, but they have little in common beyond small farm size. Champagne producers restrict production volumes, distribute wine through traditional wine merchants, and fetch high prices for their products (Champagne grapes sell for €5.50/kilo and Champagne wine sells for €21.34/liter). Languedoc, meanwhile, has high production volumes, sells wine in bulk through cooperatives and large retailers, and commands lower prices for its products (€1.67/liter). Languedoc's farmers earn only 27 percent of the wages earned by farmers in other French regions.<sup>79</sup>

I also analyze Burgundy and Bordeaux in this chapter, as they represent divergences from the Champagne model. Burgundy has historically been relatively grower-dominated and Bordeaux has historically been relatively merchant-dominated, while Champagne represents a rough balance between these two interest groups. The causes of these differences become clearer when one considers the history of each region and the structure of France's wine appellation rules. Both Burgundy and Bordeaux organized for AOC cooperation in the months following Champagne's adoption of the AOC appellation in 1935. Burgundy's local organization was grower-led, as growers became politically stronger than *négociants* during the interwar period (Laferté 2006). In Burgundy, strong village-

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territory, whereas PGI only requires the last phases of production occur in a given geographic area. Note that the 35 percent price differential is observed when measured in euro per *ettogrado*.

<sup>78</sup> White Italian IGT prices are especially high in comparison to other table wine categories, principally due to high demand for Prosecco (IGT-Veneto) and Pinot Grigio (also IGT-Veneto). Prosecco-based IGTs sold for 9.84 euro/*ettogrado* (2007) and Pinot Grigio-based IGTs sold for 9.04 euro/*ettogrado* (2007) (ISMEA 2008b, p. 64).

<sup>79</sup> The French Ministry of Agriculture does not collect data on regional grape prices (nor does any other national French agency). The only region that publicizes its grape prices is Champagne, likely because the price is higher than in other regions, implying that Champagne is a "higher quality wine" from the beginning. The only study I found linking the prices of grapes to the price of wine was an analysis of the Argentine wine sector by James Simpson. The author found a clear, consistent linear relation between the price of grapes and the subsequent market price of wine—i.e., each half-peso (per kilo of grapes) increase was correlated with an increase of 1.6-1.7 centavos per liter of wine (Simpson 2011).

level grower groups led to the establishment of 116 Burgundian appellations—against the wishes of *négociants*, who feared too many appellations would be confusing to consumers (Colman 2008).

Bordeaux’s winemaking landscape was developed by bourgeois producers who have historically oriented production toward Anglo-Saxon export markets. Bordeaux is known for its luxury wine producers, but there are over 10,000 growers in Bordeaux and most producers are not in the luxury sector. Rather, they position themselves to benefit from the Bordeaux brand name (Colman 2008). Bordeaux has fewer than half of the appellations than we see in Burgundy (57), despite the fact that Bordeaux’s production volumes are more than double those of Burgundy (see table 4.4). Including Burgundy and Bordeaux in this analysis enhances the contrast between the consequences of high levels of grower power, high levels of merchant power, and negotiated compromise.

**Table 4.3: Overview of Production Structures in Four Principal French Wine Regions**

	Location of supply chain power	Average farm size	Prices	Production Volumes	Dominant distribution strategy
Champagne	Shared: strong corporatist organizations with strong growers	Small	Very high	Low	Smaller-scale <i>négociants</i>
Burgundy	Grower-dominant	Medium	High	Low	Mixed strategy
Bordeaux	<i>Négociant</i> -dominant	Large	Medium	High	Wholesalers, large retailers
Languedoc	Strong growers with weak market power	Small	Low	High	Wine cooperatives, wholesalers, large retailers

#### 4.4 Luxury or Commodity? Price and Quantities

The general logic of a luxury market is to increase prices by restricting output (Karpik 2010) and controlling distribution (Cleary 2008). When effective, this strategy can redistribute market power toward the upstream side of the supply chain—especially if upstream suppliers successfully restrict sourcing options of downstream actors. These luxury market dynamics are present in the quality French wine regions with the highest historical levels of grower cooperation. These

regions have the highest per-unit prices among all French wines, while maintaining low output volumes (Table 4.4).

**Table 4.4: Prices and Volume by French Region**

	Euro per liter, 2011	Output volume (hundred million hl), 2009
Champagne	€21.34	27
Burgundy	€10.97	26
Bordeaux	€7.89	62
Languedoc	€1.67	121

From: (Agreste 2012), (FranceAgriMer 2011).

Champagne and Burgundy, for example, have extremely limited production quantities, and the highest average prices (€21.34 and €10.97 per liter, 2011). Compared to Champagne and Burgundy, Bordeaux’s producers are in a more competitive and crowded market space—perhaps due to the annual volume of AOC Bordeaux production. Languedoc’s production volume, meanwhile, dwarfs its competitors, and the low price of the region’s wines points to a degree of product commoditization. In each of these major French wine regions, there is a clear relationship between production quantities and per-unit prices.

Table 4.5 demonstrates the dominance of AOC production in Bordeaux, Champagne, and Burgundy. Despite this protection, the potential AOC production capacity varies greatly by region. In Bordeaux, most wines receive the AOC distinction, but due to the large AOC area, the shared brand is limited in its ability to create luxury through production restrictions. Only 22 percent of the Languedoc’s production is AOC, but its total approved AOC acreage is still greater than Champagne’s and Burgundy’s combined. Both of these factors are consistent with low prices of Languedocian wine.

**Table 4.5: Regional French Wine Production Statistics, 2009**

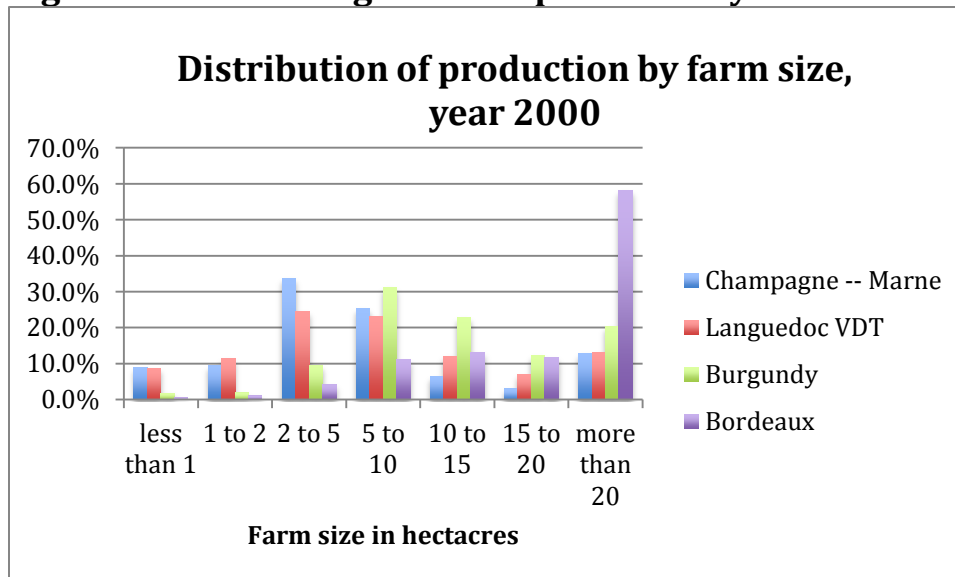
	Percentage of AOC production	Area of AOC production (hectares)
Languedoc-Rousillon	22 percent	82,600
Bordeaux	98 percent	140,700
Champagne	97 percent	30,100
Burgundy	96 percent	30,900

From: (FranceAgriMer 2011, Agreste 2012)

## 4.5 Location of Supply Chain Power: Farm Size and Distribution Channels

Two variables help explain the different distributions of supply chain power in the French wine sector: farm size and distribution patterns. Small farmers do not compete on economies of scale. These producers either create a qualitatively different product than larger farms, or an intervening factor, such as access to wine cooperatives or state-funded price supports, enables them to survive.<sup>80</sup> Larger farms, meanwhile, are associated with economies of scale and competitive pricing structures. As for distribution patterns, one would expect commodified grape production to channel through large wholesalers, large *négociants*, and grape cooperatives. In regions where growers and producers negotiate with each other, one expects to observe fewer direct sales, fewer wholesalers, and a greater role for small, traditional *négociants*. The data largely supports projected expectations (Figure 4.1).

**Figure 4.1: Percentage of wine produced by farm size<sup>81</sup>**



(FranceAgriMer 2011)

As demonstrated in Figure 4.1, a significant amount of wine production in both Champagne and the Languedoc occurs at small farms. This is due to the fact that growers in these regions are protected from fluctuations in prices, either due to the value of their shared brand (Champagne) or due to grower cooperatives' price guarantees and European Union price supports (Languedoc). Burgundy, meanwhile, has strong, small shared brands, though there has been some consolidation of farms

<sup>80</sup> Additionally, small farms may also be an attribute of economically backwards areas. Farmers may lack the capital to consolidate farms, and they may lack alternative economic choices. This may occur more frequently in the wine sector than other agricultural industries, as grapes can be successfully cultivated on poor quality soil.

<sup>81</sup> This table shows total wine surface by region, divided into percentages. For example, 58 percent of AOC Bordeaux wine areas are located in farms with at least 20 hectares of production.

as a consequence of the disappearance of traditional *négociants* from the Burgundian wine market (Personal Interview, Wine Merchant Eric Texier, July 2011).<sup>82</sup> Essentially, the increased pressure for Burgundian firms to vertically integrate increases the incentive to move away from very small farms in order to maintain reasonable per unit costs. In Bordeaux, larger farm size is a signal of vineyard consolidation, larger-scale production, and possibly broader price-based competition. Bordeaux has larger merchant-dominated brands, competes more on the international market, and relies more heavily on wine experts and wine guides (Lima and Schroder 2008, Hay 2010, Personal Interview, Political Scientist Andy Smith, February 2008 ); Across France's winemaking regions, differences between merchant-dominant areas and grower-dominant areas manifest themselves in terms of different farm sizes, wine prices, and amounts of wine produced within the state-protected AOC regime.

There is a clear correlation between producer organization, prices, and distribution patterns (Table 4.6). The Marne is Champagne's principal wine-growing region. Prices are very high in Champagne's Marne district, where nearly 65 percent of wine is distributed via small *négociants* and only 13 percent of wine is sold through cooperatives, wholesalers, and large distributors. This pattern is also true for the two other Champagne *départements*: in Aisne 79 percent of wine is distributed through small *négociants*, and in the Aube 72 percent of wine is sold via small *négociants* (FranceAgriMer 2011). Cote d'Or is one of the premier wine-growing region within Burgundy, and they produce the most expensive French wine after Champagne (EC-EUROSTAT 2008, p. 22). For Côte d'Or producers, a majority of wine is sold through large-scale buyers and distributors, with more than 25 percent of the volume in direct sales and another 25 percent to small *négociants*. Seventy-five percent of Bordeaux's wine (located in the Gironde *département*) is channeled through large-scale distributors, though 15 percent of its wine is sold through smaller *négociants*. The Aude and Hérault are the principal wine-growing regions in Languedoc. These regions receive the lowest wine prices in France. Almost 80 percent of the wine from both Hérault and Aude are sold through cooperatives, wholesalers, and large distributors.

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<sup>82</sup> Burgundy had been grower-dominated (Laferté 2006), but in the 1990s, the structure of distribution in the region changed. *Négociants* bore a great deal of economic risk, and beginning in the mid-90s, several *négociants* went under. Whereas traditional *négociants* used to blend wines to create a unique taste, today growers increasingly bottle their own wines. Now, most Burgundian *négoce*s are specialized distributors who secure short-term export contracts. As a result, the risk of excess stock has been pushed back from the *négoce* to the growers. In a way, this is actually a long-run consequence of concentrated grower power. Strong grower power increased the risk and vulnerability of the *négoce*, and after the collapse of most of the region's *négociants*, this risk has been transferred back to the grower (Personal Interview, Wine Merchant Eric Texier, July 2011).



**Table 4.6 Tracing the Supply Chain: Distribution from French Farms, 2000/2001<sup>83</sup>**

	Sales to cooperatives, wholesalers, large distributors	Direct sales to traditional wine stores, restaurants, direct export,	Sales to small <i>négociants</i> , other sales	Average price per liter
Champagne (Marne)	13 percent	22 percent	65 percent	€21.34
Burgundy (Cote d'Or)	45 percent	29 percent	26 percent	€10.97
Bordeaux (Gironde)	75 percent	10 percent	15 percent	€7.89
Languedoc (Hérault)	78 percent	14 percent	7 percent	€1.67
Languedoc (Aude)	80 percent	12 percent	8 percent	€1.67

(FranceAgriMer 2011)

The data on French wine distribution in Table 4.6 confirms the stated hypotheses: producers with strong shared brands sell wine through specialized merchants, and commoditized producers sell wine through bulk distributors. There is a clear relationship between price of wine and method of product distribution.

At the same time, producers rarely follow only one distribution strategy. Instead, they diversify their strategies to maximize potential market rewards and minimize market risks: sales through large-scale distributors (especially wine cooperatives) tend to be low-reward and low-risk, while direct sales are (potentially) high-reward, high-risk (Personal interviews, quality French winemakers in Languedoc, July 2010). Bulk-sale prices are relatively stable year to year, whereas direct sale contacts can be one-time orders (Personal Interview, Eric Texier, July 2011). The grapes in the Marne command such a high market value that nearly all growers in the area are locked into long-term contracts with specific *négociant* houses. Only the wine that does not meet the *négociant's* quality standards will be channeled through cooperatives, wholesalers, or large retail chains. Almost all Champagne producers (89 percent) opt to sell at least some portion of their wine through specialized wine merchants (FranceAgriMer 2011).

While Champagne is an outlier case, producers in other French winemaking regions also follow a strategy of distribution diversification, combining direct sales, traditional *négociant* sales, and bulk sales to large distributors. Burgundian producers, for example, pursue an average of 2.5 different distribution strategies (Table 4.7) In Bordeaux, producers average two distribution strategies apiece, most

<sup>83</sup> Data from FranceAgriMer 2011. Note that these regions are ranked from the most expensive wine (the Marne, in Champagne) to the least (Aude and Hérault, both in Languedoc Roussillon).

dividing their efforts between bulk sales to large distributors and sales to small merchants. Champagne producers follow, on average, 1.4 different distribution strategies. In Languedoc, producers pursue on average 1.9 different distribution strategies, with 80 percent of the region’s producers pursuing bulk sales to cooperatives or large producers.<sup>84</sup> Those producers that have diversified are bottling their own wine and selling directly to consumers or to small *négociants*. Ultimately, the predominant trend in most AOC regions is for farmers to follow a mixed distribution strategy in order to manage economic risk.

**Table 4.7: Average Number of Distribution Strategies Pursued, per Producer**

	Distribution strategies pursued, per producer
Marne (Champagne)	1.4
Cote d'Or (Burgundy)	2.6
Gironde (Bordeaux)	2.1
Hérault (Languedoc)	1.9
Aude (Languedoc)	1.9

FranceAgriMer 2011

Within the French wine industry, market dynamics parallel the broader cross-national case studies examined in this study: merchant-dominance leads to a greater reliance on market adaptation and a more competitive market space, compromise between growers and merchants leads to protected market dominance, and grower-dominance leads to a type of isolation from market trends. Some of these differences provide an important parallel between certain French and Italian regions. Specifically, the French region of Bordeaux bears some similarity to the merchant-dominated Italian quality market, including a reliance on wine guides and adapting wine styles to accommodate the American palate. Notably, Bordeaux wine makers have been accused of changing the taste of their wines to increase their scores in Robert Parker’s *The Wine Advocate* (the so-called “Parker effect”: (Lima and Schroder 2008, Feiring 2009). Wine guides have a minimal role in Champagne

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<sup>84</sup> It is important to point out the relationship between dominant distribution strategy and historical access to capital. Just as the AOC emerged in wealthier regions, where there was a demand for quality wine, wine cooperatives emerged in less economically advanced regions with less capital and weak histories of quality production. Cooperatives dominate percentages of production outputs in Languedoc-Roussillon, Provence Cote d’Azur, and the Rhone-Alps (FranceAgriMer 2011). For each of the *départements* in these regions, the majority of both AOC and table wines are produced by cooperatives (up to 76 percent of production in parts of Languedoc and 85 percent in parts of the Rhone-Alps). Cooperative production of both AOC wines and table wines are less than 50 percent in all other French departments (FranceAgriMer 2011). This points to possible correlations between wine prices and history, capital, producer organization.

and Burgundy (indeed Robert Parker is legally barred from reviewing Burgundian wines).<sup>85</sup>

#### 4.6 The Italian Supply Chain

Generally speaking, market strategy in the wine industry is determined by the distribution of power between growers and merchants. Local-level Italian cooperation has remained weak and Italian wine regulation has failed to enhance the market protection of grape growers. As a result, a market-responsive, competitive production model emerged. The Italian wine market supply chain concentrates power with large producers and wine distributors.

The Italian market has over one million growers, but supply chain channels are concentrated at two levels: the winery and the wine distribution network. Eighty-three percent of winemakers are responsible for only 1.5 percent of the country's output. At the other end of the spectrum, 0.2 percent of winemakers control 41 percent of the country's production. Additionally, 78 percent of domestic Italian wine value is channeled through modern distribution outlets—*il distribuzione moderna* (DM).<sup>86</sup> The DM principally includes hypermarkets, supermarkets, and discount chains. According to the Ministry of Agriculture's research branch, ISMEA: "A weak point in the Italian wine industry has always been excessive vineyard fragmentation and the small size of individual firms. Greater business aggregation would provide a balance against the consolidated force of the financial and distribution systems" (ISMEA 2008b, p. 29).<sup>87</sup>

Most Italian wineries and cooperatives are small and vertically integrated (Seccia, et al. 2008, p. 2). Larger Italian wineries are not vertically integrated, and they could theoretically exercise oligopsony power when setting grape prices for farmers (*ibid.*, p. 2) While Italian grape prices are not publically available, Italian wine market concentration can be measured. In Seccia et al.'s paper "Market Power and Price Competition in the Italian Wine Market," the authors calculate the concentration index of the Italian wineries, finding results that parallel the ISMEA data: 32 percent of Italy's national wine market share is held by only nine large firms. The next 37 percent of market share is held by 684 firms, with Italy's more than 72,000 other wineries divvying up the remaining 31 percent of market share. But despite this high level of market concentration, only one large Italian wine firm has sufficient brand loyalty to maintain a relatively inelastic demand curve. The other eight large firms' wines are essentially interchangeable, leaving them with

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<sup>85</sup> American and British wine critics play an important role for Bordeaux wine sales in international markets, where a wine score is often easier for a consumer to decipher than a mark from the French appellation system.

<sup>86</sup> Modern distribution channels dominate the French market as well, but to a lesser degree (65 percent to Italy's 78 percent, ISMEA 2008b, p. 46).

<sup>87</sup> *L'eccessiva frammentazione dei vigneti e le limitate dimensioni rappresentano da sempre un punto di debolezza del settore vino in Italia. Una maggior aggregazione imprenditoriale permetterebbe, infatti, di dare più forza nei confronti di altri sistemi, come quello finanziario o quello distributivo.* ISMEA 2008b p. 29).

little or no ability to increase marginal revenue over marginal costs.<sup>88</sup> The Seccia et al. study points to the simultaneous existence of high levels of downstream market power and highly elastic product demand.

## 4.7 Regional Italian Distinctions

In both France and in Italy, quality wine production emerged in regions that had access to capital, and where there was historically a demand for higher quality goods. Quality wine production developed in Piedmont, at the behest of French aristocracy who married into the house of Savoy.<sup>89</sup> In other Italian regions—such as Tuscany and Sicily—quality wine production emerged later with local landed elites, taking root in Tuscany in the 1960s and in Sicily in the 1990s. These local elites had distinct advantages over local grape farmers, including greater access to capital, greater training in marketing, the ability to hire wine experts (or to acquire their own expertise via training), and access to political and economic networks. The economic development of southern Italy has proceeded at a much slower pace; still today the region is economically underdeveloped in comparison to northern and central Italy, and the region remains a laggard in quality wine production.

This distinction between northern and southern wine production reflects regional differences in wealth, cooperation, and organization that have existed for decades/centuries.<sup>90</sup> There is a significant difference between the prevalence of wine quality regulation in the wealthier, industrialized northern Italy and in the poorer agricultural South. Protected dominations are concentrated in northern Italy: Piedmont alone has 45 DOC and 10 DOCG, followed by Tuscany (36 DOC, 7 DOCG, and 6 IGT) and Veneto (25 DOC, 3 DOCG, and 10 IGT). Southern Italy represents over half of all Italian wine grape production (51 percent), but only 28 percent of this amount comes from DOC/DOCG grapes (ISTAT 2007).<sup>91</sup> As of 2007,

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<sup>88</sup> The Seccia et al. study demonstrates the linkages between market share, market power, and price competition. The authors have a mark-up variable that measures a firm's ability to push marginal revenue over marginal costs. Seven of the nine largest Italian wine firms were able to obtain marginal revenue between 0 and 2 percent greater than their marginal costs. For the eighth firm, the mark-up could be pushed to 8 percent above the firm's marginal cost. The ninth firm faced a relatively inelastic demand curve, and could successfully raise prices by 300 percent over marginal costs.

<sup>89</sup> After Piedmont developed its *terroir*, its wines were exported to elites in other northern Italian regions (Personal Interview, Aldo Vacca, Director of Produttori del Barbaresco, July 2011).

<sup>90</sup> Even today, the old legacies of consumption are still observable: consumers in northwest and central Italy spend an average of 51 euro on annual wine expenditures, compared to 38 euro in the South.

<sup>91</sup> Southern Italy is the poorest region in the country, and according to political scientist Robert Putnam, is characterized by low levels of social trust (Putnam 1994). I asked a member of the *comitato nazionale delle vino* (the Italian version of the French INAO) why DOC regulation and wine experts were concentrated in Italy. The *comitato* member argued that northern producers have been more skilled in coming together to create the production rules and institutional structure, which were prerequisites for DOC consideration (Personal Interview, July 2010). For him, the issue of social cooperation came before the issue of quality.

35 percent of Italian wine production was DOC-DOCG, 29 percent IGT,<sup>92</sup> and 36 percent table wine (ISMEA 2008a). Fifty-seven percent of IGT is concentrated in two northern regions: Veneto and Emilia-Romagna (2007 data). Conversely, 43 percent of all table wine production is concentrated in just two southern Italian wine regions (Puglia and Sicily). In addition, large vinification and packing firms are concentrated in Emilia-Romagna and Veneto. For southern producers, vinification and bottling is frequently completed by these powerful northern Italian firms. According to the ISMEA, this arrangement causes value to be captured by the northern upstream actors:

Veneto and Emilia Romagna have a dynamic market for local (wine) products, while remaining active on a national level. The most important packing companies are located in these regions. The southern traditional production area still struggles to hold onto the added value generated by the successive phases vinification<sup>93</sup> (ISMEA 2008b, p. 27).

On the other end of the spectrum, Italy's vertically integrated wine firms are concentrated in Tuscany and Piedmont, where higher prices enable them to withstand higher capital costs due to the added value of the product (ISEMA, 2008, p. 28).<sup>94</sup> Thus in Italian wine production we have large actors who dominate fragmented growers (table wine), and atomized vertically integrated wine firms.

## 4.8 Italian Farm Size

Initially, it may appear surprising that Italy's DOC-DOCG farms tend to be larger than the country's table-wine farms (Figure 4.2). But this difference in farm size may reveal more about differences in regional Italian wine production than differences between DOC-DOGC and table wine producers. Very small farms tend to be concentrated in southern Italy. Like their counterparts in southern France, small southern Italian producers benefit from European Union price supports as well as guaranteed prices from wine cooperatives.<sup>95</sup>

Because Italian quality producers tend toward vertically integrated production (ISMEA 2008b) they have an incentive to consolidate, explaining the larger size of the DOC-DOCG farms. Italian farm sizes are significantly smaller than French farms due to the number of very small farmers in southern Italy. Sixty-nine

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<sup>92</sup> IGTs are Italian table wines with a broad geographic indication, i.e., IGT Sicily. Under IGTs, producers can blend any type of grape varieties and can use include up to 15 percent of grapes from beyond the indicated area.

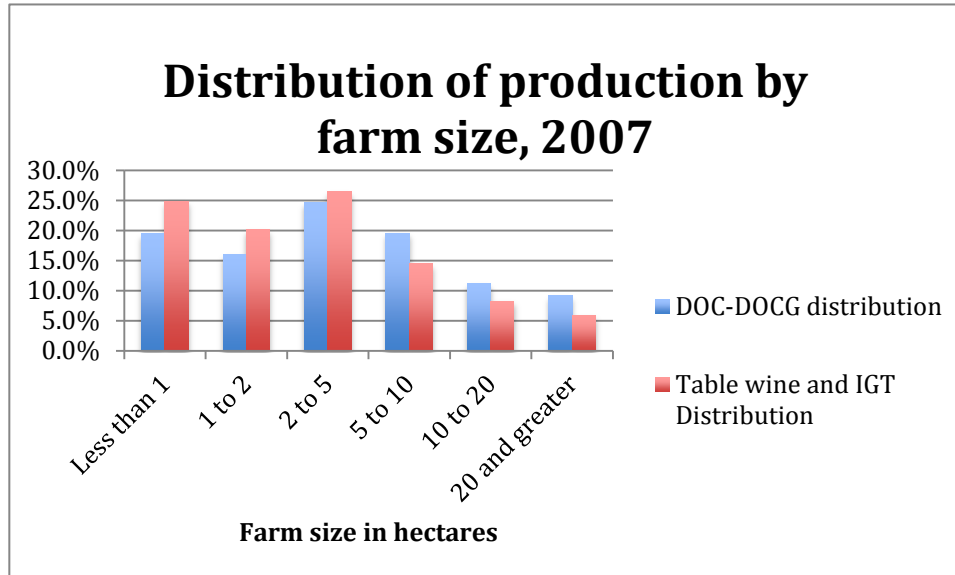
<sup>93</sup> *Veneto ed Emilia Romagna, in particolare, oltre ad avere un mercato dinamico per i prodotti locali, risultano molto attive anche in ambito nazionale. In queste regioni, infatti, hanno sede le più importanti aziende confezionatrici, cooperative e non, che si approvvigionano anche nel Sud. Per contro il Sud, tradizionale bacino di produzione, fa ancora fatica a mantenere al suo interno il valore aggiunto generato dalle fasi successive alla vinificazione*, ISMEA 2008b, p 27).

<sup>94</sup> There are 21,000 winemakers in Tuscany and more than 10,000 winemakers in Piedmont. Other northern and central regions range from 2,500 to 5,000 winemakers per region, while southern regions range from just under 1,000 (Puglia) to 2,500 per region (Molise) (ISMEA 2008b).

<sup>95</sup> Other factors that may keep southern firms on the smaller side include a lack of capital access, a conservative culture that resists change, and the perception of a lack of viable economic alternatives for small grape growers.

percent of Italian wine is grown on farms of five hectares or less, and 44 percent of all Italian grapes are grown on farms smaller than two hectares.<sup>96</sup> Across every wine regulatory category, farms are smaller in southern Italy than in the country's northern and central regions (ISMEA 2008b).

**Figure 4.2: Distribution of Italian DOC-DOCG production, by farm size (2007)**



ISMEA, 2008

#### 4.9 Italian Wine Distribution

Asymmetries of size, capital, and power among economic actors in the Italian wine industry are strongest at the distribution level, and ISMEA notes that market power is increasingly located downstream with large winery brands or retail chains. The consequences of distribution consolidation especially impacts vertically integrated family wineries. According to ISMEA, “the aggressive pricing policies of concentrated retail interests reduce the margins of suppliers” (p. 46).<sup>97</sup> ISMEA describes the character of a supply chain that concentrates power further down the supply chain:

<sup>96</sup> Forty-six percent of southern Italian vineyards are two hectares or less, compared to 39 percent of northern Italian vineyards. Additionally, 73 percent of all grapes in southern Italy are grown on farms of five hectares or less, compared to 64 percent for the rest of the country.

<sup>97</sup> *La DM, pur praticando politiche di prezzo aggressive, che riducono i margini dei fornitori...*, (ISMEA 2008b, p. 46)

Retail buyers choose their suppliers predominantly by the following criteria: size and continuity of the supply, quality consistency, low price, minimization of logistics costs and storage (transport and storage), the terms of delivery. The retail chain values geographic marks (IGT and DOC-DOCG), and they emphasize value for money. There remain difficulties for small producers seeking to gain access to the shelves of the large modern distributors. Among the most important obstacles most were the insufficient production volumes and the financial conditions imposed by the retail chain” (ISMEA 2008b, p. 44, translation mine).

Quality wine producers face obstacles as well: small, vertically integrated family wineries fear brand degradation that would likely result from their entering the mass-market retail trade, and they have adopted a range of strategies to try to mitigate this risk.<sup>98</sup>

For producers of table wine, their principal barriers to entry into the retail distribution market are their small size and their lack of capital. The fifteen largest suppliers of table wine (aggregated wine cooperatives) account for only 36 percent of sales value at the retail level. The largest table wine company, the Caviro wine cooperative, has a 10 percent market share. The second-largest supplier, the *Gruppo Italiano Vini* wine cooperative (GIV), has a 3 percent market share. All other firms have a combined market share of less than 3 percent (p. 46).<sup>99</sup> ISMEA confirms the “strong weight of modern distribution in the wine sector. Across the Italian wine market, wine has increasingly become characterized by the point of sale, and the market has adapted to this new structure.”<sup>100</sup>

#### 4.10 Italian DOC-DOCG Wine Production Structure

Italian DOC-DOCG wines earn significantly lower prices than their French AOC counterparts (€3.39 versus €5.59 per liter). Much of this price differential is

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<sup>98</sup> Quality firms are especially hesitant to affix the brand of a mass-market retailer to their quality product, as they are fearful of the subsequent brand damage. To attempt to mitigate this risk, producers have adopted different strategies: some entered the retail trade only with certain products, others produced dedicated retail-market products, and others decided not to use retail distribution channels: “*Le resistenze verso le insegne della DM di molti produttori italiani, soprattutto in relazione ai VQPRD, era legata al pericolo di vedere ‘declassato’ il proprio marchio una volta entrato nella DM. Le strategie seguite sono state quindi differenti: alcuni hanno deciso di entrare nella distribuzione organizzata solo con alcuni prodotti, altri con prodotti dedicati e altri hanno deciso di non utilizzare tale canale*” (ISMEA 2008b, p. 46).

<sup>99</sup> *Soprattutto per i produttori di vino da tavola, per definizione un prodotto di massa, l’unico ostacolo all’ingresso tra i fornitori della DM resta, infatti, il vincolo dimensionale e la capacità finanziaria di adeguarsi alle politiche di prezzo di quest’ultima. In Italia la forte frammentazione a livello produttivo si rispecchia anche tra i fornitori della DM. Da considerare, infatti, che le prime 15 aziende fornitrici di questo canale rappresentano il 36 per cento delle vendite a valore. L’azienda fornitrice leader della GD è Caviro, con una quota pari al 10 per cento, seguita da GIV con il 3 percent. Le altre industrie hanno tutte una quota inferiore al 3 per cento* (ISMEA 2008b, p. 47).

<sup>100</sup> *Intanto, in un contesto distributivo segnato da profondi mutamenti, si conferma il forte peso della distribuzione moderna nel settore del vino. Il vino è infatti diventato uno strumento caratterizzante il punto vendita, su cui il trade ha puntato ristrutturando ad hoc gli allestimenti ad esso dedicati* (ISMEA 2008b, p. 41).

explained by the low-value added of many DOC-DOCG Italian wines.<sup>101</sup> Some of this price differential is the consequence of the structure of the Italian wine supply chain and different ways of competing at the high end of the market. Specifically, two Italian geographic brands dwarf their other DOC-DOCG competitors: market leader Barolo (selling for 677 euro/quintal in 2008/2009), and the second-most expensive Italian geographic brand, Brunello di Montalcino (selling at 595 euro/quintal in 2008/2009).<sup>102</sup> As previously noted, small, vertically integrated wineries dominate in Piedmont (Barolo's region) and Tuscany (Brunello's region). With in-house production, firms are less reliant on the behavior of other producers: producers can be more certain of prices, quality, and quantity. They can also build their own brands and attempt to find distribution networks. The strategy of vertically integrated wine production can lead to quality wines, but it can also bring a great deal of economic risk to the producer, especially as market trends change and the winery may be left with excess product.<sup>103</sup> As a result of this increased risk, the producer may be more apt to adapt to changes in the preferences of downstream buyers.

But bringing production in-house has critical market consequences. Italian wineries with in-house production lack the scale or political organization that would enable them to provide a counterweight to the market power of downstream distributors. A second important consequence of prevalent in-house production is there is no differentiation between "grower" interests and "merchant" interests within the vertically integrated firms. French growers increased their market power by limiting access to grapes, but vertically integrated Italian firms have a greater incentive to increase output. This may explain why the number of bottles of Brunello di Montalcino and Rosso di Montalcino each increased by nearly 50 percent in eight years, from 1998 to 2006 (Corrado and Odorici 2008a, p. 9), 2008b).<sup>104</sup> Some of this increase is due to the city's expanding geographic limits, which today makes Montalcino the third-largest Italian city (as measured by surface area).

This expansion of production helps Italian wine producers in the short run, but inhibits their reputation as luxury producers in the long run. In the short run, producers expand market share and maintain (relatively) reasonable price levels. But in the long run, the gap between quality Italian and quality French wine prices increases ([www.wineaustralia.com](http://www.wineaustralia.com), 2006), as French producers pursue a restricted quantity production and Italians expand production quantities. The market-driven approach of small vertically integrated quality Italian wine firms may, ironically, help explain why they struggle to compete with top French luxury wines: it is not

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<sup>101</sup> As noted in Chapter Three, the top 100 Italian protected DOC-DOCG designations capture 80 percent of total DOC-DOCG value, while Italy's other 236 DOC areas capture the remaining 20 percent of total market value.

<sup>102</sup> A quintal is a unit of mass equal to 100 kilograms. Barolo and Brunello are DOCG outliers in terms of price: the third-most expensive DOCG is Barbaresco (Piedmont), at 340 euro/quintal, followed by Chianti Classico (Tuscany, 277 euro/quintal) and Roero Arneis (Piedmont, 257 euro/quintal).

<sup>103</sup> This differs from the risk structure associated with cooperatives or traditional wine merchants.

<sup>104</sup> Rosso di Montalcino is the DOC version of the DOCG Brunello, and these two wines are often produced within the same family wineries.



about shared brand protection and quality limits, but rather about demand-driven factors such as market expansion.

#### **4.11 Conclusions**

Locations of supply chain power explain the price differential between French and Italian wines. In France, where quality grape growers are politically organized, wine quantities are restricted and prices are higher. In Italy, upstream market actors demonstrate weaker levels of cooperation. Consequently, these growers remain atomized, power shifts to downstream actors, and producers compete in a more crowded market place.

The Italian model competes favorably in the mass market. The French protectionist model is effective in creating the perception of luxury and of high-value added. While the Italian model may offer little protection to small farmers or little brand value to large wineries (as discussed in (Seccia, et al.)), Italian growers are competitive in the table wine market. Unlike luxury wines, table wines are driven by the perception of a favorable price/quality intersection.

In comparison to their French counterparts, Italian wine producers remain politically fragmented, while downstream producers remain consolidated and exert strong market pressure on upstream producers. Absent broad cooperative institutions, Italian wine firms remain small and flexible, and cooperate in an ad hoc fashion. Such flexibility helps them mitigate market risks associated with vertically integrated, small family firms. However, it also keeps producers responding to the needs of large, price-competitive distribution firms and to changing customer trends. This market pressure helps establish Italian producers as competitive in the production of table wines, where consumers are driven by a positive price-quality intersection. At the same time, this downstream pressure inhibits the ability of Italian regions to establish themselves as producers of a constant, superior luxury product—as producers in some French regions have done. The next chapter investigates the relationship between supply chain power, distribution, and the construction of luxury.

# **Part V**

## **Conclusion**

# Chapter 5

## Conclusion: Luxury, Brands and Politics

### 5.1 The Politics of Luxury

My dissertation has demonstrated how strong political organization and subsequent market restriction can lead to high value-added production. Producers' political organization can move brands upward in the supply chain by limiting supply, controlling quality, and creating a type of bounded competition. French wine production rules reflect the capacity of economic actors to organize for market protection and frame their economic interests in line with the broader social interest. When faced with declining prices and a more competitive marketplace, French grape growers politically organized and changed the rules of the game instead of adapting to cheaper production standards. Their new rules of production decreased quantity, increased prices, and increased consumers' perception of quality. This development enabled protected French wine producers to compete in a different market segment from their competitors. Instead of responding to changes in market demand, they defined quality in terms of traditional production. They then responded to increased demand by restricting production quantities, thereby increasing prices. Prices for regulated French quality wine dramatically exceed prices for Italian wines and French table wines because French quality producers wove together the goals of market protection (a growers' objective) and market competition (a merchants' objective), all protected under a system of legitimate national regulation.

My analysis has important implications for competition in the wine sector today. French producers now define what wine quality is: it is traditional, it expresses the land, it is unique. Market competitors have two choices: to compete with the French and try to beat them at their own game, or to change the rules of the game. The first strategy has met with limited success. French producers claim that their *terroir* provides them with a competitive advantage. Other wines have challenged this assumption, beating French wines at prominent tasting contests, yet French wines continue to earn higher prices.

The other strategy is to change who defines quality. For instance, quality can be defined by market experts and protected by individually owned brands, instead of defined by French producer- and state-defined shared geographic brands.

Another solution is to try to combine the two approaches—which has been the dominant quality strategy in Italy, the United States, and other growing wine markets. These producers compete on unique geographic attributes, attempt to build brands, and use wine guides to guarantee quality. Thus far, we have seen this approach associated with popular quality wines, but the atomization of market actors makes it difficult for producers to secure the long-run market protection we see in the high value-added markets.

Another potential solution could be to follow the approach of producers in the broader luxury goods market, who build individual brand value primarily through tight distribution control. It is to this example we now turn.

## 5.2 Brand Location and the Construction of Luxury

My analysis of the wine sector emphasized the importance of supply chain protection in creating “bounded competition” and in empowering product manufacturers over product distributors. A similar story characterizes other successful European luxury sectors. The luxury sector is a clear example of building value through innovative forms of supply chain control. As demonstrated by our investigation of the French wine market, successful luxury producers shape their brand through not only through trademarks and copyrights, but also by limiting production quantities and by controlling distribution. These market restrictions do not arise endogenously. Instead, luxury brands come from politically constructed market constraints that enable producers to restrict quantity and control the perception of quality. Luxury firms build their brands through vertical restraints known as “selective distribution.” Like quality French wine producers, luxury producers limit production, restrict market access, and tie the product to intangible attributes, such as a dream of history, tradition, and heritage.

Luxury is defined by prices that are driven by scarcity rather than production costs. The luxury sector is a worthy subject of inquiry due to its potentially high economic returns, its size, and its ability to strengthen the French and Italian national brands. The luxury sector is France’s number one export industry outside of Europe, with annual sales volumes standing at 31 billion euros (Comité Colbert, 2006).<sup>105</sup> Eighty-two percent of French luxury sales occur in international markets, and one-third of France’s domestic luxury sales can be attributed to foreign visitors. These products both promote the idea of France and are promoted by the idea of France, as a French luxury goods trade organization explained, “The luxury industry and its products are identified with unique French character and style” and are “another way for France to exert influence” (Comité Colbert 2006: pp. 7, 9). The world’s second-largest luxury goods exporter is Italy, whose sales volumes are just over half of France’s (2006). The United States ranks third. Within the broader

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<sup>105</sup> By luxury sector, I refer principally to fashion firms, but also to brands (leather goods, watches), perfume, glass makers, and others. Comité Colbert is an organization of French luxury firms and its list of members is representative of what I mean by “luxury firms.” See [www.comitecolbert.com/les\\_maisons.html](http://www.comitecolbert.com/les_maisons.html) for the list of 75 members.

luxury market, France and Italy have dominated the high-end fashion market over the past few decades. Italy is the top exporter of high-end fashion products and France is the world's third-largest producer of high-end fashion.<sup>106</sup>

Despite the idea of luxury production as traditional and unchanging, the structure of the luxury market has undergone significant transformation since the 1970s. First, Italy's global recognition as a luxury manufacturer is relatively new, as marketing consultant and winery owner Ampelio Bucci explains: "In only 20 years (from 1970 to 1990), [Italian luxury brands'] notoriety had risen to a global level and they had established a presence in all the principal markets."<sup>107</sup> And since the 1980s, firm ownership is increasingly concentrated across the luxury sector; most French firms have consolidated and Italian firms are in the process of consolidating (Personal Interview, Saviolo, February 2008). (Djelic and Ainamo 1999) refer to these concentrated ownership patterns as "umbrella holding," best exemplified by the large luxury firms Louis Vuitton Moët Hennessey (LVMH), Pinault-Printemps-Redoute (PPR), and the Richemont Group.<sup>108</sup> Luxury firms are increasingly converging on a singular competition model—a model that constructs a "brand dream" through tight image and distribution restrictions. While sharing ownership, each firm sells a different, specific, and controlled "dream." Like French wine, the luxury dream is tightly integrated with tradition, heritage, and geography: selling the dream of Paris or the dream of superior Italian craftsmanship.

Brands serve three purposes: to differentiate a product from potential substitutes, to provide a level of quality guarantee, and to limit supply. Firm brand matters in luxury production, but, critically, so does geographic brand. The shared geographic "Made in" label is often central to constructing a luxury brand. For example, Gucci may benefit both from the image "Gucci" evokes, the "Made in Italy" label, and even from the idea of an "Italian" quality product (despite the fact that Gucci is technically a French firm, as it is owned by the French holding company PPR).

Large international luxury firms are an interesting addition to this study because they are simultaneously located both upstream (from retailers) and downstream (from the small and mediums enterprises (SMEs) who manufacture their goods). Producers rely on flexible definitions of "Made in" in order to expand their production, but they tightly regulate distribution as a means to construct an

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<sup>106</sup> Europe's textile and clothing sector employs more than 2.5 million workers at approximately 200,000 companies. These firms account for 4 percent of European manufacturing production and 7 percent of manufacturing employment (PPR, February 2008). The United States is the world's second-largest exporter of designer fashion (Research memo, PPR, 2008).

<sup>107</sup> Tungate 2008 p. 16, quoting Ampelio Bucci in *Repères Mode 2003*.

<sup>108</sup> LVMH is a French holding company with 24 billion euros in revenue and 3 billion euros in profit for 2011. It holds the portfolio of Louis Vuitton, Moët-Hennessy, Givenchy, Kenzo, Christian Lacroix, Céline, Christian Dior, and Loewe, among others. PPR is also a French holding company, with 12 billion euros in revenue and 1 billion euros in profit for 2011. It holds Gucci, Yves Saint Laurent, Stella McCartney, Sergio Rossi, Bottega Veneta, Tods, and Giorgio Armani, among others. The Richemont Group is Swiss-owned, with 9 billion euros in revenue and 1.5 billion euros in profit. It owns Lancel, Chloe, Cartier, Van Cleef and Arpels, Montblanc, and an array of other luxury watch and jewelry firms. These holding companies own retail chains as well, including the cosmetic retailer Sephora (LVMH), Fnac (PPR), net-à-porter (Richemont).

idea of exclusivity around the brand. At the core of every luxury brand is the idea of restricted access. “Access” can be taken to mean two things. First, it refers to who can put a brand on a label—what products can carry the mark “Dior”? Who can use “Made in Italy”? Secondly, it refers to consumer access to the brand experience. Luxury producers control who can sell their product and at what prices. Prices and quantities are set to establish the brand as “limited access,” rather than to maximize short-run sales.<sup>109</sup>

Global luxury firms attempt to bridge two worlds: the world of high quality and the world of the mass market. We can understand how luxury producers link these different market forms by looking at the puzzle of French *haute couture*. Luxury fashion originated in Paris in the middle of the nineteenth century, and *haute couture* was dominated by a small group of French players until the 1960s. Still the preeminent player in the international fashion industry, France’s *haute couture* is a nationally regulated industry with eleven formally recognized fashion houses.<sup>110</sup> These eleven houses create custom-made *couture* for a global market base of approximately 200 customers (Personal Interview, Legal Council at French fashion house, February 2008). Given this miniscule consumer base, it is hardly surprising that ten out of the eleven French *haute-couture* houses lose money on every *haute couture* line (Personal Interview, Agnes Barrett, CEO Agent Secret, October 2007). But *haute couture* fashion shows and luxury garments generate publicity and prestige for a firm’s other brand lines. Global luxury firms make their profit in the lower two rungs of the market—namely, accessories and cosmetics (Personal Interview, PPR legal council, March 2008; Personal Interview, legal council at a French luxury firm, March 2008).<sup>111</sup> Thus the goal is to build a *couture* brand, protect it, and pass on its luster to mass-produced goods. Few can afford *haute couture* or even *pret-à-porter*, but the market expands for a pair of \$200 sunglasses or a \$40 eyeliner. Through this tiered structure, every consumer can “experience” the dream of the luxury brand. In other words, this structure allows

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<sup>109</sup> Luxury firms do not compete on low prices, and some firms (including Louis Vuitton) refuse to discount their prices to liquidate the collection from previous seasons.

<sup>110</sup> (Service des études et des statistiques industrielles 2005).

<sup>111</sup> Specifically, the majority of luxury firms license their name to independent firms to manufacture accessories, perfumes, and cosmetics. Design and manufacture of these products are often done completely outside of the luxury house. For example, the Italian glasses company Luxottica designs and manufactures sunglasses for nearly all French and Italian luxury houses (Luxottica also is a major distributor of these licensed products—their “Sunglasses Hut” holds 30 percent of the U.S. market). Similarly, a few large fragrance and cosmetics companies conceptualize and produce products “inspired” by luxury collections.<sup>111</sup> According to fashion journalist Dana Thomas, “This ‘mass-produced luxury’ arguably is little qualitatively different from other ‘non-luxury’ goods on the market with the exception of the designer label” (Thomas 2007). This sentiment was echoed in an interview with a Luxottica executive that aired on *60 Minutes* in October 2012. Luxottica Product Manager Isabella Sola was asked to explain the difference between two pairs of nearly identical sunglasses—a pair of Coach sunglasses and a pair of Vogue sunglasses—one of which was hundreds of dollars more expensive than the other. She stated: “They are not the same!” and pointed to the different insignia’s on side of the frame. (Complete transcript and video accessed October 12, 2012: [http://www.cbsnews.com/8301-18560\\_162-57527151/sticker-shock-why-are-glasses-so-expensive](http://www.cbsnews.com/8301-18560_162-57527151/sticker-shock-why-are-glasses-so-expensive))

luxury brands to secure high margins in the mass consumer market, while maintaining the idea of rarity, scarcity, and inaccessibility.

Luxury firms seek to protect the sheen of their high-range products and drive sales of their mass-produced consumer goods. Restricted market access and tight brand control enable luxury firms to move away from commodity production and compete in what Lucien Karpik calls a “market of singularities”:

The differences between “commodities” and “singularities” are cultural constructs, and the variation in their status compose veritable biographies. The first fall into the category of generalized equivalence; the second, whether they are goods, services, or persons, are “uncommon, incomparable, unique, singular,” incommensurable in sum, and consequently excluded from the sphere of exchange. The “career” of these goods is tied to the extension of the market, and singular goods can be preserved only by safeguarding them in state-protected enclaves. In fact, as soon as we concern ourselves with values, a great variety of reasons can be adduced to justify rejecting the market.... Singularity is preserved in culture and lost in the market. In passing from the former to the latter, it can only be disqualified (Karpik 2010, p. 5).

This perspective reflects a long-held French view dating back to the views of Louis XIV’s economic minister Jean-Baptiste Colbert, who perceived market competition to incompatible with quality production (Chapter 2). This is also the same logic behind the French *appellation d’origine contrôlée* (AOC) wine regulation. Similarly, Karpik’s idea that luxury value is preserved in culture and lost in the market is validated by the experience of the former couture band Cardin, as well as the experiences of American luxury brands Ralph Lauren and Calvin Klein. Beginning in the 1970s, these luxury firms began expanding their range of products, lost control of distribution, and their brands lost their luster. This kind of erosion of luxury brand power has impressed upon luxury producers the importance of distribution control (Personal Interview, Agnès Barrett, *Agent Secret*, October 2007). As the English law firm Ashurst writes in its guide on Selective Distribution in the European Union:

Retailers are often primarily interested in competing on price with the aim of winning a greater number of consumers through lower prices. Suppliers, on the other hand, may have different incentives, such as competing on customer service and experience to attract new consumers to their products and to enhance their brand image. From a supplier’s perspective it may be necessary to impose quality standards to achieve these goals (Ashurst LLP 2011, p. 3).

For European luxury producers, market singularity is protected through tight control over product distribution, secured as the successful result of joint French-Italian lobbying efforts to obtain competitive exemptions from the European Union’s “free movement of goods.” Powerful lobby groups such as Comité Colbert and Italy’s Alta Moda, along with some of the main “umbrella holding firms” (notably LVMH and PPR), have been critical in framing the issue as “quality protection” and applying political pressure at the European level. Specifically, European luxury

producers secured exemptions from general EU competition law in 1999, through the Commission Regulation 2790/1999. This Vertical Agreements Block Exemption (VBER), or “selective distribution,” is one of the EU’s most significant competition exemptions, enabling suppliers to determine the conditions of product distribution in ways that depart from the EU’s basic trade principles (Ashurst LLP 2011, p. 2). VBER allows firms to determine which retail outlets can sell a product, where their stores can be located, how sales staff interact with customers, how products are displayed, and price points.<sup>112</sup> VBER also enables luxury firms to regulate their image through distribution control, and to sell through lower-priced consumer goods.<sup>113</sup> Like French wine producers, luxury fashion firms framed market restriction as quality protection. According to the White Paper presented to the European Commission on behalf of LVMH:

LVMH considers that the existence of selective distribution networks is indispensable to the very existence of the luxury goods industry and the preservation of the image and economic value of high-end branded products. The remarkable success of the European luxury industry is based on the possibility to safeguard the economic incentives that result in the creation, the continued innovation and the value of its intangible capital. From an economic standpoint, the importance of investment in brand image and in highly sophisticated capital and labour-intensive distribution networks is only viable if its intangible value is protected from “free-riding” (Cleary 2008, p. 4).<sup>114</sup>

This idea of protecting luxury creation and the “intangible” qualities of a brand in order to prevent “free-riding” parallels the argument made by quality French wine producers regarding the AOC regulation regime a century earlier. As expressed in the Karpik quote and exemplified by French wine producers, there is a belief that the free market is at odds with luxury production. According to this logic, the state should protect upstream producers against price-based competition from downstream market actors. The arguments for vertical restraints in luxury fashion production parallel the argument for French AOC wine regulation: VBER, like French AOC regulation, puts forward Colbert’s idea that the free market and quality production are incompatible.

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<sup>112</sup> Some firms, such as Louis Vuitton, have complete control over their retail sales. Other firms, such as Gucci, mix retail and wholesale distribution (Gucci is a 50/50 distribution mix; Personal Interview, Daniella Della Rosa, Gucci Legal Council, March 2008).

<sup>113</sup> According to the luxury firms, selling lower-priced, mass-produced consumer goods allows a broad base of consumers to buy into the brand’s “dream.”

<sup>114</sup> Cleary et al. elaborate: “Among contemporary economists, the consensus on vertical restraint issues is strong. The importance of the investments required to create and preserve a brand image has long been recognized as an important dimension of developed economies. In so far as there is consumer demand for luxury goods, that is demand addressed to products with specific characteristics (image, prestige, service, price), economists consider that it is normal for suppliers to organize... numerous economic studies have emphasized that suppliers and distributors would have no incentive to invest in a luxury distribution network—which requires promotion expenses, training of an important sales force, and significant fixed assets—if competing distributors could ‘free ride’ and benefit from this effort without having to commit to the same expenses” (Cleary 2008, p. 5).



From the perspective of regulation, both VBER and AOC protect quality production, regardless of the structure of ownership. And while wine and fashion rely heavily on supply-chain controls to construct value, the two industries vary greatly on both ownership structure and production agreements. There are thousands of French and Italian wine producers, and a handful of luxury fashion firms. Quality wine producers are linked by horizontal and vertical production agreements. Most luxury firms outsource significantly, and create value through tight distribution control. It remains to be seen if consumers will continue to pay large price differentials for “luxury” products over lower-cost goods that are manufactured by the same firm and using the same equipment.

Even outside of VBER and the AOC, luxury firms find other means to decrease quantities, build luxury brands, and increase the power of producers over distributors. The vast majority of luxury producers deliberately limit quantity production to build the idea of singularity and increase prices.<sup>115</sup> For example, luxury Bordeaux wine producers are pursuing a production model that consists of a premier luxury wine brand and a “second” wine brand. Managers at the top chateaux explained that the second wines enable them to keep their top wines impeccable and still sell “very good wines” that didn’t quite meet their exceptionally high standards (based on personal interviews at Haut-Brion, Chateaux Margaux, Chateaux LaTour, all in February 2008). Outside of this circle of producers, however, wine industry analysts consistently argued that production houses create these second brands in order to restrict quantities of their first lines and keep their prices exceedingly high (Personal Interview, Andy Smith, co-author of *Vin et Politique*, March 2008). Of course, it is possible that there is truth to both points of view: firms are increasingly selective regarding the grapes that are included in the wines, and they look to limit market supply.<sup>116</sup> But a second brand also enables the top wine producers to reach the mass market without losing brand value, similar to other tiered luxury brands.

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<sup>115</sup> Additionally, there is an idea that quality and quantity are inversely related in quality wine production. Producers claim to keep yields limited because this improves the quality of the grape: fewer grapes on a vine lead to higher-quality grapes. More grapes on a vine lead to decreased grape quality; as a result, the production of grapes on each vine is restricted (Personal Interview, Public Relations Manager Barbara Wiesler-Appert, Chateau Haut-Brion, February 2008). Similarly, producers argue that vines need to be planted a certain distance apart in order for the vines to produce a grape of a certain quality. Some consumers struggle to determine whether these planting practices lead to higher-quality wines. What these practices undeniably achieve, however, are lower quantities and higher prices.

<sup>116</sup> The Bordeaux market is distinct from other French markets due to the strong role wine critic Robert Parker plays in the region. Bordeaux firms have widely been accused of changing their wines in order to receive higher scores from Parker (Lima and Schroder 2008, Feiring 2009). Firms may create a small batch of wine to achieve high Parker scores, and subsequently produce higher volumes of their second wines. Note that some French regions have no “Parker effect,” including Burgundy, where he has been legally banned from reviewing regional wines (Personal Interview, Wine Merchant Eric Texier, July 2011).

Through this backwards supply-chain control, firms are able to practice something akin to advertising.<sup>117</sup> A recent struggle between Roederer CEO Frederic Rouzard and American rapper and media mogul Shawn Carter (a.k.a. “Jay-Z”) demonstrates one way in which luxury brands shun market growth in favor of restricted market access. When *The Economist* asked Rouzard for his thoughts on American rappers’ affection for Roederer’s Cristal champagne brand, the CEO replied: “What can we do? We can’t forbid people from buying it. I’m sure Dom Perrignon or Krug would be delighted to have their business” (“Bubbles and Bling” 2006). Jay-Z noted the contradiction of a CEO looking to dissuade consumption and to prevent a new group of consumers from promoting the luxury brand: “You would think the person who runs the company would be most interested in selling his product, not in criticizing — or accepting criticisms of — the people buying it. ...We gave those brands a narrative, which is one of the reasons anyone buys anything: not just to own a product, but to become part of a story” (Jay-Z 2011). The battle with Jay-Z was essentially a struggle over the extent to which a supplier can actively shape their product image.<sup>118</sup> For Rouzard, his desire to control Cristal’s specific (elitist) “image” was more important than bringing Cristal to a broader (and a young, black, American, urban) market base.

Luxury production, then, is about much more than supply and demand. It is about brand protection and brand definition. As in the wine market, luxury firms have power over distributors because producers have successfully defended the notion that market protection (and supply chain restriction) protects quality. This brand power is a result of supply chain power and market restrictions. Whether or not VBER protects quality can be debated; it is undeniable that it helps producers build the semblance of quality differentiation.

### 5.3 Made in ...Italy?

European luxury producers provide two different stories regarding regulatory protection. In one story, luxury producers are “upstream producers” seeking protection from downstream price competition (i.e., retailers). The second story involves putting the luxury firm downstream from the subcontracted manufacturing small and medium enterprises (SME). SME firms have increasingly outsourced and consolidated in response to increasing price pressure (Personal Interview, Stefania Saviolo, Director of the Master in Fashion, Experience, and Design Management of SDA Bocconi, February 2008).

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<sup>117</sup> Some luxury firms do not engage in any direct advertising. When I asked the General Manager of Chateau Margaux, Paul Pontallier, how the brand was promoted, he replied: “We do not promote the wine. The wine sells itself” (Personal Interview, March 2008).

<sup>118</sup>As Jay-Z writes, the hip-hop community was changing the story of Cristal: “Just by drinking it, we infused their product with our story, an ingredient that they could never bottle on their own.... When people all over started drinking Cristal at clubs — when Cristal became a household name among young consumers — it wasn’t because of anything Cristal had done. It was because of what we’d done” (Jay-Z 2011).

While the names of these SMEs may not be recognized by luxury consumers, their craftsmanship and the “Made in Italy” label have historically distinguished them from similar market competitors. Today, the “Made in Italy” label remains “an extremely important mark of quality,” even for luxury French firms (Personal Interview, Legal Council at a top French fashion house, March 2008). Consumers rely on different brand signals depending upon the consumers’ market context. A French consumer may place little value on whether her handbag is made in Italy, Eastern Europe, or in China, and instead place value on production details, such as stitching patterns or the quality of raw materials. According to legal council at top French fashion firm, however, emerging market consumers’ lack of exposure to product differentiation makes these customers more reliant on secondary marks of quality, such as product origin. In China, a “Made in China” label might dissuade the Chinese consumer, and lessens the perception of product differentiation between lower-priced domestically produced goods and luxury goods (Personal Interview, Legal Council at a top French fashion house, March 2008). As a result, the “Made in” mark yields power in the world’s most rapidly growing luxury markets (Comité Colbert Report, 2006).<sup>119</sup>

Despite the continued high demand for the “Made in Italy” label, some of Italy’s top quality yarn producers are in the red (Segal 2010). Much like French grape growers prior to the AOC regulation, expensive Italian textile manufacturers are unable to differentiate their product from low-cost Chinese production. Italian producers are struggling to compete both with outsourced Chinese production, and with illegal Chinese workers in the Italian region of Prato.

Prato had once been the example of Italian flexible cooperation, named the “Third Italy”<sup>120</sup> (Berger and Locke, 2002). It had been the country’s most important producer of quality fabrics, but today it is responsible for 27 percent of Italy’s fabric imports from China (Donadio 2010). Currently, the “Made in Italy”<sup>121</sup> mark can be legally used on imported fabrics that are used for products assembled by illegal immigrants in Prato, and Prato now has the highest concentration of Chinese immigrants in Europe (*ibid.*, 2010). Currently there are fewer Italian-owned than Chinese-owned textile businesses in Prato (there are fewer than 3,000 Italian-owned textile businesses in the region, compared to 3,200 Chinese-owned businesses, (*ibid.*, 2010). The vast majority of illegal Chinese immigrants in Prato are recent arrivals, employed in the manufacturing sector, and working in the underground economy (*ibid.*, 2010). As a result, they generally lack the training of

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<sup>119</sup> Conversely, luxury wine consumption in emerging markets is driven principally by individually owned brands—not by shared geographic brands. In other words, China’s demand for Chateau Lafite does not easily translate to increased demand for other Bordeaux wines, and growing demand for Gaja does not increase demand for other Barbaresco wines (Personal Interview, Aldo Vacca, July 2011). In emerging markets, origin is important for fashion, but not for wine.

<sup>120</sup> “Third Italy” refers to the economic success of small and medium-sized enterprises clustered in specific regions of central and northeastern Italy that focus on high-quality, innovative production in the sectors of textiles, leather, ceramic tiles, and furniture.

<sup>121</sup> Note that “Product of Italy” refers to agricultural production and “Made in Italy” refers to manufacturing. These distinctions are both defined at the EU level. The state has the power to increase the strength of the “Product of” production standards (as France has done), but the EU has blocked Italy from strengthening the “Made in” mark.

their traditional Italian competitors, but the immigrant-owned firms offer the “Made in Italy” label demanded in emerging markets at a fraction of the price. These firms’ success at securing winning production bids appears to have led to increased fragmentation among local producers—there is a growing divide between “traditional Italian” producers in the Prato and the immigrant community, who the native Prato producers view as low-skilled workers threatening the traditional system of production (Personal Interview; Laura Gori, President, Scuola del Cuoio; February 2008).<sup>122</sup>

Unprotected Chinese workers (either in China or in European countries) can nearly always offer lower prices than traditional Italian workers, as these employees frequently work in squalid conditions, are paid significantly less than minimum wage, and do not pay taxes (Donadio 2010). Dana Thomas, journalist and author of *Deluxe: How Luxury Lost its Luster*, wrote about an episode of luxury production in 2008 that illustrates some of these dynamics:

Italian reporters for Rai 3 discovered and filmed undocumented Chinese workers making Bottega Veneta bags in a slum-of-a-workshop in the leather manufacturing region of Prato outside of Florence. The workers were paid just a few dollars a day—versus the \$25 an hour Italian union workers earn—to do the intricate weave that is Bottega Veneta’s signature and its price. At the time, Bottega Veneta spokesman stated that the work had been farmed out by one of its subcontractors and the company didn’t know about it. But there’s the hitch. Bottega Veneta likes to brag—as it did in a *New Yorker* article—that its products are produced at its home factory in Vincenza, Italy, by loving and coddled artisans. In reality, it subcontracts, as is the case with all Gucci Group brands (Thomas 2011).

Italy’s new Reguzzoni-Versace Law (2010) is the country’s latest effort to define the “Made in Italy” label. Under this law, clothing can be manufactured as “Made in Italy” if two phases of manufacturing are completed in Italy. This is stricter than the European Union’s regulations, which require only that the last substantial phase of manufacturing be completed in a country to receive the “Made in” label. Though this law would provide only a minimal protection to Italian producers,<sup>123</sup> the European Union prevented Italy from implementing it on the grounds that it was

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<sup>122</sup> While Italy and France are still at the global center of fashion design and quality craftsmanship, there is a fear that this geographic comparative advantage is shifting elsewhere. According to Laura Gori, there is an increasing shortage of artisans in Italy. In both Italy and France’s leading artisanal/design schools (the *Scuola del Cuoio* in Italy and the *Institut Français de la Mode* in France), the overwhelming majority of their students are international, principally from Korea and Japan. These international students tend to return to their home countries after learning tools design and craft at these top schools (Personal Interviews, Laura Gori, President and CEO *Scuola del Cuoio* February 2008; Pierre Bergè, Director *Institut Français de la Mode*, April 2008). According to the school administrators and industry leaders I interviewed in both countries, there is a widespread belief that French and Italian students see traditional artisan training as a part of an older economic model and less prestigious than white-collar professions.

<sup>123</sup> Small Italian textile manufacturers argue that this law does little to protect them (Segal, *New York Times*, August 2010). For example, “Made in Italy” still applies to imported fabric and to products that are partially assembled outside of Italy. On a practical level, the “Made in Italy” law would remain unable to differentiate their product from black-market, lower-cost substitutes.

protectionist and anticompetitive. As a result, there is currently no clear solution to strengthen the market position of Italian luxury workers and the “Made in Italy” brand.

The Italian quality olive oil sector is yet another example of the weak protection of upstream producers with adverse effects to the Italian quality brand. It is estimated that 50 percent of all Italian extra virgin olive oil (E.V.O.O.) sold in the United States contains domestic seed oil and/or imported olive and seed oils (Mueller 2011). According to one olive oil expert, oil substitution “is so widespread that few growers can make an honest living” (as quoted in Mueller, 2007).<sup>124</sup> What appears to be Italian extra virgin olive oil is often neither Italian, nor extra virgin, nor pure olive oil.

As in the case of the “Made in Italy” label, much of this mislabeling of Italian olive oil is legal according to European Union law. Oil merchants are prohibited from blending olive oil with seed oils and labeling them as “extra virgin,” but it is legal for imported olive oil to be branded as a “Product of Italy.” According to the European Union’s Protected Geographic Indication (PGI) laws, a product can bear a national geographic mark if the final stages of production are completed within the country. These final stages are argued to impart a degree of local know-how and determine the national character of the product, which extends beyond the geographic origin of the agricultural product.

Like the “Made in Italy” mark in Italian fabrics and textiles, a loose definition of the “Product of” distinction provides brand owners (fashion houses, olive oil merchants, etc.) with access to a shared geographic brand while also granting them a high level of flexibility on sourcing options. Despite a long history of quality Italian olive oil production, there is a strong risk that some producers will be forced out of the market not due to a lack of demand, but because they are unable to distinguish their product from lower-priced, low-quality substitutes. The market structure advantages downstream processors at the expense of upstream farmers.

In each of these examples, we observe a correlation between the protection of upstream producers and the ability to maintain a national comparative advantage. The protection of upstream producers is associated with higher levels of market protection. When upstream producers are atomized, their ability to collectively distinguish themselves is marginalized and their protected market space diminishes.

## **5.4 Luxury Production: Protection or Innovation?**

In the luxury sector, we see two different dynamics: luxury firms dominate both downstream production (retailers) and upstream production (product

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<sup>124</sup> The structure of the olive oil market acutely harms Italian olive growers. During the 2003-2004 harvest, only one percent of the oil produced in Italy’s principal olive growing region, Puglia, brought local producers a profit. And as prices decrease, growers increase production volumes to make up for lost income, further depressing current prices: E.V.O.O. is selling for \$2,900 a ton in 2012, down from \$6,000 a ton in 2005. These lower prices are at least partially caused by an increase in production volumes ([www.internationaloliveoil.com](http://www.internationaloliveoil.com), accessed April 12, 2012).

manufacturers). This structure reflects the history of how producers have organized in each context to create value: French luxury developed around individual designers, and Italian luxury developed around master craftsmen and their networks. The initial objective in the French fashion sector was protection of design, to prevent other producers from manufacturing less expensive versions of the fashion designs. Italian quality, conversely, was tied into the ability to flexibly apply an advanced skill set to make a high-quality product. Thus value for French producers came from innovative design, while value for Italian producers came from innovative production structures.

Current EU regulations reflect the historical strengths and vulnerabilities of the EU's strongest producers. VBER reflects the historical need of French producers to protect designer value. Conversely, a weak "Made in" definition reflects the accepted narrative in Italian industrial production: value-added derives not from protection, but from competition and flexibility. Relatedly, quality manufacturers in Italy never organized for state protection from market competition. As in the case of wine, Italians perceived flexible production as a means to provide them with competitive strength, not as a weakness. One could argue that luxury regulation protects the traditional model of French brand ownership but not the traditional model of Italian production.

Thus it appears that the French have been more successful in protecting a "French vision" of luxury, while Italian producers have faced increasing global competition. This is an accurate perspective, with two important caveats: first, French producers (of both wine and of fashion) historically organized for political protection, first at the national level and later at the European level. By the time they debated their case in the European context, these groups already had the support of their domestic government agencies as well as broad popular support. Secondly, not only were Italian producers politically fragmented (organized in a voluntaristic, *ad hoc* fashion), but the broader framing of the economy was fundamentally different. Italian producers believed flexibility was their strength,<sup>125</sup> and indeed in both fashion and wine the innovative Italian approach was associated with market

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<sup>125</sup> French value was tied up in the brand and Italian value was related to industrial creativity. According to Stefania Saviolo, director of the Master in Fashion, Experience, and Design Management of SDA Bocconi, these historical differences impact modern production strategies in the two national contexts, despite the emergence of the "umbrella-holding firms" and the broader trend of Italian SME consolidation. The French model is still primarily driven by the designer brand, though this has mutated as the market has evolved: "the French have a fashion show, then sell a fragrance." Italian production, meanwhile, continues to rely on industrial innovation. Saviolo argues that there is a movement in Italian production from local industrial districts to a meta-district, or "long network." Firms practice a type of "strategic innovation" and then subcontract the work through some creative arrangements, as Saviolo explained: "For example, a subcontracting company will say to Armani, 'I will go to China and manage from there, and act as an intermediary between you here and the operations in China.' So the supplier can still act with Armani, retain some flexibility, keep a foot in Italy, and a foot in China to save costs."<sup>125</sup> These producers have been able to demonstrate a degree of entrepreneurial drive that appears to elude French fashion producers. As in other value-added industries, Italians innovate, while the French protect. Italian quality producers have demonstrated (and continue to demonstrate) a fundamental flexibility with production.

growth for most of the twentieth century.<sup>126</sup> These early market approaches are still guiding formal and informal production standards today.

## 5.5 Concluding Comments: Cooperation, Competition, and Control

In the preceding pages, I demonstrated that different institutional configurations favor different actors, and institutions and actors both shape production behavior and are shaped by it. Asymmetries of supply chain power are endemic to any supply chain. How producers organize to resolve these problems ultimately determines consumers' perceptions of quality and locations of value.

As markets become increasingly globalized, wealthier nations struggle to compete with cheaper production from developing nations. Through innovative forms of supply chain cooperation and by securing state protection, quality producers have protected their market space by limiting price-based competition. The different locations of supply chain value derive from who controls the brand and who defines quality. The institutionalization of strong producer organizations in France led to the construction of a supply-dominant production chain in the country. These supply-dominant systems are characterized by high barriers to entry and stand in contrast to highly competitive buyer-driven commodity chains (where control is held further down the production chain by branded manufacturers and retailers) (Gereffi 1999). In many cases, these supply-dominant systems result in a scarce product, high prices, and high levels of quality control.

This shift in supply chain power and subsequent market protection developed where producers were politically organized and were successful in setting the terms of the debate. Instead of framing protectionism in terms of "market restriction," the debate was framed in terms of "quality protection" from counterfeit products. Market restrictions were justified in terms of quality guarantees. In the case of wine, restrictions took the form of a government quality guarantee; for other luxury firms, they take the form of "authorized sellers." In both cases, the imperative of preventing counterfeiting leads the owner of the brand to exert a high degree of control over the supply chain.

Our analysis of the French and Italian wine markets is generalizable beyond agriculture and beyond Western Europe. Supply chain cooperation can be a critical tool to enable firms to move away from price-based competition and toward creating the perception of quality differentiation. Indeed, behind the idea of the "blue ocean" or the "monopolistic value creation" (Chapter One) is the notion that firms should aim for segments of the market where they can secure long-run market stability and a degree of market slack. The French quality wine market provides one clear example of how producers can create demand instead of responding to it—

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<sup>126</sup> The legal counsel at a top French fashion house expressed how her firm worked exclusively with French producers for some goods (such as handmade lace and *piece à la manche*), and with Italian firms for leather and knitwear. She noted that the Italian firms would agree to production, and then figure out how to get something accomplished. French firms could be more difficult to work with, as they generally were not open to projects that were new or that required creative solutions.

how “inefficient production” can benefit both producers and consumers. Other successful, high value-added brands have different strategies for organizing their supply chain, but in each case the location of value is upstream, and these actors exert a powerful influence over price and distribution. For luxury producers, supply chain restriction and brand control is key to their “blue ocean”.



## Field Research and Interview Data

My empirical inquiry is based on personal interviews, direct observation, and published materials collected during sixteen months of field research conducted between July 2007 and August 2011. The majority of this research was conducted through the *Institut National de la Recherche Agronomique* (INRA-SupAgro) in Montpellier (Languedoc), France and *Collegio Carlo Alberto* near Turin (Piedmont), Italy. I conducted a total of 134 interviews with government officials, winemakers, merchants, wine exporters, journalists, representatives of local producer groups, and wine academics, and others. Nearly all of the interviews were conducted in person, and interview duration usually ranged from one to two hours. My data collection was conducted in each of the following regions: Bordeaux, Champagne, Burgundy, and Languedoc (France); Tuscany, the Veneto, Emilia-Romagna, Sicily, and Piedmont (Italy). One goal of my research was to collect data in order to compare the French and Italian case across other national cases and sectors, I also conducted in-person interviews in the Willamette Valley, San Francisco, and New York, with an array of leaders from the American wine industry, American wine lobby groups, and trademark attorneys. Additionally, I interviewed main players in French and Italian luxury production, including trademark lawyers at the top fashion houses, academics who study luxury production, and an array of industry insiders (see table on page 96).

## Interviews Conducted in France and Italy

	France	Italy	Total
<b>Government officials</b> <sup>127</sup>	<b>29</b>	<b>17</b>	<b>48</b>
-National	17	13	22
-Subnational	12	4	16
-European Union			2
<b>Local Political Actors</b>	<b>6</b>	<b>9</b>	<b>15</b>
Consorti /interprofessional council employees	3	2	5
Rural-sector union representatives	3	7	10
<b>Wine Industry Actors</b>	<b>45</b>	<b>31</b>	<b>76</b>
Cooperative directors	4	4	8
Wine merchants	2	2	4
Growers	15	4	19
Luxury Wine Producers	11	2	13
Regional Wine Promoters	2	6	8
Traveling Wine Consultants	1	1	2
Academics and Journalists	10	12	22
<b>Luxury</b>	<b>17</b>	<b>11</b>	<b>28</b>
In-house Council, Luxury firms	4	4	8
Other Legal Council (geographic trademarks)	1	1	2
Officials at Luxury Training Institutes	4	2	6
Luxury Lobby Groups	1	0	1
Other Luxury Executives	2	1	3
Academics and Journalists	5	3	8
<b>Total interview subjects</b>			<b>167</b>

Note: Some subjects held positions in multiple areas, so category subtotals sum to more than the total number of interview subjects

<sup>127</sup> Including officials from the Ministries of Agriculture, the INAO, the *Comitato Nazionale delle Vini*, Ministries of Trade.

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