# Welcome to the Club? - An Economical Approach to Geographical Indications in the European Union.

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## 1 Abstract

The legal protection of geographical indications in form of the Council-Regulation (EEC) No. 2081/92 is one mainstay of the "new" European quality policy. This instrument is supposed to meet three objectives: answering the growing demand for products with identifiable geographical indication, securing higher incomes for producers and harmonising the legal practises. The "Roman" (French and Italian) appellations of origin were used as a paradigm. In general four types of geographical names can be distinguished: generic indications, indications with full legal protection (like the appellation of origin), indications protected by competition law and individualised geographical indications. Geographical indications generally are collective name monopolies. Products with geographical indications dispose of an acquisitional potential. Thus, the price-sales curve will form a monopolistic gap. It is shown that monopolistic behaviour can be favourable and in some cases only monopolistic action might secure the supply. But the concept of firms forming one monopoly needs collective action. The club theory is a possibility to approach geographical indications by neoclassical economic theory. Producers form a club deriving benefits from sharing the geographical indication. They face costs in form of erection costs and exclusion costs. Especially the exclusion costs (control costs) raise questions on the ability of self-financing and indirect subsidies. Club theory can explain some of the empirical observations and factors of performance. To find explanations for the collective behaviour the theory of conventions is introduced. Conventions help to decrease transaction costs. But they differ crucially within the European member states and will lead to unavoidable misunderstandings. The definitive exclusivity of the instrument of the European quality policy (Council-Regulation EEC No. 2081/92) proclaimed by the European Commission pushes "northern" countries in a "Roman" system. This jeopardises the quality conventions in the "northern" countries and endangers the acquisitional potential of the traditional "Roman" system.

**key words: Geographical indication, monopoly, club, PDO, PGI, quality policy**

## 2 Willkommen im Klub? - Eine ökonomische Betrachtung von geographischen Herkunftsangaben in der Europäischen Union.

**- Zusammenfassung -**

Der Rechtsschutz geographischer Herkunftsangaben in Form der EWG-VO Nr. 2081/92 ist ein wesentlicher Bereich der „neuen“ europäischen Qualitätspolitik. Mit diesem Instrument sollen drei Ziele erreicht werden: Befriedigung des wachsenden Bedarfs an Produkten mit ausgewiesener Herkunft, Sicherung höherer Einkommen für Erzeuger und die Harmonisierung des Rechtsrahmens. Die „romanischen“ (französischen und italienischen) Ursprungsbezeichnungen dienten der Verordnung als Paradigma. Grundsätzlich existieren vier Typen von Herkunftsbezeichnungen: Generische Herkunftsbezeichnungen, Herkunftsangaben mit umfangreichem gesetzlichem Schutz, Herkunftsangaben, die über das Wettbewerbsrecht geschützt werden und individualisierte Herkunftsangaben. Herkunftsangaben sind im Normalfall kollektive Bezeichnungsmonopole. Damit ausgezeichnete Produkte verfügen über ein mehr oder minder ausgeprägtes akquisitorisches Potential. Die Preis-Absatzkurve bildet demnach einen monopolistischen Spielraum. Es wird gezeigt, dass monopolistisches Verhalten vorteilhaft sein kann und in besonderen Fällen sogar nur ein monopolistisches Verhalten zu einem Angebot führen wird. Notwendig für diese Form des Monopols ist das kollektive Handeln mehrerer Einzelfirmen. Die Club-Theorie als neoklassischer Ansatz, ermöglicht eine Untersuchung von geographischen Herkunftsangaben. Erzeuger schließen sich in einem Club zusammen, um aus dem Vorteil einer gemeinsamen Herkunftsangabe zu profitieren. Dabei entstehen Kosten in Form von Erstellungs- und Ausschlusskosten. Insbesondere die Ausschluss- bzw. Kontrollkosten lassen die Frage nach der Fähigkeit der Eigenfinanzierung bzw. indirekter Subventionen aufkommen. Die Club-Theorie kann einige Beobachtungen und Erfolgsfaktoren von geographischen Herkunftsangaben erklären. Um kollektives Verhalten zu verstehen, wird die Theorie der Konvention herangezogen. Konventionen verringern Transaktionskosten, aber sie unterscheiden sich stark nach den Mitgliedsländern. Dies führt zu unvermeidbaren Missverständnissen. Die von der EU-Kommission geforderte Exklusivität der EWG-VO Nr. 2081/92 zwingt die „nördlichen“ Länder“ in ein „romanisches“ System. Damit setzt sie nicht nur die Qualitätskonventionen in den „nördlichen“ Ländern aufs Spiel, sondern gefährdet auch das akquisitorische Potential des traditionellen „romanischen“ Systems.

**Schlüsselwörter (d/e): Geographische Herkunftsangabe, Monopol, Klub, GGA, GUB, Qualitätspolitik**

## 3 Introduction

The reform of the Common Agricultural Policy in 1992 led – among other modifications - to a paradigmatic change from a *quantity* to a *quality* oriented food policy. The European Communities wanted to transfer the observation, "*that consumers are tending to attach greater importance to the quality of foodstuffs rather than to quantity*" into new policy instruments (OJ, 1992). One mainstay of this initiative is the Council-Regulation (EEC) No. 2081/92 on the protection of geographical indications and designations of origin for agricultural products and foodstuffs (cf. BUCHHOLZ, 1997; KRIMPHOVE, 1993). It is supposed to be an answer to the "*growing demand for agricultural products or foodstuffs with an identifiable geographical origin*" (OJ 1992). Further objectives of the regulation are the harmonisation of the national legal practises for the protection of geographical indications[1] and the securing of higher incomes for producers with registered products, especially in less-favoured areas. Here, the preamble explicitly refers to the success in *certain* member states.
So far, the success in these *certain* countries[2] is based on wine and - to a much smaller extent - on cheese (TILMANN, 1993; LAGRANGE et al. 2000; AGE, 19 Oct. 1992; AGE, 09 Jan. 1995; AGE, 15 Feb. 1993). Despite the fact that protected geographical indications exist likewise for industrial products[3], this instrument of property law was introduced solely for agricultural products and foodstuff; wine and spirits are excluded (HEINE, 1993).
The general idea is simple: the Council-Regulation (EEC) No. 2081/92 gives protection for a regional name monopoly (cf. PERRIER-CORNET, 1990; MORAN, 1993). Depending on the aquisitional potential of the monopoly, the producer will have positive income effects: e.g. the French AOC-wine[4] has realised a price increase since the 1960's by 10 %, while non AOC-wine dropped by 30 % (cf. LAGRANGE et al., 2000; TORRE, 2000).
The economic research on the "curiosity" PDO/PGI[5] has drawn attention - primarily in France and Italy (TORRE, 2000). But most of the economic research was published after the implementation of the EEC-Regulation and important work is still in progress.[6] A great number of these publications are case studies, empirical evaluations or investigations on

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1 The term *indication* is used in this paper in a general sense and subsumes the two categories geographical *designation* and geographical *indication*.
2 HEINE (1993), representative of the European Commission, refers explicitly to the experience of some *southern* member states.
3 Regional geographical indications for non-food products will not be considered in this paper, e.g. Brussels lace, Meissen porcelain, etc.
4 AOC means *Appellation d'Origine Contrôlé* and is a controlled designation of origin.
5 Protected Designation of Origin (PDO), Protected Geographical Indication (PGI), cf. footnote 1.
6 The final report of the FAIR-Project: *PDO-PGI products: market, supply chains and institutions* is announced to be published in 2000.

institutional, organisational and juridical aspects.[7] Since the European Union has made the protection of geographical indications to one of its premises, several researchers analyse the economic and institutional conditions for developing PDO/PGI-products. BARJOLLE and SYLVANDER, after three years of investigation within a European Research group[8], could not identify one single factor that guarantees a product to be successful. They assume that a conjunction of the following factors is required: product specificity and relevant market (factors related to supply and demand) and operator motivation of the participants, coordination-cooperation in terms of product and marketing management, legitimacy and effectiveness of institutional support (factors relating to internal organisation) (SYLVANDER et al. ,1999; BARJOLLE et al., 1998b, 1999, 2000).[9]

Eight years after the adoption of the Council-Regulation (EEC) No. 2081/92, this article tries to give some general theoretical explanations: What are the economic characteristics of geographical indications? Can they explain the key success factors relating to supply, demand and internal organisation? Is the regulation theoretically able to fulfil the given objectives: *harmonisation* of legal practice, answer to consumer expectations of "*growing demand*" and *securing higher incomes*?

Answers to these questions will be approached by neoclassical economic theory, the theory of clubs and the "économie de convention". This article gives a brief introduction to the complexity of geographical indications and will not take a dynamic view, i.e. how clubs or conventions emerge.

## 4 Geographical indications as a part of industrial property law

Geographical indications are part of our language, history, economy, identity[10] and juridical system. TILMANN (1976) wrote almost 500 pages about geographical indications and many lawyers joined in the vivid debate. In a general sense four different types of geographical indications can be identified (HARTE-BAVENDAMM, 1996; HONIG, 1996)[11]:

- ?? **Generic geographical indications**

  Generic geographical indications can be used without restriction (e.g. Gouda), if the

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[7] Refer to this incomplete list: MULTON, 1994; ALLAIRE et al., 1995; NICOLAS et al., 1995; ARFINI et al., 1998; BERANGER et al., 1999; LAGRANGE, 1999; DAPP, 2000 and in Germany: BECKER et al., 2000; BENNER, 2000; BESCH et al., 2000.

[8] The FAIR-project (see footnote 6) had a participation of researchers from Italy, France, Great-Britain, Greece, the Netherlands and Switzerland.

[9] Other authors name similar key factors. For example GRIENBERGER (2000): character of the product, organisation, demand and governmental support.

[10] CAPUS (1947) calls them "une des principales richesses de la France et une de ses gloires nationales".

[11] Names who just resemble to a geographical indication ("Kassler" actually named after a butcher) and geographical indications without signalising their real provenance ("Capri" for an ice, city names for radios) are neglected in this article.

consumers do not expect a certain provenance. Nonetheless, generics often classify groups of products (e.g. Pilsener for a light coloured, well hopped beer) and are therefore sometimes settled in a code of practice (BUNDESANZEIGER, 1994).

A lot of generic food names face the problem of acceptance. Americans call every sparkling sweet wine *Champagne*, French producers denied the Spanish geographical indication *Turron d'Alicante* its provenance[12] and the protection of *Parmesan* for a hard cheese from Parmigiano-Reggiano is refused by German producers (WIECHMANN, 1995, 2000). Before the Council-Regulation (EEC) No. 2081/92 goes into effect, a list of generic food names was supposed to be published. So far, it has not been done.[13] And it is not likely that it will be published in the future, but the European Court has forced the European Commission to indicate which part of the name is protected (EUGH 1998).

?? **Indications with full legal protection**

A geographical indication can be protected by a legal act, such as a law or a regulation (all the AOC, e.g. *Champagne* in France or with a special law, e.g. *Solingen* cutlery in Germany).[14] To sell products under such protected name is strictly prohibited for producers outside the provenance. In most cases the rightful producers in the area have to meet a certain specification or code of practice. The indication can never become a generic term juridically (at least in the country of the legislative authority or within the scope of international agreements) (GRUR, 1960).

?? **Indications protected by competition law**

A geographical name can lie somewhere between the generic and the full legal protection. This is the case for most of the geographical indications in Germany. French law is far more distinctive: only indications with full legal protection (appellations of origin) are supposed to be protected (BIENAYMÉ, 1991, 1995). In the Northern European member states, the food names are kept in a delicate balance by the – as of yet – unharmonised competition laws. This leads to the use of *relocalising* additions (i.e. *original, real*) to identify *authentic* products and to *delocalising* additions (i.e. *style, type, method*) for products made outside the region. What is

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12 Actually the protection of Turron was confirmed by the European court (GRUR, 1993).

13 Council-Regulation (EEC) No. 2081/92 Art. 3 (3): "Before the entry into force of this Regulation, the Council, acting by a qualified majority on a proposal from the Commission, shall draw up and publish in the *Official Journal of the European Communities* a non-exhaustive, indicative list of the names of agricultural products or foodstuffs which are within the scope of this Regulation and are regarded under the terms of paragraph 1 as being generic and thus not able to be registered under this Regulation."

14 Before the implementation of the Council-Regulation (EEC) No. 2081/92 the only German legally protected geographical indication was *Solinger Stahlwaren* (WEIDES, 1977; SCHLOSSMACHER, 1992).

allowed or what is prohibited, is a question of competition laws. The German constitutional court has always denied the absolute rights on geographical indications. Following their decision in 1979, the protection for geographical indications is r*eflexive*, i.e. the integrity of commercial intercourse is protected and not the geographical indications itself (cf. KNAAK, 1995b, p. 104).

?? **Individualised geographical indications**

Geographical indications can be individualised by single firms (e.g. Fachinger mineral water). In Germany, this exception is reserved for products, whose reputation - and therefore the existence - of the geographical indication is due to the effort of the firm or when new producers are unlikely to settle (e.g. verdicts *"Rosenheimer Gummimäntel"* or *"Vittel"*; cf. TILMANN, 1976; KNAAK 1995b). To avoid false monopolisation of geographical names, trademark-offices in the European countries do not accept pure geographical trademarks.[15] Contrary to brands, geographical indications can not be transferred, sold or franchised.

Regarding the Council-Regulation (EEC) No. 2081/92, the majority of the 538 food names registered so far were names already protected by national laws.[16] By now, all nationally food names with full legal protection have been transferred to the European register. Since generic names are not accepted for the registration, new registration will drive from the indications that are protected *reflexively* by competition laws. The individualised indications are not likely to apply, because in a juridical sense they lose their monopoly[17].

To meet the quality aspect - specified in the preamble - the protection is limited to qualified geographical indications, i.e. products which have a proven link between their characteristics and the origin.[18] This link is gradual and therefore two types of geographical indications are offered: The protected designation of origin (PDO)[19] and the protected geographical

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15 The European Court has clarified this lately by the "*Chiemsee*"-verdict (EUGH, 1999).

16 See Article 17 of Council-Regulation (EEC) No. 2081/92 (short application mode). In Germany some geographical indications with a very strong protection by competition laws used the short application mode (e.g. *Nürnberger Lebkuchen*, *Schwarzwälder Schinken*), although they did not have full legal protection by a special law like the *Solinger* cutlery or the French AOC.

17 E.g. some German individual monopolised mineral waters applied, but only because they feared to lose any protection at all for their geographical names due to the change in the European legislation. The "Warsteiner" decision of the European court has clarified, that simple geographical indications can still be protected by national (competition) law (cf. Judgment of the Court of Justice in case C-312/98; http://www.curia.eu.int).

18 This is called "lien terroir" (BARJOLLE et al., 1998a).

19 Council-Regulation (EEC) No. 2081, Article 2, 2 (a): "Designation of origin: means the name of a region, a specific place or, in exceptional cases, a country, used to describe an agricultural product or a foodstuff:
- originating in that region, specific place or country, and
- the quality or characteristics of which are essentially or exclusively due to a particular geographical

indication (PGI)[20]. The first is the European model of the French AOC or Italian DOC[21]. The latter refers to the TRIPS[22]-definition of an indication of origin (KNAAK, 1995a). Since for a PGI the reputation is already enough to proof the link with the products origin (but no definition of the reputation is given) the protection seems to be open for almost every geographical food name.

## 5 Geographical indication in the monopolistic gap

Approached by neoclassical economic theory, geographic indications are considered as collective monopolies (PERRIER-CORNET, 1990; MORAN, 1993). Even if this seems to be an etymological contradiction, the existence of monopolies consisting of a group of firms was argued by OLSON (1962): "*The concept of industry in pure competition, which is everywhere acknowledged, is based on assumptions that are perfectly parallel to those required for the concept of industry in monopolistic competition, which is often denied*." We accept firms to show collective action, but generally deny it to agricultural producers. Often, they have to serve as an example of pure competition. This notion of collective action within an industry is integrated when French rural economists talk of a *filière*. This term is often insufficiently translated by (supply) chain, although a supply chain does not necessarily imply a certain coordinated collective action (MARSHALL, 1920; CHAMBERLIN, 1975; PERRIER-CORNET, 1990; SYLVANDER, 1995b).

GUTENBERG deduced the existence of "*Preislagen*" from purchase observations. They are responsible for the breaks in the price-sales curve and form a monopolistic gap within full market competition. GUTENBERG reasons that producers try to form a "*Firmenmarkt*" in order to tie consumers to their products. The binding capability, which he calls *aquisitional potential*, depends on rational and irrational aspects. All modern marketing attempts to enlarge this aquisitional potential by gaining a unique position within the market segmentation. To keep it simple, marketing for mass markets has reduced this to the term unique selling proposition (USP). HAUSLADEN (2000) argues in this issue of the AGRARWIRTSCHAFT, why we could likewise find a unique local proposition (ULP) for

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environment with its inherent natural and human factors, and the production, processing ***and*** preparation of which take place in the defined geographical area." (Accentuation by authors)

[20] Council-Regulation (EEC) No. 2081/92, Article 2, 2 (b): "Geographical indication means the name of a region, a specific place or, in exceptional cases, a country, used to describe an agricultural product or a foodstuff:
- originating in that region, specific place or country, and
- which possesses a specific quality, reputation or other characteristics attributable to that geographical origin and the production ***and/or*** processing ***and/or*** preparation of which take place in the defined geographical area." (Accentuation by authors)

[21] *Appellation d'Origine Contrôlé* and *Denominazione di origine controllata*

[22] Agreement on Trade-Related Aspects of Intellectual Property Rights

regional products. As the country-of –origin or better the region-of-origin research shows, a product referring to its provenance can influence the act of purchase on different levels (OBERMILLER et al., 1989; PAPADOPULOS et al., 1993; VON ALVENSLEBEN, 2000 ). For the following analysis it will be sufficient to agree that even commodities like potatoes - if they are differentiated e.g. by referring to its unique origin - can have a monopolistic gap. Of course it could be objected that not all regional products have a positive acquisitional potential and some provenances may be unknown (e.g. *Schleusinger Kachelwurst*), but TILMANN (1976, p. 17) investigating the danger of fraud, argues from the view of a general consumer: *„Der Hersteller wird schon wissen, warum er die geographische Herkunft einer Ware so in den Vordergrund stellt; er wird an eine bestimmte Verbrauchererwartung anknüpfen; was aber andere Verbraucher kennen und schätzen, wird auch für mich nicht schlecht sein.“*[23]

If it is accepted that a brand, as an indication of a firms origin, has an acquisitional potential and hence a monopolistic gap, it should likewise be accepted for indications of a geographical provenance. Once this is acknowledged, it is easy to deduce the rent of such a collective action. Figure 1 shows the GUTENBERG price-sales curve p(X) with a monopolistic gap. The optimal production level ($X_M$) for the monopolistic producers is where the marginal revenue curve (MR) intersects the marginal costs curve (MC). The COURNOT-point (cp) on the price-sales curve shows the price $p_M$ for the product. The profits for firms with monopolistic behaviour (they might be called *filière* or trusts) is the rectangle $P_M$-cp-w-v. The optimal output ($X_P$) for producers showing polypolistic behaviour is at the given price $P_P$ on MC (Point t). Their revenue is the rectangle $P_P$-t-u-v. But this is a short-run view. In the long run (see Figure 2) the price-sales curve, due to substitution effects, might shift from $P_{(X)}$ to $P'_{(X)}$, that is the situation where the price-sales curve touches the average costs curve (AC). In this case the monopolistic industry does not make profit, but the product is still being produced, while with polypolistic behaviour the price will not even cover the total average costs and the product would not be supplied anymore. This is the case of destructive competition where only the monopoly *secures* supply and loss is at minimum ($P_U$-t-u-$P_{Pt}$). The producer surplus of the monopolistic group is the area $P_{M'}$-cp-w-v (Figure 2). Depending on the acquisitional potential (decline and begin of the monopolistic gap) collective behaviour is favourable. Additionally, PDO’s and in exceptions PGI’s often support this monopolistic action by limiting the production factor *land*. This *natural* restriction might force the output left of

[23] “The producer will know why he has labelled his goods with its apparent origin. He will appeal to a certain consumer perception and what other consumers know and appreciate will not be a bad for me.” (translation by authors)

optimum (COURNOT-point) and leads to a suboptimal situation. On the other hand, this limitation might be responsible for the success of some geographical indications. The Champagne wine production stretches 24 500 ha and an additional over 4 800 ha are qualified. Referring to JOHNSON (1988) the price of land qualified to produce Champagne vineyard is about 25 times the price of normal wine growing land. The high price is due to strict scarcity. But even animal production can be geographically limited. For every *Poulet de Bresse* 10m² of land have to be reserved, which limits the output[24]. Beaufort producing cows are restricted to an annual yield of 5 000 l of milk (RENARD, 1994). Specifications in terms of code of practice can also create additional scarcity for food products which otherwise are somewhat independent from land use (e.g. use of non-silage milk may be required). Although these restrictions seem artificial, the *Roman* countries (France, Italy and Portugal, Spain) have upheld their restrictions voluntarily.[25]

Three statements of this analysis should be highlighted. First, a geographic indication can favour monopoly behaviour due to its acquisitional potential. Secondly, monopoly profit for a group of producers (filière) is only possible through collective action. Third, in some cases only monopolistic action might secure supply.

## 6 Geographical indications and collective action

The sociologist SIMMEL (1908) illustrates that every human being is part of one or several groups. Political theorists developed hereby the theory of (pressure / peer) groups and suppose: “every group has its interest. An interest […] is the equivalent of a group” (BENTLEY, 1949). OLSON (1992) distinguishes exclusive (which he calls “closed shops”) from inclusive groups and deduces by his analysis of collective action that the small will exploit the large[26]. But it is BUCHANAN’s (1965) publication “An Economic Theory of Clubs” which founded the club theory and “bridges the SAMUELSON gap between private and pure public goods” (CORNES et al. 1996; SAMUELSON, 1954). Building a bridge starts from the banks, hence a club good will be achieved by sharing a private good or excluding others from a

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24 The main specification for the production of Bresse-chickens are: 10 m² free accessible land per chicken; groups consists of not more than 500 chickens; between every group the hen run has to be idled for a certain period of time (*vide sanitaire*); a chicken coop is limited to 50 m², the area of free access for the chickens has to be at least 5 000 m². At the age of 35 days the chickens are fed with cereals (corn or wheat) and milk based products. For finishing, a fattening period of 8 to 15 days (1 month for capons) in wooden hen houses is required. The age of a Bresse-chicken is therefore at least 4 months, for a capon 8 months. The production of AOC-Bresse-poultry represents around 690 000 animals per year (source: http://www.economie.bresse.com/, August 2000 and personal e-mail from CIVB@wanadoo.fr with a German press-release on Bresse poultry).

25 Some authors (e.g. TILLMANN, 1976) call indications of origin a *Roman* tradition, others (e.g. Chen, 1997; Lorvellec, 1997) call them a “catholic” tradition in contradiction to the “anglo-saxonian” or “protestant” tradition.

26 A correction of this supposition is given in SANDLER (1992).

public good (cf. BONUS, 1977; see also Figure 3). If use of a private good is shared, it has changed its degree of publicity (depending on rivalry and excludability) and becomes a club good. If a public good, like a view if a sunset, changes its degree of publicity by excluding others, e.g. at some particular scenic places you might have to pay a fee for being able to enjoy that view, thus a pure public good has become a club good.

### 6.1 Club definition and characteristics

"A club is a voluntary group of individuals who derive mutual benefits from sharing one or more of the following: production costs, the membership characteristics or a good characterized by excludable benefits". CORNES and SANDLER highlight several characteristics of their definition[27] (CORNES et al. 1996, p. 347):

a. "Voluntarism" is important to distinguish between a pure public good and a club good. A club member joins voluntarily, if his benefits equals or exceeds the membership payments. If a club good is publicly provided, voluntarism will be less crucial.
b. "Sharing" leads to rivalry by crowding or congestion and to a finite number of members.
c. "Exclusivity" distinguishes between member and non-member and gives the non-member the option to join another club or not to join at all.
d. From c. derives the existence of an "exclusion mechanism".
e. "Dual decision": This means that the provision (decision to provide the club good) and the membership decision (how many members join) must be determined simultaneously to result the club optimum.
f. The voluntary provision of a pure public good is normally associated with a "suboptimal Nash equilibrium"[28] (e.g. free rider) and a governmental provision may be necessary.

CORNES and SANDLER use the *typical* club, e.g. a sports club, just as model. Every firm can be considered as a club, even a country might be regarded as a club. At the poles of a club good the private good could be defined as a club good with one member (thus the membership optimum condition can be dropped) and a pure public good is a club good with the whole population as members (hence, the membership condition can be dropped as well, because no exclusion is possible or done).

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[27] An extensive introduction to the club theory is given in CORNES et al. (1996). Club theory applied to agricultural economy in Germany can be found in ZIMMER (1994a, b). The first application to origin-linked food names has been done by TORRE (2000). Another French publication is BARHAM (1992). An interesting example of applied club theory is SANDLER et al. (1999).

[28] A Nash-equilibrium is the allocation that is left after all inconsistent allocations are eliminated or in the terms of game theory, when neither player wants to change strategy (For further reading on the suboptimal Nash-Equilibrium refer to CORNES et al., 1996, pp 153-161).

### 6.2 PDO/PGI Clubs

Geographical indications - as an intellectual property - can be determined as immaterial good (cf. JEHORAM, 1980). Applying the theory of public goods and the club theory to the geographical indication (cf. section 4), a generic geographical name can be termed as a pure public good. The legally protected indications of origin (second type, cf. section 4 of this paper) can be considered as a club good coupled with governmental support to provide it. The geographical indications protected only by competition law are club goods with no or little governmental support in the property of a more or less latent group. The individualised geographical indication can be named as private good. Matching PDO/PGI clubs up to the club characteristics some peculiarities deserve further attention (cf. TORRE, 2000).[29]

a) Voluntarism

The decision to provide a PDO/PGI is voluntary. But once the group is established, all the producers using the protected name within the delimitation are compulsory members, even if they have not applied for the protection. An involuntary member has to pay the control costs or risks to be fined. On the other hand, all compulsory members share the benefits. Any member might leave the club by abandoning the use of the name. But the exit is not without disadvantages as it can be shown in the case of the PGI “Nürnberger Lebkuchen”.[30] The benefit of selling ginger bread with a PGI increases with the extent of export. Exporters are in general larger producers. They have supported the application as a PGI and thus benefit the most from the protection. Local handicraft producers, although having founded the reputation of the indication, are now *involuntary* members of the PGI club. Inspection costs have to be paid and the private inspection body is not likely to charge small bakers less when they claim to take only low profit in using the geographical name. A small baker has three options: to leave the club by abandoning the use of the indication, to pay the inspection fee or to be a free-rider.

b) Sharing

A PDO/PGI is shared by its member. The group consists of legitimate producers in the

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[29] TORRE declares the reputation of an AOC-product as the club good, but he neglects that the group *uses* a reputation by *providing* the protected name. The reputation is not the good, it is (if positive) the benefit. This distinction can have externalities to other clubs. E.g. the PGI *Volailles de la Champagne* is the club good of the poultry group in the French Champagne, but the reputation will in all probability be due to the beverage *Champagne*, provided by the *AOC-club Champagne*.

[30] Nuremberg ginger bread

delimited region. But it is not evident if extension leads to signs of congestion. It is assumed that at the beginning new members increase the utility for everyone due to camaraderie, but after a critical number of members, congestion will occur. In fact, the functioning of PDO clubs is less imperilled, for the reason that membership and volume of production of the club good is limited by geographical demarcation and discriminative specification. PGI clubs are more likely to show congestion (due to their weaker limitation constraints), but scandalous fraud or adulterate food production food production will damage AOC benefits dramatically. TORRE (2000) draws attention to crowding as a danger for the whole sector of origin linked products by supposing that *new* indications like the German PGI's for beer and mineral water might decrease profits for existing PDO/PGI's.[31] This view raises further questions on *hostclubs*, i.e. clubs of clubs, like the French INSTITUT NATIONAL DES APPELLATIONS D'ORIGINE (INAO) or the European register itself (CORNES et al., 1996). They provide the shared club good AOC or PDO/PGI.

c) Exclusivity

PDO/PGI's have exclusivity characteristics. The Council-Regulation (EEC) No. 2081/92 describes the extent of potential exclusion.[32] The group itself defines exclusion in terms of geographical limitation and production restriction for the product carrying the geographical indication. Only producers in the delimited area following the code of practice can join the club. But once the club is established the club becomes (legally) inclusive for the delimited region, referring to the club theory exclusivity is provided by compulsory membership (cf. a)).

d) Exclusion mechanism

The exclusion mechanism is part of the PDO/PGI legislation. Private or public inspection bodies inspect members complying with the rules while authorities supervise the rest of the

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[31] In this context the 32 geographical names for French poultry could also be referred to.

[32] Council-Regulation (EEC) No. 2081/92, Article 13:
"Registered names shall be protected against:
(a) any direct or indirect commercial use of a name registered in respect of products not covered by the registration in so far as those products are comparable to the products registered under that name or insofar as using the name exploits the reputation of the protected name;
(b) any misuse, imitation or evocation, even if the true origin of the product is indicated or if the protected name is translated or accompanied by an expression such as 'style', 'type', 'method', 'as produced in', 'imitation' or similar;
(c) any other false or misleading indication as to the provenance, origin, nature or essential qualities of the product, on the inner or outer packaging, advertising material or documents relating to the product concerned, and the packing of the product in a container liable to convey a false impression as to its origin;
(d) any other practice liable to mislead the public as to the true origin of the product."

economy. The exclusion mechanism is therefore limited by the borders of the European Union and likely to be imperfect. This might explain why France intends to extend TRIPS negotiations to the legal protection of food names and why inspection in general is always a matter of discussion within the clubs (AGE, 14 Aug. 2000).

e) Dual decision and suboptimal Nash equilibrium

The dual decision is also relevant to PDO/PGI clubs, although membership depends little on congestion. Still, the decisions of provision and membership have to be taken simultaneously. Concerning optimality and equilibrium of a PDO/PGI club, Council-Regulation (EEC) No. 2081/92 tried to solve the free-rider problem by compulsory membership for all legitimate members using a geographical indication. If an equilibrium could be reached without public support, this governmental support would have to be considered as a subsidy. In this respect it is interesting to know that 80 % of the 93 Mio. FF budget of the French application and inspection body INAO is paid by the French ministry for agriculture with less than 20 % being covered by parafiscal taxes collected from the producers (INAO, 1999).

CORNES and SANDLER use the BUCHANAN club just as a simplified model of a homogeneous club with a fixed amount of membership dues and no further discriminative assumptions. But PDO/PGI clubs are definitely not homogeneous. The *members* do not pay fixed dues, but rather inspection fees. PDO/PGI clubs are also discriminative: e.g. they want to keep producers out who supply goods of inferior quality and might impair club's *reputation*. In terms of the taxonomy of clubs by CORNES and SANDLER, PDO/PGI clubs are heterogeneous, variable and non partitioned (CORNES et al., 1996, p. 355). These types of club need a sophisticated evaluation. For future PDO/PGI club research, the point of view has to be fixed first.[33] Later, the essential questions will focus on the exclusion and its costs. Some simple assumptions can be done beforehand. Figure 4 shows a simple PDO/PGI club. The benefit will depend on the acquisitional potential and increase at the beginning of membership (camaraderie and sharing of fixed costs). But at a certain size, the benefit per person will shrink due to overproduction or overcrowding. The costs show a different curve: they decrease dramatically in the beginning and start to increase with a certain size caused by increasing coordination and exclusion costs. The optimal club size is reached at the point

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[33] The maximisation of average net benefits does not implicitly lead to the maximisation of total net benefit: Assume a four-member club with a total utility of 16 000 € and an eight-member club with a total utility with 18 000 €. The latter has the highest total utility, but the four-member club has the highest average utility. Therefore either a view from within the club or a total economy view has to be chosen (CORNES et al., 1996). Due to the non-partitioned nature of PDO/PGI-clubs the optimal number of clubs (at least from a hostclub-perspective, e.g. the INAO or the European register) will provide a core solution, which implies that no individual or group can improve upon the situation by forming a different partition (cf. SHAPLEY, 1971).

where marginal benefit equals marginal cost. The *natural* limitation might help again to explain why some PDO/PGI clubs are more successful than others. If the membership size is kept left of $s_{opt}$, even though the club could bear more members, overcrowding cannot occur.

If the acquisitional potential is taken as a given fact (since traditional indications might not be able to increase their binding ability by marketing efforts) the investigation has to focus on the club costs.

### 6.3 PDO/PGI club costs

Most of the prime costs of PDO/PGI clubs were already paid by the generations that founded the reputation. But erection costs are very different in France and in Germany. While the French application and inspection body INAO assists the PDO producer during the application process and does not levy extra money on this service, German PDO/PGI groups easily spend some 50 000 € for juridical support[34]. Additional costs might be maintenance costs, member meetings for example. By far the most important costs for PDO/PGI clubs are the exclusion costs. The difference between a generic food name, e.g. *Camembert*, and a PDO/PGI, e.g. *Camembert de Normandie*, is the reduction of publicity, in terms of branding certain products with the geographical indication[35]. Reducing publicity means excluding others, therefore exclusion costs will occur[36]. To avoid usurpers ( i.e. non-members exploiting club-advantages) every similar product sold on the market would have to be checked, since the name is immaterial and prime costs for usurpers are close to nil. Additionally, producers of other goods will like to use some attributes of the club good, e.g. its reputation[37]. This *banalisation* is a congestion by non-members, but the costs for perfect exclusion would be exorbitant. A protection level of the French AOC Champagne, could not be financed by a club itself, just imagine the number of inspectors needed to monitor all retailers in the world.[38] Most of the inspection costs are therefore taken upon governmental institutions (cf. free rider and Nash equilibrium). The authorities inspect the proper use of food names and punish

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[34] In Germany the PDO/PGI-group has to pay an application-fee of 1 725 DM to the *Deutsche Patent- und Markenamt* (DPMA), but the authors know PGI-groups who have paid over 130 000 € for juridical support.

[35] The publicity will only be reduced to a certain extent, because a strictly private food name, which nobody is allowed to use is nonsense in marketing. This would be like a letter without an address in order to keep privacy (BONUS, 1977).

[36] Conventions or moral behaviour will reduce exclusion costs.

[37] E.g. *Champagnerweizen* (Champagne-wheat beer) or *Champagner unter den Mineralwässern* (The Champagne among mineral waters) (GRUR, 1969; KLETTE, 1988)

[38] An economic analysis of *fine* and *coarse* exclusion can be found in HELSLEY et al. (1991). They deduce that the benefits of fine exclusion might not be justifiable, if the costs for the exclusion are higher. But technical improvements reducing exclusion costs might easily change the degree of exclusion (e.g. decoding for cable TV).

usurpers.[39] To reduce the inspection costs for the authorities, services are shared with other governmental duties and imitators are deterred by fines. It will be difficult to show whether this raises or diminishes public welfare. The inspection costs are so enormous compared to the profit, that geographical indications will be provided only if they are born by the public. If the protection of geographical indications is seriously questioned, it should likewise be questioned for brands or patents.

For PDO/PGI clubs the club-financed part of the control costs is fairly low. In France a parafiscal tax is charged on the volume of produce referring to the specification, but this is not even enough to cover 20 % of the INAO budget. In Germany, every member has to pay inspection fees for each product produced, either to a private or public inspection body (depending on the Länder) (cf. DPMA 2000; MEYER, 1997).

## 7 Simply different conventions?

This paper has approached the European PDO/PGI system mainly by neoclassical economic theory. It has been deduced that a coordinated group can derive rents or profits from a regional name monopoly. Depending on the acquisitional potential, the rent of the monopolistic gap will differ among regions and products. This might explain some of the key success factors, e.g. *product, demand* and *specifity.* The application of club theory allowed the deduction of some reasons for collective action which focused the view on exclusions costs.

To understand PDO/PGI clubs the question arises how the collective action works and why it works better in one case and worse in another. Neoclassical economic theory can only propose if someone will be *better off* or *worse off* with collective action. If we want to understand how the coordination operates we have to refer to *behaviour*, *interests* or *beliefs* (cf. OLSON, 1991; CAMPBELL, 1987).

FRENCH economists approach this question with a socio-economical premise to coordination which they call *l'économie de convention* (DUPUY et al., 1989; ORLÉAN, 1994). Their view is influenced by presumptions of SIMON (1955), LEWIS (1969) and LEIBENSTEIN (1976). "… the task is to replace the global rationality of economic man with a kind of rational behaviour that is compatible with the access to information and the computational capacities that are actually possessed by organisms, including man, in the kind environments in such organism exist" (SIMON, 1955). Inspired by the theory of games of pure coordination (SCHELLING, 1977)

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[39] In Germany, inspection is performed by the *Lebensmittelüberwachung* (LÜG, 1997).

LEWIS deduces that coordination problems are solved by behavioural regularities, i.e. a convention.[40]

French *conventionists* deduce from these theories that "l'accord entre les individus, même lorsqu'il se limite au contrat d'un échange marchand, n'est pas possible sans un cadre commun, sans une convention constitutive" (DUPUY et al. 1989). French agricultural economists state French quality labels, e.g. *Label Rouge* or *AOC*, as *conventions of quality* (SYLVANDER, 1995a; DELFOSSE et al., 1995; SYLVANDER et al., 1994; ALLAIRE et al., 1995). Following EYMARD-DUVERNAY (1993), "neither market nor collective rules are efficient devices to improve quality". Sellers cheat and clients do not communicate with sellers. Hence, it can be deduced that conventions, norms, customs[41] or rules are an important part of coordination and might be seen as a possibility to decrease transaction costs. In the case of PDO/PGI clubs, these costs are primarily erection costs (application for registration) or exclusion costs (control). A severe problem for the European legislation is that conventions differ crucially from country to country and from group to group.

Another difficulty is the question how conventions emerge. While LEWIS considers conventions as possibility to *describe* anticipated behaviour, SYLVANDER et al. (2000) try to use the theory to *predict* coordinated behaviour. They detect different phases of negotiation, but still the result will not be predictable. But it seems questionable if an agreement is really a convention. It is not a convention that cars drive right or left. It is *by* convention that cars drive on the left side in the UK and Japan and on the right side in France and Germany. In France the application for a PDO is very different from an application for a PGI, in Germany PDO and PGI follow exactly the same application procedure. The French application-body INAO has developed its own definitions, resulting in a language hardly translatable (e.g. *terroir*, *typicité*, *specifité*) (FROC et al. 1998; MARTY, 1997). All this might be *by* convention,

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[40] LEWIS gives as a rough definition of a *convention*:
"A regularity R in the behaviour of members of a population P when they are agents in a recurrent situation S is a *convention* if and only if, in any instance of S among members of P,
(1) everyone conforms to R;
(2) everyone expects everyone else to conform to R;
(3) everyone prefers to conform to R on condition that the others do, since S is a coordination problem and uniform conformity to R is a coordination equilibrium in S"(LEWIS, 1969, p. 42, for his full definition see p. 76).
One of his examples is: "If we are contented oligopolists who want to maintain a uniform but fluctuating price for our commodity, we dare not make any explicit agreement on prices; that would be a conspiracy in restraint of trade. But we can come to a tacit understanding – that is, a convention – by our ways of responding to each others' prices. We might for instance, start to follow a price leader: one firm that takes the initiative in changing prices, with due care to set a price in the range that is satisfactory to all of us" (LEWIS, 1969, p. 46).

[41] "Sociologically [a custom] is the control over individual action enforced by collective moral or economic sanctions. Legally it is the added control exercised by the courts in their use of physical sanctions, according to the method of deciding disputes." (COMMONS, 1932; 1950)

but even if the European legislation has found a European agreement in form of the Council-Regulation (EEC) No. 2081/92, it has not yet (and might never) become a *unique* European convention.

## 8 Implications for the European quality policy

While some coordination is fairly easy to define (e.g. Council-Regulation (EEC) No. 2092/91 and its positive list), the European quality policy faces at the point where collective action is needed, different *conventions* that will lead to different behaviour and performance of the market participants.[42] Different interpretations (some people speak of misunderstandings) will be hard to avoid, certainly if the directives are so meaningless as in the case of Regulation (EEC) No. 2081/92, but the achievement with the full legal protection of geographical indications is enormous, not only in the Roman countries.

Right now, the most critical problem is the *exclusivity* proposed for *every* qualified geographical indication applicable to agricultural products and foodstuffs. The European Commission seems to sacrifice the two objectives *increasing rural income* and *consumer protection* for the goal of *harmonisation* by banning all forms of combined quality and origin indication (e.g. national and regional quality signs) which are not registered by the Council-Regulation (EEC) No. 2081/92. By forcing all geographical indications into the *Roman* system, the Commission does not only jeopardise the loss of confidence of people in those countries and regions who have different systems of geographical indications, but it also endangers the acquisitional potential of the traditional protection systems in place. What has been regarded as a victory of the French quality policy could soon turn out to be a rude awakening for traditional quality products (cf. AGE, 27 Jul. 1992; 27 Apr.1992, 14 Aug. 2000; AGE 04 Sept. 2000). The INAO as the French *hostclub* for geographical indications might be asked if they want to sacrifice their *cultural capital* (cf. THROSBY, 1997) and the European Commission might be questioned if *harmonisation* means to extinguish the differences or just to reconcile the contraries.

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[42] In Germany the concept is – like in other northern countries - hardly known and even if the willingness-to-pay exists, the consumer will not recognise products with PDO/PGI (cf. VAN ITTERSUM et al., 1999). The European register has already become a list where almost any product seems able to register (cf. French poultry, German mineral water).

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