

# **International Trade in Wine and Geographical Indications – Common Interests between the EU and South Africa**

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I, the undersigned hereby declare that the work contained in this thesis is my own original work and that I have not previously in its entirety or in part submitted it at any university for a degree.

## ***Abstract***

European-South African trade relations concerning wine and spirits are characterized by various opportunities and, at the same time, a range of conflicts. The latter notably relates to the dispute over geographical indications and designations of origin. Considering this confusing amalgamation of discord and harmony, it is the purpose of this study, entitled “International Trade in Wine and Geographical Indications – Common Interests between the EU and South Africa“, to understand the rationale for trade in wine from both sides of the coin. Moreover, this research assesses possible multilateral and bilateral solutions for dealing with trade frictions between the EU and South Africa and identifies common interests with a view to establish a lasting foundation for blossoming trade in wine and sustained growth. The underlying methodology is a qualitative interpretative approach and bases on insights into modern marketing and international management theory.

On this basis the “objective” interests of the EU and South Africa in trade in wine are analysed in order to assess the coming into existence of the Trade, Development and Cooperation Agreement as well as the Wine and Spirits Agreement. Pivot of these trade negotiations is the dispute on geographical indications, which is scrutinized by looking into relevant chapters of the WTO and its TRIPS Agreement. With regards to the Wine and Spirits Agreement it is salient to ask whether it is economically and politically reasonable for South Africa to accept a financial package from the EU to secure the ‘voluntary’ phasing out of a number of trademarks and geographical indications. The study concludes with an outlook regarding the globalisation of the world’s wine market, potential future investment flows between the EU and South Africa and the need for an effective marketing strategy in order to become or remain global player in an increasing competitiveness caused by globalisation.

## **Opsomming**

Europese en Suid-Afrikaanse handelsverhoudinge in wyn en spiritualieë word gekenmerk deur verskeie geleenthede en terselfdertyd 'n reeks konflikte. Laasgenoemde hou merkbaar verband met die twis oor geografiese indikatore en aanwysings van oorsprong. Gegewe hierdie verwarrende tweedrag en harmonie, is die doel van hierdie studie, getiteld “Internasionale Handel in Wyn en Geografiese Aanwysings – Gemeenskaplike belange tussen die EU en Suid-Afrika”, om die ‘rationale’ agter die wynhandel van twee kante te beskou. Verder ondersoek hierdie navorsing moontlike multi- en bilaterale oplossings vir die handelswrywing tussen die EU en Suid-Afrika en identifiseer gemeenskaplike belange met die doel om 'n fondament te bou vir volhoubare groei in die wynhandel. Die onderliggende metodologie is 'n kwalitatiewe verklarende benadering, gebaseer op insigte uit moderne bemarkings- en bestuursteorie.

Op hierdie vlak word die ‘objektiewe’ belange van die EU en Suid-Afrika in die wynhandel ontleed om gevolgtrekkings oor die Handels-, Ontwikkelings- en Samewerkingsooreenkoms en die Wyn- en Spiritualieë- Ooreenkoms te maak. Onderliggend aan hierdie onderhandelinge is die twis oor geografiese aanwysings, wat noukeurig ondersoek is deur relevante hoofstukke van die WHO Ooreenkoms en sy TRIPS-komponent te raadpleeg. Met verwysing na die Wyn- en Spiritualieë- Ooreenkoms is dit voor die hand liggend om te vra of dit ekonomies en polities verstandig vir Suid-Afrika is om 'n finansiële pakket van die EU te aanvaar in ruil vir die vrywillige uitfasering van 'n aantal handelsmerke en geografiese aanwysings. Die studie sluit af met 'n blik op globalisering van die wêreld se wynmarkte, die potensiele toekomstige vloei van beleggings tussen die EU en Suid-Afrika, en die behoefte aan 'n effektiewe bemarkingsstrategie om 'n globale speler te word.

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# **Chapter One**

## **1. Introduction**

The wine industry forms an integral part of international trade and international direct investment flows. Opportunities as well as potential conflicts in the global wine business affect perceptions, positions and vested interests of different stakeholders, may it be states, companies or parts of civil society. These shaped and shaping interests are reflected in multilateral as well as bilateral negotiations and agreements. Thus, preparatory talks as well as the final version of the Trade Development and Cooperation Agreement (TDCA) between South Africa and the European Union (EU) is an illustrative example of who thinks what and who will act how. Accordingly, the agreement does not only reflect but also foreshadows behaviour and positioning.

In addition to the TDCA South Africa and the EU have signed an agreement on wine and spirits and thereby defined their future cooperation in an exemplary way. Difficult negotiations preceded the signature, first and foremost due to questions on how to define and categorize geographical indications and indications of origin. This research examines this outstanding example of trade talks as well as the outcome itself and assesses the underlying strategy which has guided and guides each party's positioning. Certainly an interesting question to pose will be why it has been economically and politically reasonable for South Africa to accept a European financial package which secures the voluntary phasing out of certain trademarks, like "port" and "sherry".

## **2. Problem Statement and Relevance**

Unsurprisingly the process of globalisation has started to impact on and has even led to a structural change in the wine industry (European Commission, General Directorate for Agriculture, 2000a, 2000b). Worldwide production as well as the demand for wine has increased. In South Africa and other countries that are part of the New World wine group understanding of wine business has developed that is guided by new production methods and oenological procedures, industry efficient business relations and modern concepts of

marketing. These developments and the inherent potential for gaining competitive advantage vis-à-vis the old wine world urge traditional wine industries like the European one to review and sustain global positioning (Anderson et al. 2001). Economic strategies and national interests belong to the domain of top-secret information. However, it is interesting to know which aims South Africa and the EU pursue and which of the approaches will result in a strategic fit vis-à-vis the competitor.

There is no denying the fact that trade in wine is of substantial commercial importance for the overall trade relationship between the EU and South Africa. Vini- and viticulturally, many commonalities in terms of experiences and attitudes exist, for instance, oenological methods. However, at present several conflicts between the EU and South Africa overshadow prospering trade relations. In particular the existing regulations on geographical indications and indications of origin have created discontent. In times of strategic revision and fiercely combated market shares in order to become or remain a global player trade frictions unnecessarily block economic development towards open markets worldwide. Hence, what is the core problem of this discontent?

Within the framework of the WTO, agreements exist, which explicitly refer to trade in wine. The Trade Related Aspects of Intellectual Property Rights (TRIPS) prescribes special regulations on wine and spirits which forbid the use of trademarks, such as “sherry” or “port”, if the good has not been produced in the ‘original region’ – regardless whether the location of origin is indicated, whether the geographical indication is translated or whether it is modified. While these conditions correspond to European interests of accessing foreign markets and protecting domestic ones (European Commission, General Directorate for Agriculture, 2000a, 2000b) such prioritisation of traditional wine industries contradicts the interests of members of the ‘New World’, like South Africa. Despite these imbalances both trading partners apparently found common ground when signing the TDCA with its additional Wine and Spirits Agreement. Who benefits? Do the agreements offer a win-win solution for trade in wine?

Particularly this last aspect is salient due to the EU South Africa agreements representing an outstanding example towards trade negotiations between the EU and the United States, New Zealand, Australia (to be renewed), Canada, Chile or MERCOSUR which are to be negotiated in the near future. All the more it has been surprising that at the time of data collection

academic research that highlighted this precedent case of negotiations concerning trade in wine was almost non-existent.

### **3. Purpose of Study**

In consideration of the urgent need for answers and the personal advantage of having had access to confidential information deriving from the European Commission this study aims to fill the research gap. More precisely the purpose of this study is to:

- Enhance the understanding of the present economic importance of trade in wine between wine producing countries and regions, exemplified by the case of South Africa and the EU;
- Assess existing multilateral and bilateral solutions for alleviating trade frictions between the EU and South Africa;
- Identify and assess the diverging and common interests of the EU and South Africa with a view to lay the theoretical foundation for blossoming trade, sustained growth and commonly shared welfare.

The analysis will not only portray the bilateral relationship between the EU and South Africa but it will also critically assess the Wine and Spirits Agreement as part of the TDCA. Moreover, the analysis will reveal strategic interests of both trading partners and foreshadows who benefits the most. In consequence it has to reflect on the question of who will attain a strategic fit and become or remain a global player when reacting to the opportunities and challenges that globalisation brings about. This in turn will deliver answers to European as well as South African industrialists on how to remain or become competitive under increasing competitive pressure.

### **4. Research Approach**

The study is based on a qualitative approach and has made use of the method of literature review. It focuses on the description of facts and figures, compares European with South African interests and finally interprets the results. Thereby EU South African trade relations are considered to be the dependant variable, which is influenced by many independent

variables, such as trade barriers of the WTO, national interests or the process of globalisation. This approach is appropriate to identify core causalities and, once understood, to assess the problem statement in its contextual complexity, which partly derives from the overlap or interaction between Economics and Law. Hence, both academic disciplines need to be taken into account particularly when dealing with the WTO and the international trade system.

With regards to the unit of analysis, which can be defined as “the kind of empirical cases or units that a researcher observes, measures, and analyzes in a study” (Neuman, 2000:521), the study focuses on the state whereby the EU is considered as a unitary actor. There is no denying the fact that the EU represents the interests of its member states. However, in the wake of exercising a Common Agricultural Policy (CAP) or representing a single European market – two aspects which are salient to consider when analysing the European strategy of its wine industry – it is almost coercive to present the union as single actor. In contrast, the level of analysis, which is “a way to talk about the scope of a social theory, causal explanation, proposition, hypothesis or theoretical statement” (Neuman, 2000:513), is not and cannot be one-dimensional. Certainly, the pivot of this thesis is the international trade system or in other words how national and international markets are shaped by the forces of globalisation. However, South African and European interests need to be assessed in order to understand the debate on geographical indications. Finally, the thesis refers to basic elements of modern client-oriented marketing theory. Hence, the analysis will give reference to all levels of analysis ranging from the micro to the macro-level.

#### **4.1. Scope, Data Reliability and Validity of Study**

The time of data collection was limited to a period of 12 months, more precisely from February 2001 to February 2002. With regards to secondary sources, most of them have been located in the library of the University of Stellenbosch, South Africa, or have been downloaded from the internet. Several documents have been made available by the German Ministry of Agriculture. Legal texts of the WTO have been considered due to TRIPS playing an important part of the problem assessment of this study. Particularly this latter source enhances the validity of this study because statements have been interpreted by internationally accepted rules.

Finally a few primary sources have been made available albeit under the obligation of discretion. These sources include confidential information provided by the European Commission and are present in the form of an exchange of letters. Moreover, personal contact with relevant authorities could be used to enhance understanding and validate certain assumptions. The author is aware that critics might consider these primary sources to be unreliable due to the lack of reference. In turn, one could argue that particularly these confidential diplomatic sources enhance the validity of this research because they enrich it with inputs deriving from those who had been directly involved.

## **4.2. Research Procedure and Contribution**

The sifting of the collected material revealed three pillars upon which the problem statement of the research topic is based and according to which the analysis and the different chapters have been designed. Apart from the first chapter, which familiarises the reader with the problem statement, its relevance, the aim of this study as well as with the methodological approach, the second chapter presents the first pillar upon which the problem assessment relies: the juxtaposition of European and South African trade interests. After having provided for a general picture on their trade relations, the interests of each party are scrutinized. Hereby, aspects such as the multifunctional agricultural and wine economy, historical structures or the industrial strategy targeting the current development of increasing competitiveness will be considered by referring to Spies (1999) or the European Commission. First conclusions will reveal whether a win-win situation in trade between the EU and South Africa is thinkable.

The analysis of the first pillar will lead the reader into the understanding of the third chapter, which deals with the WTO and its relevant regulations impacting on any negotiation for trade in wine. It will become clear why regulations on geographical indications hamper South African and European trade relations, why they can be defined as the root for current trade frictions and why they form the second pillar of the problem statement. The fourth and final chapter is devoted to an in-depth study of the TDCA and the Wine and Spirits Agreement. This last pillar dealing with the state-of-the-art between the EU and South Africa will be guided by questions whether the TDCA enhances trade between South Africa and the EU or whether one of the two trading partners benefited from the agreements at the cost of the other.

Additionally, an admittedly speculative perspective will be proposed to foreshadow how the wine industry and market structure could look in the near future and whether it further stimulates trans-border acquisitions, joint ventures and fusions. This foreshadowing of trends makes this research particularly interesting for industry representatives from South Africa as well as the EU because it reflects on current strategies and whether they will fit future needs.

### **4.3. Limitations of the Study**

The research consists of a number of subjects pertaining to trade in wine, multilateral and bilateral trade relations, regulatory approaches, industrial policies and competition. The fact that this contribution deals with such a wide range of issues is both an asset and a liability. The asset might be that deeply interrelated subjects are treated within their complexity and context. Liability derives from the danger of treating some of the subjects in insufficient depth. With regards to in-depth analysis, priority has been given to the assessment of the pertinent normative framework for multilateral trade as provided by the WTO. Consequently, the opportunity cost is that other variables, such as globalisation, have not been dealt with in a similar profound way. However, this latter aspect might stimulate further research.

## **5. Theoretical Approach**

The successive liberalisation process of the wine industry, the deregulation and re-regulation, the opening-up for Foreign Direct Investment (FDI) as well as the pressure for adaptation and development of competitive advantage, which result from industrial strategies, will lead to a wave of trans-border acquisitions and fusions in wine production and in trade in wine. This development will take a grip on the value-added chain, from the development of natural resources to wine production, to marketing, to logistics and finally to sales. Already today such concentration processes in production and trade are visible.

However, economic players encounter these developments in various ways. Some profit and establish or consolidate their competitive advantages while others run severe deficits. Neither the EU nor South Africa have thus far experienced severe downward trends of wine as an export commodity. In contrast both trading partners are known for a history of success or a recent successful strategy. In this respect, it is important to reflect on the mindsets behind the

European and the South African marketing strategy respectively. While the first is characterised by a long tradition the latter concentrates on new marketing methods which lean to the highly successful Australian example. In the following both point of departures are characterised in order to provide the reader with an overview of traditional and modern marketing concepts.

## **5.1. Wine and Its Cultural Significance**

Among the beverages that humans learned to prepare in the course of thousands of years, wine always played a distinguished role. Wine, a most pleasant and digestible beverage, energizes and elates human beings. It chases away concerns and promotes openness. Celebrations, formal or informal gatherings and private moments are often accompanied by a shared bottle of wine. In ancient times, Egyptians and Babylonians appreciated wine. In China it was already known four thousand years ago. In Athens and Rome wine had such a high reputation that people erected altars and temples for Bacchus and Dionysus. However, no higher honour was ever assigned to wine than that introduced by Christians: wine became the symbol of Jesus' blood in the Holy Mass (Jakob et al., 1985:11-13). Traditionally, wine is of great cultural and economic importance for the countries adjacent to the Mediterranean. Here, wine is a common beverage, which is barely missing in a household, regardless whether rich or poor. Here, people share common understanding and knowledge concerning its production, its development and its utilization. People know about types and classes of wine and are proud of living in wine regions.

In essence, wine is the beverage won by alcoholic fermentation processes of the juice from fresh bunches of grapes. Over time a number of vine cultivars developed to which special names were given such as Riesling, Silvaner, Burgunder, etc. Wines that are produced on the basis of different types of grapes have different colours, tastes and alcohol contents. From the simple, cheap wines, which are produced and drunk in quantity, to the noblest premium winners a large diversity exists, which makes endeavours in this field unique (Jakob et al., 1985:11-13). The culture of wine is concentrated on the earth's moderate climatic zones. Very old wine regions are situated around the Mediterranean basin. But also in Germany, Austria and Hungary a rather traditional wine culture was established. Over the last two centuries the U.S., Australia, Chile and particularly South Africa became rich and important

wine regions. In comparison to the old wine world the members of the New World Wine Group (NWWG) are however guided by a completely different approach, which is determined by a client-oriented modern marketing strategy.

## **5.2. Customers and Wine**

The understanding of the relationship between product and customer and the objective to concentrate on prerequisites for efficient sales activities is fundamental to gain success in the wine business – at least according to representatives of the Australian wine industry (Barclay, 1999a). In general, a product is considered to be anything that is capable of satisfying customer needs. Regardless of the common differentiation between products and services, what a customer is buying is a service (Jobber, 1995:246–247). Customers buy because of believing in the satisfaction of needs and wants (Thompson, 1993:290–298). Colour, shape and price determine the decision-making process of buying a product. More subtle components include styling and quality levels. The most important element in the success of any organisation is a satisfied customer. Indeed, some believe that an obsession with customers can lead to a sustainable competitive advantage (Dalrymple, 1995:117-119). Thus, customers next to competitors are the critical driving force that empowers a market economy.

Two features of the derived demand for alcoholic drinks are of particular relevance. Firstly, alcoholic drinks are a product addressing the affluent society; they are a luxury. Secondly, there is some evidence in support of the view that although total demand for alcoholic drinks in general and spirits in particular has not been buoyant in recent years the demand for superior quality or relatively high-priced brands might increase. Consumption of brandy or wine is not only a matter of ‘quenching one’s thirst’ or ‘satisfying one’s taste buds’ but also a sign of affluence and status. Status and affluence can be signalled by drinking the most prestigious and high-priced brands. These are so-called externalities in consumption (Jones & Morgan, 1994:68, 69).

A frequent popular criticism is that advertisement, in particular in the alcohol industry, distorts consumer preferences, creates new and unnecessary wants and results in a social waste of resources. Little evidence supports this view. In contrast, the less dogmatic and puritanical customers apparently equate advertisement with merits. Furthermore, there is no

denying the fact that promotion of good products and brands might even help the customer to get more value for less money and certainly assists to learn about product quality in a time and effort-saving way (Jones & Morgan, 1994:73-74). And, subconsciously, flair of style, beauty, happiness, warmth and love, societal status, mystery and transcendence are transferred and this is why labels, geographical indications of origin with 'great names' and the design of bottles are of such significance to product differentiation.

### **5.3. Promotion Strategies and Intellectual Property Rights (IPRs)**

The history of the traditional wine industry is characterized by a long period of fragmentation of national markets, which have been dominated by family-owned enterprises. In the 1970s and 1980s the industrial structure altered, caused by the rise of transnational beverage corporations and international negotiations, which opened national markets to foreign products. A process of rationalization and increased business concentration began. It was exceptional for one enterprise to undertake each of the three main tasks, namely are making wine, distributing it and, simultaneously, producing 'real' beverages. Usually, contracts between wineries and growers as well as between wineries and distributors/importers were used to link the players acting within the three stages. Furthermore, the promotion of wine involved a great multiplicity of brands (Jones & Morgan, 1994:173–174). Today, there are many integrated enterprises operating at a global scale. Competition in the cross-border wine industry has increased tremendously. Thus, the challenge of high performance in promotion planning and solid protection of IPRs has further increased.

Laws covering IPRs promote competition and international trade in two key ways, firstly, by promoting innovation and, secondly, by providing consumers with better information. Innovation and information are of key interest to consumers. In the area of wine, key IPRs are those arising from the protection of geographical indications and trademarks. These are an important source of labelling information for the customer and protecting customers against misleading or confusing wine designations. Various risks to the consumer and producer will occur if intellectual property is not given enough protection. Increasing protection up to a point where gains to producers are outweighed by the costs to customers would not make sense. Over-protection runs the risks of higher prices, lower technology and less competition. It also runs the risk of upsetting the benefits flowing from fair competition, innovation and

consumer protection. This complex balance of economic effects implies that there is no easy rule of optimal regulation for intellectual property protection (Earl, 1999:128-129).

Brands, geographical indications and trade marks are factors for success concerning survival and growth within the wine industry. In the past, these were based on production technology and the ensuing quality of products. In the future, it will be crucial to base them on a combination of creativity in marketing and proactive international competitive capacities. As a result of customer education and competitive pressure, the segmentation of the international wine market will become more pronounced. Rich people are likely to drink less wine but they will focus on quality. The access for non-wine-drinkers to wine is facilitated by brands. Allegedly, this development will evoke a segment for fine or high-quality wines and a segment for everyday wines. These two segments might become increasingly independent from each other as time passes. Branding might even become the engine of the general wine economy. And for that very reason the legal protection of trade marks and of indications of origin – both in local regions and in international trade – has become and will become even more important.

#### **5.4. Product Mix, Promotion and Marketing Mix**

One of the key jobs of a marketing manager is to influence the selection of a mix of compatible products. On the basis of a winning marketing mix, these products need to be promoted properly in order to be sold successfully. At the same time the right product mix promotes efficiency in production, pricing, promotion and distribution. If the business is to be successful the product mix and marketing mix will reinforce each other.

In a small organization the product mix might consist of a few items only, but in a large firm, it can comprise thousands of products. It is important to understand that decisions concerning the buyer's choice of wine are altogether more complex than choices about beer for example. In selecting a wine the consumer begins with having to make a decision on issues such as whether to buy sparkling or still wine or to choose between red, white and rosé. Consider for instance the consumer who has decided to buy a bottle of white wine. For some customers, price is everything: anything will do provided it is cheap. For other customers, setting a maximum price is merely the first step in making the selection of wine more manageable.

Some are attracted by particular labels. But, variety can be bewildering. The final decision will depend partly, if not largely, on the image that the selected wine represents. In turn, the marketing of wine must aim to make customer choice a less perplexing task (Jones & Morgan, 1994:175–177).

#### 5.4.1. Promotion

Promotion planning is a systematic decision-making process, pertaining to all aspects of development and management of a firm's promotional efforts. Promotion can be defined as any form of communication used by a firm, in order to inform, persuade, or remind people about its product, services, image, ideas, communal involvement, or impact on society (Baker, 1987). Promotion includes brand names, labels and packaging. However, customers must be aware of the distinguishing characteristics, particularly of new products, before developing favourable attitudes toward them. Good promotion means that firms are able to establish an image (based on product quality), interact with the production chain and distribution channel, provide service to customers, and complement other marketing functions. Promotion is an important element in any firm's marketing plan. A good promotional plan complements the product, distribution, and price components of marketing (Evans, 1982:411–413).

The promotional part of the marketing mix contains the following instruments. Unfortunately, terminology is carelessly used in practice and the following scheme must be subject to some caveats (Crosier, 1987:290–292):

- *Advertising*, i.e. promotion via recognizable advertisements placed in definable advertising media with determined space and time elements and directed at a target audience.
- *Publicity*, i.e. promotion via news releases distributed to news media in anticipation that they will earn editorial mention and be noticed by a target audience.
- *Direct mail*, i.e. promotion via mailings distributed by post or door to door to specific target consumers.
- *Packaging*, i.e. promotion via design, label and display, intended to be seen at the point of sale by potential customers.

- *Sales Promotion*, i.e. a portmanteau term describing promotion by means other than those so far defined. Economic-induced sales promotion comprises devices, such as price deals; communication-initiated sales promotions refer to i.e. product literature, point-of-sale advertising, sponsorship or competition.

#### **5.4.2. Selling**

The essence of marketing and the ensuing distribution activity is selling. This economic core activity consists of personal, individual and persuasive communication, which aims at achieving planned-sale objectives. Selling skills are too often viewed as a natural ability or talent rather than as a technique, which can be acquired. A successful salesperson is someone who has mastered the art of persuasive communication. Sale techniques involve understanding people's logical and emotional reactions to promotion. It is important for salesmen to agree to a common definition in order to concentrate their minds and inspire their efforts to sell more effectively. Even when faced by a group of people, salesmen address individuals, each one with a particular need, preference and prejudice. Customers want to be assured that their wants and attitudes are understood. This will only be achieved if communication in sales is client-oriented.

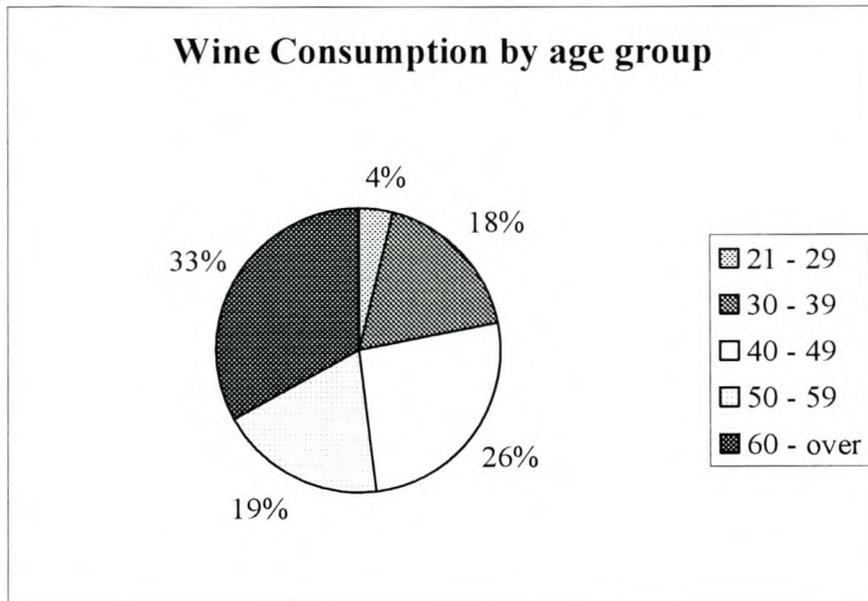
In the eyes of many customers there is little difference between the products and services offered by competing companies. Customers even have to be persuaded that distinctions are helpful (Baker, 1987:289-290). Product knowledge is too often taken for granted by companies. It is sad that experiences of hearing countless salesmen talking unintelligible gibberish do not support this complacency. Sales representatives are usually given inadequate knowledge, which is slanted to the company. Salesmen must be taught about products from the customer's point of view. Buyers buy the *benefits* of the product; these benefits derive from technical features of the product. These basics should be kept in mind before meeting a client because only in this way thinking and selling will be customer-oriented (Lidstone, 1987:274, 279, 280).

#### **5.4.3. Marketing**

Marketing is a concept that should be part of the culture of a business organisation, as well as a set of activities that must be managed. The decision to produce certain products or services,

their positioning in the market in relation to competitors and the relevant pricing, distribution and promotion strategies are key aspects of marketing strategies. If an organization is marketing-oriented, decisions about products and services will clearly relate to the needs of the market. Product design, geographical indication, label specification, quality and packaging will be designed to customer and consumer preferences. Prices will be influenced by competition and consumer perceptions of quality in relation to alternative products or services. Advertising and promotion will seek to show how the product or service meets consumer needs and will target specific segments of the market; thereby the product will be made available where customers expect to find it. If the needs of customers are not met, potential clients may well buy from competitors of the company.

Concerning wine, consumers are likely to become more knowledgeable and selective. In future, products might be attributed to different age groups even more than it is already done today. Population size, gender, and age hold important implications for marketers. A large and growing population sustains rising product sales and offers new opportunities of various kinds in the long run. The slow growth rate of the population, on the other hand, means that firms must strive to satisfy existing markets first. Moreover, they should realize that sales growth must be shifted to superior products. In addition, it may be necessary for firms with high-growth objectives to enter new markets, to develop related product lines, to diversify or to take those products off-line, which target declining markets (Evans, 1982:90–91). Amongst the age group of “over forty” world wine consumption accounts for 80% of the total volume consumed (see Figure 1). This trend will continue benefiting from the aging generation of the ‘baby boom’. At the same time there will be a decrease of four percent concerning the age group “21 to 40”. If per capita consumption remains constant total wine consumption of each age group might increase by 25% until the year 2015 (Evans, 1982:92).



Source: International Wine Marketing, 2002

Figure 1: Wine Consumption by Age Group in 2000

Since wine consumption is split almost fifty-fifty with regards to gender, it can be assumed that the projected growth rate will remain constant. With heightened awareness of the quality of wine and increased spending power, the time is now to acknowledge and target the age group “21 to 40” (Barclay, 1999a). Rapid population growth in countries with abundant rural labour means that national markets are characterized by similarities concerning demography, economic structure and agricultural productivity. In light of a majority of rather young citizens of these countries, population growth will persist even if fertility fell sharply because a large proportion of people have yet to reach reproductive age (Tomich et al., 1995:12-14).

The marketing strategy for each product and service must be linked to objectives and to the other functional strategies which comprise the competitive strategy. According to Thompson it must address three major concerns (1993):

- how to meet customer needs more effectively than competitors
- how to compete with other manufacturers
- how the various marketing mix elements should be used.

#### 5.4.4. Brand Management

For any company, performance is about ‘competing for preferential choice’ by existing and potential stakeholders, i.e. customers, employees, etc. The understanding of the “value of brands” is a relatively recent financial and marketing phenomenon (Spawton, 1998:417-420). A brand, which is a distinctive term, a symbol, a design or any combination of the above (Jobber, 1995:246,247), is considered to be the key to delivering value. Indeed, well-managed brands create value as they convey an image to the customer. As brands become increasingly important and valuable, robust brand management is crucial (Fiskud, 1999). Branding is the process by which companies distinguish their product offerings from those of competitors. Successful branding generates customer loyalty and repeat purchases, enables higher prices – thus, better margins – and provides a springboard for additional products and services.

Brand awareness is a cognitive function that establishes a link between brand and product class. The two levels of ‘brand awareness’ are breadth of brand awareness correlated to market share and depth of awareness that produces loyalty (Spawton, 1998). Both types of awareness have very important effects on the consumer’s decision-making because they affect, firstly, the number of people in a market, who have bought the product at least once in a given time period, and, secondly, the frequency of purchase. The recent revival of interest in brands addresses a competitive strategy. In many cases brand management is focused on preventing the entry of other economic actors into oligopolistic industries. Brands or more generally differentiated products figure prominently in the theoretical literature on international trade and investment and are grounded in models of imperfect competition.

The wine industry is market driven. Distribution and marketing rather than production technology are the main driving forces because of the nature of the product. Brand names, product differentiation and innovations in packaging, all play a major role in the survival and growth of businesses. Leading firms in the wine industry have traditionally developed a diversified set of brands, although in recent years some firms have followed a policy of consolidation and have concentrated on a selected number of reputable brands. Brand positioning, brand management and innovative organizational changes in distribution are characteristic features of competitive strategies. Another feature of the wine and spirit industry, which has attracted much attention, is its expenditures on brand advertising (Jones & Morgan, 1994:65–66).

The selection of a brand requires systematic efforts at generating alternative brand names (Wind, 1982:500-503). In the wine sector, companies which compete in an increasingly global environment with world products need a sound policy concerning the maintenance of their 'fleet' of brands. In this regard, it seems that the meaning of quality is little understood. In fact, the definition of quality is based on a classification<sup>1</sup> and/or on a sensorial quality<sup>2</sup>. Product quality is vitally important because it is the basis on which brand equity is established. The sector needs to embrace a better understanding of 'perceived quality', which comprises not only properties of the product itself but also the total package which is conveyed by wine.

Perceived quality is the basis of differentiation between one wine and another. Wine brands of any denomination provide strong psychological associations with the consumer. The influence of other people<sup>3</sup> differentiates wine from other alcoholic beverages and 'taste' is considered to be the prime selection driver. Brands are based on such associations. The most widely used differentiation tool in wine marketing is the 'price-value' mechanism because consumers are not necessarily price sensitive when pursuing ideals of hedonistic consumption. Hedonism encapsulates the total wine offering. Therefore, it is not good enough to produce a preferred wine. All associations of a brand need to be considered in order to support this message and to communicate it to the consumer.

Worldwide the wine sector is continuing to develop and launch new labels to capture niche segments. Not all of these new labels are successful. In fact the failure rate for such ventures is currently in excess of 80% (Spawton, 1998:417-420). Thus, it is important to continuously monitor the market in order to grasp quickly changing taste preferences. These determine the relative fortunes of the wine brand and also the ranging policy<sup>4</sup> that is inherent in the range. In this respect, brand management must be open to market changes. Moreover, in the wine business management of change must be highly proactive. At the end of the day, wine companies need to know their 'winners and losers' and need to develop on tomorrow's winners (Spawton, 1999a:90-94).

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<sup>1</sup> E.g. an appellation regime

<sup>2</sup> Colour, odour and taste

<sup>3</sup> Friends, peers, family, guests

<sup>4</sup> I.e. which varieties/blends

## **Chapter Two**

### **1. The EU and South Africa**

The EU is South Africa's most important trading partner. In 1999, 47.2% of South Africa's imports were sourced from the EU while 42.2% of the exports were channelled towards the EU. This implies that 45% of South Africa's total trade is currently with the EU (BER, 1999). This very intense trade relationship between South Africa and the EU provided the rationale in terms of objective interests for both parties to work towards the establishment of a free trade agreement.

#### **1.1. Trade in Wine and Industry Policy**

In general, the relationship between the EU and South Africa pertaining to trade in wine is a thorny subject. It is well known that the EU is perceived as having a considerable problem with the practice in South Africa regarding geographical indications. The same EU, deploying an impressive strength in wine production and trade in wine, is accused of practising agricultural protectionism. Some of these issues will be discussed in the following chapters.

Geographical indications of origin, i.e. the names of places, areas or countries, are appropriate instruments in particular for product differentiation in marketing strategies. As explained earlier, this might benefit the consumer, who receives more value for equal money. Accordingly, certificates of origin are salient and, as influencing factors on market success, they became a major issue during negotiations between South Africa and the EU concerning the protection of various traditional terms and designations in the field of trade in wine. Representatives of Spain and Portugal, for instance, argued that they would not accept South Africa selling bottles, which are labelled "Sherry" or "Port". From their point of view, these designations should refer to Spanish Jerez and Port from Portugal.

While no big change in designation policy and practice has occurred, some compromises and adjustments could be arranged during the negotiations for the South Africa-EU Free Trade Agreement. However, with respect to geographical indications, the final version is far from

being clear and transparent. The EU, for instance, wanted South Africa to call its Port and Sherry Tawney or Ruby in future (Theuringer, 1999), while now the agreement prescribes that Port and Sherry are exclusive labels, which cannot be used for equivalent South African products, it does not specify alternative names at all. Hence, the EU-initiated comprehensive solution with regards to the controversy of a wine and liquor agreement remained unrealised; an agreement pertaining to the use of traditional designations in trade between SA and EU has not been reached yet. Considering this state of affairs, it is necessary to fully understand the trade interests involved by assessing the underlying industry/structural policy interests. As a matter of fact, industrial policy is the other side of the trade policy coin. As a protective tool, subsidies may have more adverse economic affects.

The interrelations between trade theory and trade practice comprising tools such as tariffs, quotas, non-tariff barriers and “industrial policy-strategies as trade policy instruments”, might become more visible in listening to a joke, that is known among trade negotiators: What is the difference between trade theory and trade policy? Answer: Trade theory deals with the questions of who has his hand in whose pocket, while trade policy deals with the issue of who must take his hand out. In this respect, how do trade in wine between EU and South-Africa and industrial policy approaches such as the EU-Common Agricultural Policy and the South African “Vision 2020” perform?

## **1.2. South Africa’s Export Performance**

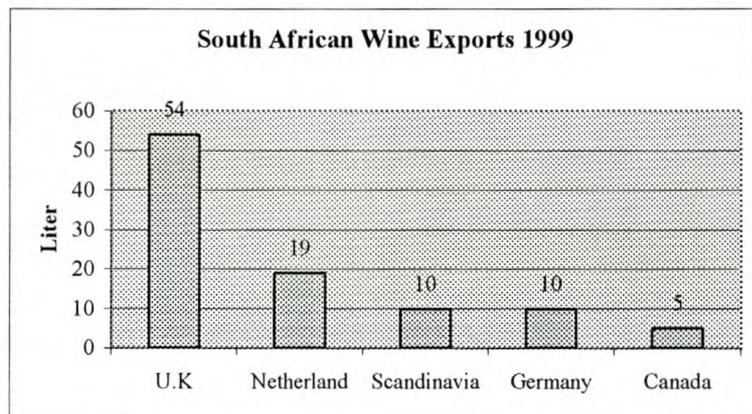
South Africa has started exporting aggressively and with considerable success into the world wine market since the lifting of sanctions in the beginning of the 1990s. As a matter of fact, South Africa’s performance in exporting wine improved continuously both in quantities and value in the last decade. In 2000, export volume increased by 16% to 152 mn litres worth \$182 mn (\$1.29/litre), which table one indicates:

**Table 1: Exports by Volume and Value**

	1994	1995	1996	1997	1998	1999	2000
<b>Litres in mn</b>	51	73	100	111	118	131	152
<b>US \$ in mn</b>	n/a	n/a	n/a	n/a	131	154	182
<b>\$/Litre</b>	n/a	n/a	n/a	n/a	1.05	1.18	1.29

Source: International Wine Marketing, 2002

South Africa's export dynamic is impressive. The international growth of South African wines is limited only by vineyard plantings. Today, South Africa grows 63,000 bearing acres of the classic international varieties, of which Pinotage accounts for 12,000 acres (Nicholson, 2001:60-62). The major export markets for South African wine have been European ones, where numerous traditional links between South Africa, the U.K., the Netherlands and Germany exist. The U.K. accounts for over 40% of total wine exports, followed by the Netherlands, Scandinavia, Germany and Canada. According to Figure 2, the five largest markets accounted for more than 75% of the total trade volume.



Source: International Wine Marketing, 2002

**Figure 2: Major Markets of 1999 Exports**

Accordingly, important clients of South Africa's wines are Scandinavian and Western European countries. In this respect, the importance of Europe as a strategic partner for South Africa becomes prominent (German Embassy, 2000), even more when taking the development of South African-EU relations concerning trade in wine into account (table 2).

**Table 2: Wine Exported into the EU**

Imports out of South Africa	EU			
Year	1997	1998	1999	2000
Wine (DM in mn)	270.5	339.1	387.7	421.6

Source: International Wine Marketing, 2002

As the data exemplifies, the South African wine industry has grown strongly over the past five years and wine imports from South Africa into the EU have increased annually. Thus, the trade case advocates for a comprehensive and sustainable framework designed to enhance mutual benefits of trade between South Africa and the EU.

### 1.3. The TDCA between the EU and South Africa

In the process of negotiating a free trade agreement with the EU, South Africa pursued the following four strategic objectives (Correspondence EU/South Africa, 2000, 2000a):

- To gain preferential access to its major export market;
- To attract foreign direct investment
- To contribute towards the restructuring of the economy with a view to improve its global competitiveness; and
- To consolidate already existing strategic trade links with the 15 EU member states.

The bilateral negotiation process between South Africa and the EU started after South Africa's first democratic elections in 1994. The comprehensive TDCA between South Africa and the 15 EU member states was concluded during March 1999 and finally signed by all parties in Pretoria on 11 October 1999<sup>5</sup>. The TDCA encompasses a number of issues, including political dialogue, provisions for free trade, economic co-operation, financial assistance and development as well as social and cultural co-operation. Both parties are members of the WTO and due to the TDCA covering "substantially all trade" it needed to comply with the rules of the multilateral institution.

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<sup>5</sup> In international treaty making, agreements normally come into force only after having been ratified by national parliaments in due course.

The TDCA addresses two main issue-areas, which are trade, including trade in both industrial and agricultural products and trade related issues (Dugard, 2000:359–361). The latter category refers to:

- Border measures, consultation on agricultural policies, fiscal measures, relationship with other customs unions and free trade areas, antidumping and countervailing measures, safeguard action and measures, exceptions and rules of origin;
- Rights of establishment and the freedom to provide services;
- Current payments and movements of capital;
- Competition policy;
- Public aid;
- Other trade related provisions such as government procurement, intellectual property, co-operation in the field of standardisation, metrology, certification and quality assurance, customs co-operation and co-operation in the field of statistics;
- Economic co-operation, including in the fields of industry, investment promotion and protection, trade development, micro and small and medium sized enterprises, telecommunications and information technology, posts, energy, ,mining and minerals, transport, tourism, agriculture, fisheries, services and consumer protection and health;
- Development co-operation;
- Cooperation in other areas-including science and technology, environment, culture, social issues, information, press and audiovisual, human resources, the fight against drugs and money laundering, data protection and health; and financial aspects of SA-EU co-operation.

The Agreement is to be administered by a Co-operation Council that is additionally authorized to decide on all matters covered by the Agreement. In the case of disputes relating to the interpretation or application of the Agreement, each party may consult the Co-operation Council, which in the end will settle the dispute by means of binding decisions. If this procedure is unrealisable due to whatever circumstances, the Agreement contains provisions for arbitration.

A salient question with regard to the FTA is to what extent its relevant normative content is fully beneficial to South Africa in the different fields of agriculture. The answer to this question depends upon the specific areas concerned. While a number of so far sensitive

agricultural exports to the EU stand to benefit because of new quota limits, it seems to be clear that the export subsidies paid to EU producers are making the going tough for South Africa agricultural exporters, both in the EU market and in third markets. Domestic food processors also stand to face stiffer competition from EU producers as local tariffs are reduced. In addition, EU export subsidies are becoming a major trade issue between the EU and other countries (BER, 1999).

#### **1.4. The Agreement on Trade in Wine**

In view of the complexity of the issues pertaining to international trade in wine and spirits and the still unclear definition of strategic interests in this field, the TDCA did not include trade in wine. Therefore, both parties decided to create favourable conditions for the harmonious development of trade and the promotion of commercial co-operation in the wine sector on the basis of equality, mutual benefit and reciprocity in a separate instrument.

According to the consolidated text of the draft agreement between the EU and South Africa, the overall objective was to facilitate and promote trade in wine originating in the regions on the basis of non-discrimination and reciprocity. The draft agreement contained a set of rules and guidelines, notably pertaining to (European Community/South Africa, 2000):

- Oenological practices and processes and product specifications,
- New oenological practices and safeguard provisions,
- Reciprocal protection of wine names and related provisions on description and presentation,
- Protected names; certification documents and analytical reports.

However, the South African government explained that practice based on the draft version of the Agreement would result in serious legal, economic and financial consequences for South Africa's wine and spirit industries. Eventually, these developments would even disable the government to honour its commitments in the implementation phase of the Agreement. Amongst others, a crucial issue of this line of argumentation was the exclusion of South African wine blends with third country wines from the provisions of the Agreement.

Considering these obstacles, is it possible to reach a mutually beneficial agreement on wine that maximizes the opportunities in terms of common interests and minimises the problems for South Africa and the EU alike? From a liberal's point of view, the obvious answer to this question is that all partners must open their markets. Subventions and industrial policies have to be stopped and markets need to be relieved from protectionist measures in order to free trade and investment. Nevertheless, the development in countries such as South Africa, which are industrialised and at the same time less developed, can barely depend on the opening of market access and the market mechanism alone. As a matter of fact, most of these countries cannot enjoy the benefits of trade liberalisation to an optimal extent unless appropriate 'interventionist' development strategies are pursued and reliable partners are cooperated with.

While many regions in the world have benefited significantly from free markets and globalisation, for much of Africa the global economy has not become a reality. Trade between Africa and the rest of the world has traditionally been skewed towards Europe due to Africa's colonial past. Thus, Europe is the major trading partner (Standard Bank, 2000). This strong European position implies an enlightened European and South African interest to solve South Africa's problems on the basis of co-operation. As the world's largest importer of agricultural products and, together with its Member States, the world's largest donor of aid – in terms of amount and geographic spread – the EU is expected to be the developing countries' most reliable partner. Having understood this, the EU believes that trade, agriculture and development are complex and interrelated subjects, which require a comprehensive approach involving not only the WTO regarding trade aspects, but also the international financial institutions and bilateral development co-operation by EU Member States (European Commission, 2000).

Under the auspices of increasing interconnectedness the world is experiencing a surge in trade and capital flows. In this respect, it should be the primary task of the EU's development policy to create the conditions for fair shares of the growth of world production and trade. The Agreement on trade in wine demonstrates the difficulty of applying the EU's policies in practice.

## **2. Agricultural Protectionism and Industrial Policies**

The EU has a considerable problem with the practice in South Africa regarding geographical indications and, in addition, is perceived as showing some reluctance concerning South Africa's industrial wine strategies. On the other hand the EU, deploying an impressive strength in wine production and trade in wine, is accused of practicing agricultural protectionism. Therefore, the mechanisms and the potential impact of agricultural protectionism as contained in the Common Agricultural Policy (CAP) and of sector specific policies to advance the competitiveness of wine industries is the subject of the following analysis.

### **2.1. Agricultural Protectionism of the EU**

In Europe, many states have a long tradition of state intervention in the agricultural sector, be it for technical reasons, such as the sector's vulnerability to weather conditions and crop diseases, or for economic reasons, i.e. to avoid fluctuations of prices or to protect agricultural producers from price competition. In addition, agricultural policy has strong political relevance: not only does the sector constitute a considerable part of the national heritage, but also food security is of great importance to consumers. Last but not least, agriculture often weighs heavily in national politics: specific interest groups and agricultural lobbies are well-organised and influential, for instance the farm vote used to be an important influencing factor in electoral politics. To some extent agricultural policy could also be seen as a welfare institution, intended to maintain employment and population levels in peripheral areas (Reger, 1996).

The European Community's (EC) and later the EU's CAP has often been accused of being a pure protectionist measure. Before judging, CAP should first be reflected upon in the historical context. At the end of the Second World War, the European farm sector was relatively backward and characterised by a large number of small farms with low productivity and backward farming methods (Harrison, 1995). The Treaty of Rome, forming the most important basis of the European integration process, left open several options for the development of separate national agricultural policies; however, it was decided to merge the national protectionist systems into a joint European system due to the special nature of

agricultural products. The Stresa Conference in 1958 set up the basic functions of CAP. Nationally diverging prices of agricultural products were homogenized and re-established at a common level. As such, agricultural markets had to be managed. CAP was formulated and consolidated between 1962 and 1966. Its essential parts were the Common Market Organisations (CMOs) and the price support systems. The structural policy part as proposed in the Mansholt Plan was not followed up by legislation of the EC Council. The “success” of CAP led to a period of permanent surplus crises, i.e. to vicious circles of a price policy causing production surpluses and consequently high costs.

## **2.2. Reforming CAP: Uruguay Round and “Agenda 2000”**

From the mid-1970s onwards, CAP was subject to cautious attempts of reform initiated by the EU itself in order to cope with chronic budgetary problems. The build-up and destruction of surplus food, the direct and indirect costs of the high price policy as well as the negative budgetary implications of CAP when the number of farmers was rapidly falling, made reform a pressing issue. The debate reached a peak in the early-1980s when, for the first time, the EC accepted that unlimited agricultural support had to give way to quantitative control concerning production.

Apart from the already mentioned budgetary constraints, the reasons for reforming CAP were (European Commission, 2000a):

- Inherent distortions of the price-support mechanism: overproduction, especially by big farms and excessive costs, notably caused by the storage of surpluses and export restitutions;
- International tension with trade partners (the principle of Community Preference had become increasingly incompatible with the rules of free trade; the impact on Third World countries: the contradiction between stated objectives of EU development policy and the refusal to allow in agricultural products from certain Third World countries became more and more obvious; the permanent call for free trade: the dynamics of the transformation of the General Agreement on Tariffs and Trade (GATT) into the WTO exerted mounting pressure on the EU to reform its protectionist organisation of agriculture);

- High costs for consumers;
- Environmental consequences of CAP (air pollution, water pollution, loss of natural habitats and reduction of biodiversity, etc.).

Before assessing the impact of the reform of CAP, the two main reform approaches need to be distinguished. Prior to the MacSharry Reform in 1992, the First Reforms in the 1980s reduced price support and discouraged production. Also, the principle of Co-Responsibility was introduced in order to make the farmers aware of the surplus crisis and to give an incentive to reduce production and limit budgetary expenditure. Two types of instruments were used (European Commission, 2000a):

- Stabilisers: thresholds (maximum guaranteed quantities) beyond which farmers will either not benefit from the full guaranteed price but will receive a reduced price, or have to pay a special tax, or will not be able to sell their surpluses to the CMO intervention authorities;
- Quotas: production quotas.

Simultaneously, the renovation of the structural policy was introduced, comprising aid for diversification and extensification, additional income aid for set-aside of land, as well as measures for early retirement of farmers. These reforms were pursued within the framework of strict financial guidelines. At the Fontainebleau European Council in 1984 an agreement was reached after conflicting interests over budgetary questions with the U.K. had been solved. This deal provided for a limitation on the increase of agricultural expenditure, stating that increase in CAP expenditure could not be higher than an increase in the Community's own resources.

In the 1990s, an inter-institutional agreement was reached and the institution passed a multi-annual program of financial perspectives, which aimed at solving budgetary problems once and for all. A strict ceiling to limit the increase in the budget of CAP was set up: the agricultural budget was not to increase by more than 74% of the growth rate of the EC's gross national product (GNP). Despite these improvements, the First Reforms wrestled with several problems: prices did not fall enough to have an impact on production and the stabilisers and quotas were insufficient to reduce expenditures in the long run. The structural measures failed

to produce a real incentive to reduce production because of the low level of the premiums granted (Glöckler et al., 1998:113–116).

The conclusion of the Uruguay Round at Marrakech in April 1994 brought about considerable pressure to decrease prices of agricultural products. The GATT Agreement on Agriculture was intended to reduce the general levels of farm subsidy in all developed countries over a six-year period, and in particular to reduce levels of subsidised farm exports on the world market and to cut restrictions on imports of farm goods. The European answer was the MacSharry Reform in July 1991. It introduced an important change of direction for CAP because, for the first time, the reform included the concept of de-coupling payments, which meant a break in the link between price support and production. According to the European Commission, it represented the ‘most fundamental reshaping of CAP since its inception 30 years ago’. The reforms were to be introduced by 1993 and to be fully operational by 1996.

As a matter of fact, the EC’s external negotiations within GATT could not have happened without the MacSharry Reform because the heart of this plan was the attempt to de-couple financial support from the price mechanism. In detail this approach entailed (European Commission, 2000a):

- Progressive reduction of prices in the arable and beef sectors over a period of three years, to come closer to world market levels;
- Compensation for the reduction of prices by direct payments to farmers;
- Direct aid conditioned on reducing production (by set aside of land and extensification);
- Quotas and stabilisers remain in operation;
- Accompanying measures: agro-environmental measures aimed at developing more environmentally friendly types of farms, afforestation and other types of land management;
- EU finance for early retirement schemes.

A close relationship exists between CAP and “Agenda 2000”. “Agenda 2000” is an action programme, whose main objectives have been to strengthen community policies and to give the EU a new financial framework with a view to enlargement, for the period 2000 until 2006.

It was launched in 1999 in the form of twenty legislative texts relating to the following priority areas (European Union, 2000):

- Continuation of the agricultural reforms along the lines of the changes made in 1988 and 1992, with the prospect of stimulating European competitiveness, taking greater account of environmental considerations, ensuring fair income for farmers, simplifying legislation and decentralising the application of legislation;
- Increasing the effectiveness of the EU-Structural Funds and the EU Cohesion Fund by greater thematic and geographic concentration of projects on specific objectives and geographical areas and, thus, improving management;
- Strengthening the pre-accession strategy for applicants by setting up two financial mechanisms: a pre-accession structural instrument to support improved transport and environmental protection infrastructures and a pre-accession agricultural instrument to facilitate the long-term adjustment of agriculture and the rural areas of the applicant countries;
- Adopting a new financial framework for the period 2000 until 2006, which enables the Union to meet the main challenges of the beginning of the 21st century – particularly enlargement – while ensuring budgetary discipline.

The reduction by 30% of subsidies to agriculture and the stronger bundling of structural (industrial policy) assistance was decided with “Agenda 2000”. As a result several parties involved have been afraid of suffering heavy income losses. Despite all controversies “Agenda 2000” is a fair trade instrument for agrarian goods both inside the European Free Trade Zone and at the global level of the world market. In addition, “Agenda 2000”, with its strong environmental component, is an important step towards the conservation of the environment in the rural areas of EU member countries (European Commission, 2000b).

### **2.3. CAP Reform: the Wine Sector**

In the wine sector Europe is still the world leader in terms of area planted to vines, production as well as consumption of wine. The European wine sector is highly diversified, and an essential agricultural resource for many regions in the continent. Wine growing accounts for a

substantial share of final agricultural output in several EU Member States. Wine growing activities are often located in areas where other agricultural activities would be difficult or impossible.

While wine growing has experienced periods of severe crises in the past, in recent years the EU's action in this sector has made it possible to achieve a better balance between supply and demand. Overall, price levels meet expectations in the sector now, with the exception of a few specific regions and products. Nevertheless, considerable difficulties remain. Structural surpluses have decreased but the risks of surplus production over several years survive, in particular because wine growing, more than other crops, is highly vulnerable to climate fluctuations, which can have an impact on the volume and quality of production. Moreover, the rising demand for quality wine fails to offset the decline in table wine consumption.

Adjusting quickly to more open markets is a substantial problem for many wine producers; some wine growing areas are having trouble finding lucrative outlets and those whose markets are growing have not found the flexibility required to broaden their horizons. This is due to the very nature of the crop: since a vineyard lasts 30 years or more, the investment amortisation period is long. This seems particularly to be a problem in Europe with its prevailing fragmentation of wine production areas and its traditionalist attitudes with regard to crops, markets and viticultural and oenological methods.

As with other agricultural sectors, a much needed reform was to enable the wine-growing sector as a whole to improve its efficiency, cost control and competitiveness. It must also pay even greater attention than before to consumer quality requirements, to the preservation of traditional methods of production in rural areas<sup>6</sup> as well as to the diverse needs for developing the periphery throughout Europe but particularly in less favoured regions.

Despite successful efforts to support the market while controlling production and steering it towards higher quality, the sector is still subject to specific market fluctuations and is now having to face increasing competition, especially from New World wine producers.

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<sup>6</sup> Where vines play a vital role in sustaining local employment and preventing soil erosion

## 2.4. Market Intervention and Control of Wine-Growing

What was the EU's approach to the wine sector before the present reform? The diverse nature of wine-growing products and by-products, the impact of this activity on local economies which often have no alternative crops, production fluctuations, difficulties in market positioning and the long-term nature of investment in wine-growing call for sustained discipline if the sector's future is to be secured in the long run. Before the present reform the EU's action, carried out for many years under the common organisation of the market in wine, mainly consisted of two types of measures (European Commission, 2000a):

- Intervention in the market to ensure its balance by means of private storage aid, various types of distillation aid and aid for the use of grape must for purposes other than wine-making, and
- Control of the wine-growing potential to guide supply, firstly, by banning new planting and by implementing measures which provide for the abandonment of premiums, and, secondly, by planting authorisations, which were designed to redirect production<sup>7</sup> and which were limited to specific objectives, involving the production of certain types of wines.

The implementation of such measures helped to reduce the wine-growing area from almost 4 million ha in 1987 to 3.4 million ha in 1997. Average production dropped from 200 to 160 million hl, in particular due to using grape varieties that demand lower yield and provide for better quality. The various steps to control the production potential have helped to reduce the structural surpluses that had been such a prominent feature of earlier periods. In providing for variable premiums per hectare according to yield, type of crop and variety, these measures enabled a notable reduction in the supply of the table wines that were least suited to the markets.

Additionally, the nature of wine production unavoidably called for the introduction of specific technical measures. Nowadays, these measures are perceived as having helped to ensure the smooth operation of the international market and improve marketability while protecting the legitimate interests of consumers and producers. At this stage, it is worth stressing the economic benefits that the wine sector has reaped from the enhanced value of products. This

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<sup>7</sup> I.e. to favour products which are more closely tailored to the qualitative evolution of the consumer's taste

has been possible thanks to complex, yet rigorous, regulations, which have ensured that consumers could rely on accurate product specifications. The juxtaposition of value-added quality wines and ordinary wines has resulted in a far greater increase in revenue than that found in other agricultural sectors. This has largely contributed to preserving the momentum of the European wine sector. More precisely, these provisions included (European Commission, 2000a):

- Regulations on oenological practices in order to control and guarantee the healthiness and quality of production
- Provisions ensuring product tracing ability<sup>8</sup>
- Rules relating to the description, designation, presentation and protection of certain products, in particular quality wines which have been produced in specified regions.

## 2.5. CMO

The Common Market Organisation (CMO) has been designed to respond to new developments (notably the Uruguay Round and Agenda 2000), which have occurred since the entry into force of the regulatory framework of the 1990s. A regulation enacted in 1999<sup>9</sup> resulted in a considerable simplification of legislation and administrative practice by replacing the previous 23 regulations with a single one. This regulation, relating to the new common organisation of the market in wine, is the legal basis of a number of pertinent reform measures that are explained in the following in depth.

In practice, the new regulation ends the guide price system for various types of wine previously implemented as part of the intervention mechanisms. This system is no longer suited to the economic situation within the sector: production is largely fragmented and transaction methods have changed considerably in the last few years.

The total cost of the new CMO is estimated at approximately €1.3 bn per year for the period 2001 to 2005. Approximately one-third has been allocated to the measures maintained, and

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<sup>8</sup>Production declarations, registers, accompanying documents, etc.

<sup>9</sup> Regulation (EC) 1493/1999, 17 May 1999

two-thirds to new measures.<sup>10</sup> This represents a slight increase in average expenditure compared to previous years, which is justified by the aim of developing a high quality European wine-growing sector. However, the most important benefit of the reform is the improved efficiency of measures: while respecting budgetary constraints, the reform will stimulate the sector and help to prepare it for the future, in the light of general market trends, consumer expectations and the EU's international commitments.

The measures for controlling wine-growing potential remain in place but they are better targeted than before to ensure adequate guidance of supply. A system for the restructuring and conversion of vineyards has been established. The most important elements of the new common organisation of the market in wine are designed to influence the wine-growing potential, the mechanism of market intervention, producer organisations, oenological practices, product specifications and trade with third countries. All these elements contribute to the multifunctional nature of agriculture - a key feature of the European agricultural model (European Commission, Directorate General for Agriculture, 2000:1-5).

### **2.5.1. Wine Growth Potential**

Under the reformed CMO, the general ban on planting new vineyards will remain in force during a transitional period (until the end of 2020) to ensure long term balance between supply and demand. Abandonment premiums have been maintained: Member states may determine the eligible areas and conditions for the implementation of this measure. At the same time, provisions have been made for new planting rights. However, these will apply only in specific cases and will be subject to strict controls. This measure is designed to take due account of demand trends and the potential of certain producers, who are finding themselves constrained by the lack of production possibilities in areas where demand is rising. The additional rights will be allocated by 2003, up to a limit of 68 000 ha and in line with certain criteria,<sup>11</sup> with priority being given to young, newly established wine producers.

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<sup>10</sup> These measures concern restructuring and conversion, safeguarding of the potable alcohol sector and possibility of crisis distillation.

<sup>11</sup> Availability must be less than demand and an inventory of the production potential of the relevant region must be carried out.

**Table 3: Allocation of New Planting Rights**

<b>Countries</b>	<b>Ha</b>
Germany	1534
Greece	1098
Spain	17355
France	13565
Italy	12933
Luxembourg	18
Austria	737
Portugal	3760
Community Reserve	17000

Source: International Wine Marketing, 2002

Provisions remain for a system of transferring unused replanting rights to those producers who need them most. Where necessary, reserves of planting rights can be established to facilitate the process. To avoid interruptions of income, it will be possible to acquire replanting rights before the corresponding grubbing-up takes place. Furthermore, the regularisation of certain irregular planting and replanting practices shall be subject to strict conditions.

Measures to guide supply, applicable to the vineyards in order to restructure production potential in terms of quantity as well as quality, will be pursued on a more targeted basis: henceforth, it will be up to each member state to put forward the regions and types of production eligible for this aid. They involve regions where production no longer matches market demand and which will have great difficulty in responding to new consumer requirements. The measures will be financed by the EU at the basic rate of 50% for restructuring and conversion costs, the balance being the responsibility of beneficiaries. Compensation for lost revenue will be available for producers who replant after grubbing up. New planting rights, restructuring and conversion aids are conditional on carrying out an inventory. The EU member state may authorise this inventory to be drawn up on a regional basis. The purpose is to collect information on areas, varieties and planting rights – essential data for any effective action relating to path replacement of old vines with younger plants, which is a customary practice in the sector and their conversion or restructuring. This will

ensure that funds are focused exclusively on conversion and restructuring activities which are designed to promote adjustment to demand and improved quality.

### 2.5.2. Market Intervention

Given the structural effort already made to control production and the prospect of a more open market in future, community market interventions will now be concentrated on the following mechanisms:

Private storage aid for table wine and certain types of grape must has been maintained to ensure continuity of supply and control the production fluctuations to which the sector is prone. The measure should be applied in a flexible manner and should be in line with market fluctuations. If necessary, it has to be suspended.

Aid measures, which address the use of grapes that are designed to increase the alcoholic strength of certain wine products,<sup>12</sup> remain in force. In addition, they should address the preparation of other products, such as grape juice. Part of the latter aid is earmarked for campaigns to promote the consumption of grape juice within the EU. Furthermore, the European Commission has submitted a proposal for a horizontal regulation which is intended to implement measures to promote and provide information about agricultural products of the EU – including wine – in third countries. In short, aid should be used for alternative uses to wine production, and to promotion schemes.

Distillation of by-products ('wine delivery'), which is compulsory for every producer to prevent the overexploitation of grapes, has also been kept. The distillation of wine, produced from dual classification grape varieties, has been maintained to prevent the marketing of products from vineyards, designed for other uses. Crisis distillation can be applied by producers on a voluntary basis to deal with exceptional cases of market disturbance.

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<sup>12</sup> Which offsets the difference in cost between grape, must and sucrose

### **2.5.3. Oenological Practices and Product Specification**

In general the rules for oenological practices and processes have been retained, notably as regards acidification and enrichment of wine products, with the exception of some minor technical modifications. As for product specifications,<sup>13</sup> their particular significance for wine-growing in terms of added value warrants preserving a system which ensures a good level of traceability, from the vineyards to the table. The main new feature is the possibility for the bottler to include further details on the label, in addition to the compulsory and voluntary information explicitly provided for under the new CMO regulation – provided that they are documented and do not mislead the consumer. The specific system for protecting designations of origin, which applies to a sector where both production and demand are rising, remains fundamentally unchanged.

### **2.5.4. Trade with Third Countries**

Besides adjusting the various measures to the current situation in the internal market, new consumer expectations and the imperative of efficient expenditure, the new CMO must take the constraints resulting from international agreements and the position of the EU as a net exporter on board. On account of the clear market preference for products from specified origins, European decision-makers argue that it is necessary to pursue a policy of protecting geographical designations. It is argued that the ban on mixtures between imported wines and European wines and the vinification of imported grapes must be maintained to avoid a neutralisation of the sector's efforts to ensure quality. These issues are dealt with in the bilateral agreements already concluded by the EU or in those currently under negotiation. In any case, the EU should not equalize more open markets with threat but rather with challenge. Consumers have demonstrated considerable interest in wines from outside the EU and, generally speaking, demand has ceased to drop and has even picked up slightly in some member states.

Furthermore, the reduction in customs tariffs further to the 1994 Uruguay Round agreements may have contributed to an increasing trade. Nevertheless, the Union's positive external balance of trade in wine, per standard production year, has remained at some six to seven million hectolitres per year, and the income surplus increased from €1.7 bn in 1990 to €2.2 bn

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<sup>13</sup> Description, designation, presentation and protection

in 1997 and to €3.9 bn in 2001. Undoubtedly, the global wine-growing picture has changed and ‘new wine producing’ countries figure more prominently than ever before. In this environment, the guidelines as set out in “Agenda 2000” for more stringent quality standards and strict control of production will enable the Union to maintain its dominant position in future markets, which will necessarily be more open and competitive. Protecting the reputation of European products through careful monitoring of geographical indications, oenological practices and variable guidance – in short through a high quality policy – stands out as the main precondition for preserving this momentum.

### **3. South Africa: Industrial Strategies and Policies**

As Europe has a strategy comprising market intervention, control of wine growing potential, producer organisations, product specialisation and interest-oriented trade policy with third countries, why should South Africa not apply similar strategies that proactively serve the country’s interests of becoming a world player in the wine business? A successful strategy consists of four elements (Sun Tzu, 1991): firstly, a clear and simple overall objective, secondly, time and space, thirdly, volume, i.e. financial envelope, number of participants, tactics or concrete alternative courses of action, etc. and, finally, a procedural or institutional part. On what historical experience would such a South-African wine strategy be based? What should be the key elements of an industrial strategy for South-Africa’s wine industry?

#### **3.1. Historical Context**

The legacy that the South African industry must escape, if it is to succeed in the global market place, consists of an excess production of mostly poor quality white wine (Vink et al., 2001:2:5). On the other hand, if it succeeds, South Africa has the potential to become and remain a global player. Again, the strategy for realising this grand design should not be designed without a thorough understanding of historical developments. Between 1810 and the 1820s, wine was the most important export commodity from the Cape, which provided for some 90% of the total exports from the colony. At that time Britain was the largest market for the South African wine industry. The industry was heavily dependent upon state actions. When the favourable preferences of the tariff scheme of the British Empire were abolished, South African wine exports to Britain fell by 75% and plunged the industry into depression.

The industry revived and became a leader in exports again until the free trade agreement between Britain and France, adopted in 1860, led to a renewed drop of South African wine exports from £120,000 to £8,000 sterling. After a number of other problems having occurred in the latter part of the 19<sup>th</sup> century, an agitation was started in the second decade of the last century in favour of establishing a co-operative, whose membership would consist of wine farmers. As a result, a co-operative undertaking under the name *Kooperatiewe Wijnbouwers Vereniging van Zuid Afrika Beperkt (KWV)* was created. During the following decades KWV went through a number of important institutional transformations. In 1923, KWV was registered as a co-operative. In the late 1970s, KWV gained a direct interest in trade in wine through swapping interests between the beer and wine industries. Finally, in 1983 KWV started investing in the production of grape juice concentrate. This was another way of market management, i.e. of disposing of the surplus.

Regulations on wine standards have also been a feature of the industry for a considerable time. The Wine and Spirits and Vinegar Act of 1913 was followed by further laws and regulations, particularly the Agricultural Products Export Act of 1917, which regulated the quality of wines for export. The Liquor Products Act of 1989 consolidated these measures. After the establishment of the so-called super grade system, whereby KWV had been the only institution certified to conduct plant propagation, and some revisions of the pertinent legislation, with the streamlining and rationalisation of the Department of Agriculture, all functions were eventually transferred to the Vine Improvement Board in 1993 (Vink et al., 2001:2–5). Thus, there is a story of control in the industry that has its origins in the first half of the 19<sup>th</sup> century, but there is also a story of liberal entrepreneurial will in searching for excellence, as in the case of Constantia, and to survive disasters such as phylloxera and other diseases.

As a matter of fact the South African wine industry has undergone major changes between 1970 and 1990. The governmental transformation and the termination of international sanctions enabled South Africa to re-enter the world economy. One effect of the change in domestic and international politics was the reorganisation of the regulatory and institutional framework of the wine industry. Above all this is obvious with regards to the role of KWV, which formerly had the statutory obligation to regulate the industry. As well as being its marketing arm (Vink et al. 2000). It established minimum prices and imposed production

quotas. Over time KWV came to determine the minimum prices for all grape products – first distilling wine, then so-called ‘good wine’ and finally even grapes destined for juice concentrate. Since it was a buyer of last resort it obtained the right to fix the total tonnage of a particular property. This regulation was never applied to enhance quality, since these production quotas permitted yields that were sometimes as high as 20 tons per acre. The quota system also allowed KWV to determine where, and by whom, vines could be planted.

As a result vineyards could only be established in traditional wine producing areas. The occasional exception, such as the Orange River irrigation scheme, was driven by political considerations and in turn imbued the land with value, because there was a guaranteed purchase and purchase price for the crop, almost irrespective of quality. KWV may have protected the country’s growers from the full impact of markets force, but it did so at a cost to the country’s fine wine business. Minimum price guarantees and a system that focused on yield, in potential alcohol, permitted the survival of the least efficient and undermined the initiative of the more adventurous (Winepros, 2000). Today, most top-quality South African table wine comes from private producers, a few wholesaler-producers, and individual estates which make wine as well as grow their own grapes (fewer than 80 in the early 1990s). Still, today KWV plays an important part amongst the largest wholesalers, such as Stellenbosch Farmers Winery (SFW) and Distillers Corporation. However, industry functions, including research, wine education, wine propagation, marketing campaigns as well as advisory and administrative services, including the safeguard of a register on indications of origin, have become independent.

### **3.2. Elements of a Strategy**

With the removal of statutory controls and the global shift towards a more open international trade regime during the 1990’s, the operating environment of the wine industry changed fundamentally within the span of a few years. There was, moreover, an additional factor of change in the case of South Africa: The removal of sanctions. The cold winds of international competition now mixed with the warm winds of open, sanction free, global markets. After the political change of 1994, South African wines became front runners in a number of segments on the world markets. This created the impression of a new, exciting, and highly profitable operating environment for the industry. The industry emerged from the confines of a siege

industry to the expanding world markets for South African wine. What one foresaw was growth in profitability *ad infinitum*; a continuous growth in exports, limited only by constraints in natural resource availability. However, in opposition to this entirely optimistic view of the future a number of important players in the wine industry based their business decisions on a more sober assessment of the market situation. These players saw an urgent need for a long-term view which would elaborate on where the industry is heading to and where it should be heading.

At first the focus of the efforts towards a strategy for the South African wine industry was only on wines *per se*. But after extensive deliberations, it was decided to expand the brief to also cover other important sectors of the industry, such as spirits and research. The institutional framework designed to transform this broad strategy into concrete operational action is Winetech, an association of some of the most important stakeholders in the South African wine industry, namely the Association of Cape Wine Estates, the Cape Wine and Spirit Institute, the Cape Wine Cellars Committee and the Foundation for Research Development (Spies, 1999).

In addition to the strategic instrument a substantial winning strategy called “Vision 2020” has been developed (Spies, 1999). This strategy was inspired by a similar scheme developed in Australia. Its main characteristics are that all members of the value creation chain see themselves as integral constituents of the wine industry and that co-operation in this “closed system” functions on the basis of an understanding that optimal quality and product security are ensured. The South African wine industry thus understood that crucial success factors for excellence in the future are creativity in marketing based on quality and international competitive capacity.

### **3.3. Objectives of a Strategy**

In terms of a strategy, it should be the clear and simple overall objective of South Africa’s wine industry to become a successful and persistent global player. This means to offer only the best quality in wines, brandies and other grape based products<sup>14</sup> at the lowest cost, and by means of superior technology, marketing and effective logistic systems.

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<sup>14</sup> Quality is not defined in absolutist terms but in terms of market requirements and niches.

The strategic planning imperatives that flow from this overall objective are as follows (Spies, 1999):

- There must be a clear understanding within the wine industry of the long term global scene – of the dominant forces and trends shaping the future of the global wine industry, of the likely outcomes of these changes, what the key success factors of global competitiveness are today, and how they may change over the next few decades;
- There must be a clear understanding of the current situation in the South African wine industry – of how this situation evolved; the circumstances, structures and attitudes supporting the status quo, and the likely consequences of a continuation of the current dispensation;
- There must be a perception of success; a vision of an ideal state of affairs within the South African wine industry – one that not only will make it an effective and successful global player, but ultimately a leader in innovation and in the quality of its products. Such a vision must be realistic to the extent that it provides a clear and plausible strategy to a better future – but it must also be challenging and exciting in order to serve as a clarion call for all stakeholders in the industry to come forward and create a global winner.

In essence, the question is whether the South-African wine industry will decide on what needs to be done to make it a global player of repute and standing, and what the industry must do to act purposefully, coherently and meticulously, to take a proactive stance towards the future and to provide leadership, training and information to its members.

### **3.4. Key Elements of a Strategy**

Key elements of a strategy for the South-African wine sector are: the development of a strong home market, identification of niche markets, technological development, professional entrepreneurial management of companies, quality and high price strategy, optimised economic policy framework (i.e. market economy) and the usage of organisations, such as Winetech, as a steering instrument. Why the latter are of particular importance will become clearer when looking at the example of Winetech before assessing the other elements of a strategy.

### 3.4.1. Winetech

Winetech is a steering organisation and at the same time a human system. Steering organisations are managed as machine systems. Human systems are information bonded. They can become self-organising through learning, and information flow. All relevant players must have a clear understanding of, and commitment to, the vision and objectives of the industry, as well as the essential programmes that support the vision and objectives. From the various studies of “Vision 2020” the following elements of a desirable vision could be identified (Spies, 1999):

- The South African wine industry is globally competitive and highly profitable;
- The wine industry dominates its selected market niches, and will never chase market share;
- The wine industry answers to the best tradition of a global enterprise with strong cultural and civilising roots by producing unique South African products of great quality, variety and destination;
- The products of the South African wine industry are “distillates of nature”, which reflect respect for the creativeness of nature, and the great possibilities presented by the diversity of ecologies in the South African wine producing regions;
- The South African wine industry is innovation-driven and market-directed in order to ensure its continuous renewal and its ability to provide sustainable customer satisfaction in all the products and services that it offers; and
- The South African wine industry is a good citizen, it ‘walks tall’, it is an example to other industries, it is socially responsible, it develops its people, it builds relationships with its community and contributes towards creating a better society in South Africa through its infectious behaviour and path breaking successes.

Winetech operates as a ‘virtual organisation’; i.e. its de facto organisational structure is a network of participating institutions and individuals who, in one way or the other, have a strong interest in improving the competitive position of the South African wine industry. According to its constitution, the objectives of Winetech are fivefold, namely (Spies, 1999):

1. To support the wine industry with expertise, enabling it to be cost effective while producing quality wines and other grape based products through the application of environmental-friendly technologies;
2. To support the training and education of individuals for the industry - at all levels in terms of skills, knowledge and insight development – in order to ensure the practical implementation of the best knowledge and most advanced technologies in viticulture, wine-making and other grape based products;
3. To establish a culture of technological innovation, to ensure the ongoing utilisation of the best technology within the industry, and to facilitate its dissemination to all the sectors of the industry;
4. To facilitate the development of resource poor producers and to improve their access to the industry by making leading edge appropriate technology available to such producers;
5. To establish world leadership in selected niche areas of the wine industry through Winetech's network of scientific and technological expertise.

In sum, Winetech seems to provide for what is an elementary asset when trying to pursue a successful strategy. Winetech educates the industry and hence the customer, it communicates innovation, it ensures interest in new investment and helps to establish an image of the South African wine industry. As a matter of fact Winetech coordinates and supervises internal and external promotion.

#### **3.4.2. Strong Home Markets**

While the South-African wine sector should consider the international market as its primary target for future development, it should also develop its domestic market, because an effective international marketing strategy starts with local success! Specific proposals for developing the wine sector are (Spies, 1999):

- Extensive and comprehensive market research and business intelligence services;
- The development of marketing competencies within the industry;
- The development of marketing assets such as brands, advertising, promotion, reputation, logistic systems, etc;
- A central effectively financed marketing service: Wine of South Africa (WOSA) exists, independently of Winetech or "Vision 2020", and

- A comprehensive 'wine-tourism' scheme.

### **3.4.3. Economic Policy Framework within a Market Economy**

An attempt to generate a strong domestic growth market presupposes that the economic and political framework conditions are fair. A vision of creating a highly effective and globally competitive wine industry in a poor unstable South Africa is not realistic. Fair economic framework conditions would notably comprise the rule of law, democratic institutions, protection of foreign investment and property in general, easy access to credit, low taxation, light handed regulation, regulatory self restraint and particularly strong containment of corruption (Gerber, 1994).

### **3.4.4. Selected Niches**

It seems highly plausible that South Africa can make significant inroads in selected niches of the world market because of (Spies, 1999):

- The smallness of the South African wine industry within a global context, the possibilities of its rich ecology and the characteristics of the global wine market;
- The fact that wine drinkers like new experiences and that there always will be a demand for distinctively South African wines of assured quality;
- Significant export successes over the past six years, even without the benefit of a 'Brand South Africa', and without a coherent international marketing and quality assurance strategy; and
- The quality of its infrastructure, its traditions, its technological ability and its professional resources.

### **3.4.5. Professional Entrepreneurial Management**

The essential prerequisites for good international business in the wine, brandy, grape juice and concentrate sectors of the industry, in other words, the prerequisites for professional entrepreneurial management of companies are (Spies, 1999):

- Market driven and quality focused;
- Cost-effective through total value chain management and total logistics;
- Innovative, adaptive and increasingly competitive through market focused research and management of technology;
- Information bonded and learning oriented; and
- Socially responsible.

#### **3.4.6. Quality and High Price Strategy**

The South African wine industry does not primarily look for competition based on low price segments. Instead, it aims at a consistent customer and market orientation towards central and high price segments. Key elements of this quality and high price strategy are (Spies, 1999):

- Analysis and understanding of the markets;
- Development of growth and competition strategies;
- Marketing strategies;
- Communication;
- Co-ordination of the industry;
- Development and management of brands.

#### **3.4.7. Technological Development**

Finally, technological development is the basis of sustainable international competitiveness, and thus creates lasting profitability of an industry. But the real meaning of technological development is not just that there is a continuous improvement in the application of technological artefacts. Technological development is a continuous improvement in the system of competencies within the wine industry. It is a continuous improvement in human ability to always apply the best processes, procedures and technological artefacts; to be an innovator in product technology as well as to act purposefully and appropriately in terms of what the situation demands and in terms of a clear exciting vision of what can and should be done.

In fact, technological development is an extension of broad based human development, without which the sustainability of the technological progress will be compromised. Accordingly, an industry with a poor human development record cannot be an effective global player in a world that nowadays depends on human competence. Competence means to have the ability, desire, energy, insight, understanding and wisdom of doing the right things at the right time in the correct way. It requires the enthusiastic participation of developed skilful people in a quest for excellence. It also needs a supporting and understanding political, institutional, social, and wine industry environment – nationally, regionally and locally (Spies, 1999).

### **3.5. Industrial Policies and Trade – Achieving Win-Win?**

The case for liberal trade and investment flows and elimination of restrictions on the international economic exchange, both in the field of goods and services, rests on solid foundations. One of these is the fact that when individuals and companies engage in specialisation and exchange, a country will exploit its comparative advantage; another is the preference of people for more, rather than less, freedom of choice. In addition, exposure to open international exchange of goods, services and investment flows is a powerful stimulus to efficiency. Efficiency, in turn, contributes to economic growth and rising incomes. Results speak for themselves. Normally countries that have been more open have achieved double the annual growth of others (OECD, 1998:10).

Despite the fact that open trade and investment produces overall gains, some citizens, communities and political entities (often concentrated in particular sectors, such as agriculture and grape growing) experience adjustment pains and income losses as a result of liberalisation. Protecting certain sectors, such as the wine industries, and the concerned stakeholders by raising trade barriers or by unfair regulation, by granting subventions or by promoting certain heavy government induced industrial policies in most cases leads to rising prices of both imports and domestic production and places a heavy burden on consumers (OECD, 1998:12). CAP has been estimated to cost an average family of four around US \$1500 a year in artificially higher prices. This is the indirect cost to them as consumers; they are then charged a further US \$100 per head as taxpayers to subsidise farmers directly. According to estimates by the Government of New Zealand, consumers and taxpayers

transferred some US \$350 billion to OECD agriculture through a variety of border measures and domestic price support policies – a sum which is enough to pay for each of the OECD's 41 million dairy cows to fly first class around the world one and a half times (OECD, 1998:139–140).

As protection does not deliver what it promises and all concerned parties are bound to lose in trade and investment wars, there is a need for (Bhagwati, 1988):

- Proper adjustment policies responsive to concerns about distributional issues and transitional costs arising from that adjustment;
- Permanent efforts to avoid or phase out protectionist responses.

Done properly, liberal trade and investment are, and must be seen as being, not only about prosperity and greater freedom of choice but also about fairness. This means addressing the concern for the welfare of all citizens and all socio-economic entities. Fairness means that general interests prevail over special interests and those special interests are combined in win-win solutions (Bhagwati, 1988).

In dealing with the subject of trade in wine and geographical indications in the relationship between South Africa and the EU, three sets of particular issues are addressed here: First, under what circumstances do industrial policies lead to trade friction? Second, how can one achieve win-win solutions in combining the interests of concerned parties, notably in the thorny case of geographical indications? Third, is there a sustainable international regulatory framework that contributes towards minimising trade problems and helps to optimise fair trade and welfare creating opportunities?

### **3.5.1. Industrial Policies and Trade Friction**

'Industrial policy' can be defined as comprising measures which aim to facilitate and promote processes of industrial adjustment. There are measures that are indeed in conformity with a liberal market economy, such as the creation of a professional labour force, easy access to capital and credit and a fiscal policy that does not distort the mechanism of offer and demand. And there are special measures of a more interventionist nature, such as incentives for promoting special sectors or products (tax, rebates, cheap real estate or other targeted

governmental incentives for preferential economic activities). Notably the latter form of industrial policy is not viewed with favour, and there is much opposition to policies aimed at slowing down the process of structural change or keeping alive declining sectors. Positive industrial policies that are meant to accelerate structural mutations, e.g. with regard to innovation and the adjustment to high tech developments, are equally condemned, unless they are phased out in a transparent way (OECD, 1998).

In a way, those involved in the initial calculations of the gains from tariff removal had it easy: everyone knew that the gains were positive, and only the magnitude remained to be determined. This iron-clad rule has been challenged by the recent theories of imperfect competition and trade, which suggest various ways that a country may gain through the use of strategic trade policy (Grossman & Kenneth, 1995). It became discernible in the preceding parts of the present chapter, that the EU's CAP and particularly the new CMO may comprise a number of protectionist elements and that it will depend upon the details of South Africa's "Vision 2020" to what extent this strategy for the wine industries could be regarded as a protectionist industrial policy or an entirely legitimate economic adjustment scheme (Nickening, 2001:15-17).

### **3.5.2. Win-Win Solutions: Matching Objective Interests**

At first glance, creating win-win solutions is not easy. The EU handles 2% of its foreign trade with South Africa. In comparison, South Africa exports 50% of its total exports into the EU (European Commission, 2001). At present, the negotiation tactics of the EU consist of permitting, if possible, only few exceptions from restrictions in foreign trade. In trade in wine with South Africa, for instance, the EU rejected a fully fledged preferential arrangement. Behind this attitude looms the fear of creating precedents and exposing the EU to threatening competition in a field where the EU is still successful although this success may be unsustainable. Unfortunately, this stance is not a good opening position for developing mutually beneficial trade and matching the interests between South Africa and the EU – taking into account the need to overcome a number of structural problems. In addition, what happened to the expectations and promises given to compensate South Africa in due course for its change to democracy and human rights in 1994 (Sauer, 1997)?

To come to a compromise in trade policy, it is expedient to understand the objective interests of both sides. The notion of interest is not generally defined and thus open to different interpretations. Normally we might call interest what we perceive as the rational driving force of an action. Objective interests are those interests that would be agreed upon under circumstances of full transparency of information (Sauer, 1977). Part of the objective interest is 'enlightened self-interest'. Enlightenment in this case means fundamental compatibility with the interests of others. It is obvious that in the longer term nobody has the motivation and energy to go on fighting against others. There are moments of weakness or of deeper reflection. In these circumstances one is grateful if other people or entities may become the drivers (or co-owners) of our own interests instead of having to resort to coercion or even destructive action.

In some cases objective interests might have to be pushed through and then imposed on others. However, most of the time objective interests are rather accepted in harmony because of their very nature of being objective (i.e. reasonable and legitimate for varying observers). Thus, it is necessary to determine the objective interests, to create a win-win situation, where both parties have a good chance to realise their interests. In the field of trade in wine it is the objective interest of the EU and its wine industry (Sauer, 1997):

- To become so cost-effective, quality-conscious and customer-oriented that global market share is not only maintained but further increased;
- To remove trade obstacles in third import markets;
- To protect European industrial property rights, notably designations of origin.

Following the same reasoning, it apparently is the interest of South Africa:

- To use and strengthen its competitive advantages to become a world leader in the production and marketing of wine particularly in the high quality range;
- To open foreign markets for South African wine products;
- To establish a reputation as a strong and fair trade partner by living up to the norms of the WTO (GATT, GATS and TRIPS) and other multilateral schemes such as the World Intellectual Property Organisation (WIPO);
- To have strategic partners, such as the EU, for successful economic, social and political development.

South African authorities and the South African wine industry assume that the world wine market will grow around two to three per cent annually. For the domestic market a growth objective of around five per cent has been established (Nickening, 2001:36). In assessing its strength and weakness in terms of competitive abilities with a view to reach established growth objectives, it became clear that innovative creativity must be combined with qualitative capacity and international competitive ability. In terms of quality, the South Africa wine industry will specialise even more strongly in the segment of fine or high quality wines and will pay less attention to the segment of everyday life wines. Branding pertaining to qualitative high grade wines is perceived as becoming even more a key to success in a globalising world. The interest of the South African wine industry thus is to be found in a consistent customer and market orientation in the central and high price segments of wine (premium wine). This would allow South Africa to benefit from its competitive advantages (climate, terrain, experience in wine making, cheap labour, close to optimum average size of wine estates and increasing knowledge of foreign markets).

In contrast, the EU is composed of 15 Member States. The latter often have varying interests in production and trade in wine and spirits. Spain, for instance, has the most extensive wine growing areas in Europe, though France and Italy produce substantially more wine than Spain. The other EU wine producing countries are, in descending order of average wine production, Germany, Portugal, Greece, Austria, Luxembourg, the United Kingdom and Belgium. All these countries had politically to agree to a common definition of EU policies pertaining to wine, i.e. common interests and common strategies. For instance, they had to accept that wine produced within the EU is designated either as Table Wine or Quality Wine, the latter having to come from a specified, registered geographical region. Each country has its own system of definition. Wine imported into the EU, known as Third-Country Wine, must conform to European wine law and may not be blended with wine made within the EU.

The EU negotiates agreements and arrangements on trade in wine with other countries on behalf of EU member states. This means that the EU has certain expertise in establishing the common interests of its member countries and matching this common interest with third parties' interests. In 1993 for instance, it concluded agreements with Australia, Bulgaria, Hungary and Romania pertaining to wine industries and trade in wine. These agreements include many important items such as reciprocal protection and control of wine

denominations, and tariff quotas. Australia, for instance, agreed to phase out the use of generic names, such as “Champagne” and “Chablis”, while France and Italy agreed to stop using the term Tokay, now exclusively reserved for Hungarian wines. In 1999, negotiations were under way with New Zealand, South Africa, Slovenia and Switzerland. Until accords are concluded with a third country, it may not export sweet wines with a potential alcohol of more than 15% to the EU, which for example precludes Botrytized wines from South Africa. In addition, the designation “sherry” and “port” is, as explained already, a problem between South Africa and the EU (Robinson, 1996:265-266).

The trade case clearly shows that South Africa and the EU do have a common history and, more precisely, that there are common oenological traditions and methods in wine-making. It was only natural that an attempt was made to engage these common interests in a South Africa EU FTA. Today, it is in the interest of both parties to come to an early solution in the difficult field of geographical indications. However, since the termination of the last GATT Round and the creation of the WTO, basic conditions for international trade have become more attractive than ever before. More and more countries have become full partners in world trade. On the list of wine exporting nations, to whom 75% of world exports are allotted, new names increasingly emerge (Verband Deutscher Weinexporteure, 2000). This development underlines the urgency of the question to what extent bilateral solutions of trade issues should be enhanced or even supplanted by sustainable multilateral schemes that would optimise fair trade and welfare creating opportunities.

## **Chapter Three**

### **1. Towards Mutually Beneficial Trade in Wine?**

The interest in intense and prosperous trade relations concerning wine and spirits seems to exist in the mind of many decision-makers in South Africa as well as in Europe. However, some thorny problems remain, particularly with regards to the issue of geographic designation. Which solution should be focussed upon to meet the objective interests of both South Africa and the EU concerning trade in wine? There is no denying the fact that, first and foremost, possible answers have to take the existing multilateral trade system, including its instruments and practical application, into account. Hence, how can the present world trade order be characterized? What are its cornerstones?

The economic rationales for the existing trade order are, firstly, the concept of comparative advantage and, secondly, norms and rules *at usus*. Concerning the first aspect, Ricardo's ideas have revealed the existence of comparative advantage amongst economically active nations, which promote mutually beneficial cooperation but also evoke the opposite, being comparative disadvantages (Jackson & Davey, 1990:11-13). These aspects are common knowledge and, thus, will not be elaborated upon in more detail. Concerning the second aspect, multilateral treaties entail the agreed upon conditions in which trade can take place. In general, multilateral treaties are binding on more than two parties.

Some multilateral trade treaties introduce a general trade regulation between the contracting states. Many of those multilateral treaties entrust certain powers in respect of international economic exchange, notably trade and finance, upon specialised international organisations. Other multilateral treaties seek to unify the national laws of the signatories in order to achieve a speedier conclusion of international trade and finance transactions. Sometimes a state can make a so-called reservation in respect of a particular treaty provision when it enters into a multilateral treaty. If this reservation is valid the treaty provision for which the reservation is made, will not apply to that state (Houtte, 1995:3-12).

## 2. The Origin of WTO: GATT

GATT was signed in 1947 during the course of broader negotiations, which aimed at establishing the International Trade Organisation (ITO) (Winters, 1999:35-41). The ITO was to constitute the third leg of an international economic triad consisting of the International Bank for Reconstruction and Development (World Bank) and the International Monetary Fund (IMF), as well as to execute extensive power over trade and 'real' economies of its members. In the end these issues proved so contentious that the ITO<sup>15</sup> was not ratified, notably not by the Senate of the United States. While negotiations were proceeding, twenty-three countries wanted to get on with liberalising trade, the main reasoning being that many industrialised countries suffered from declining competitiveness. Asian and South American emerging economies in particular had started to produce much more efficiently and thereby out-competed the industrialized world. Additionally, another type of restriction had become popular: a number of government measures aimed at hindering the free movement of goods, such as anti-dumping measures, voluntary self-restraint agreements, and restrictions in the trade in services, import licenses and national safety standards. Thus, so-called non-tariff barriers undermined free trade.

The promoters of a liberalized trade order agreed upon a set of mutual tariff reductions and signed the General Agreement on Tariffs and Trade (GATT), which became effective in 1948. It was a temporary measure, which was merely designed to codify and sustain tariff reductions, desired in their own right. Despite its original purpose, it developed into the world's main trade agreement. The signatories became known as contracting parties that were to enter into reciprocal and mutually advantageous arrangements directed to the substantial reduction of tariffs and other barriers to trade and to the elimination of discriminatory treatment in international commerce.

Overall, the treaty was rather vague, particularly with regards to the question of how the agreed upon objectives could be achieved. Moreover, it provided for weak enforcement mechanisms only. Still, it specified two important precepts for a liberal trade order: the most-favoured nation (MFN) principle, which prescribed that every trading partner was treated

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<sup>15</sup> UN Conference on Trade and Development, Havana, Cuba, 21 Nov. 1947 to 24 March 1948, Final Act and Related Documents, Havana/Cuba.

equally,<sup>16</sup> as well as the principle of non-discrimination, which required that all imports should receive equal treatment with national goods, once they had crossed borders.

The bulk of GATT dealt with circumstances under which these precepts could be violated. For example, customs unions were allowed to grant mutual tariff preferences, less-than-fair-value trade was allowed to be taxed, and export subsidies were allowed to be granted for agricultural products. The treaty also constrained governmental attempts to withdraw or undermine tariff concessions. Once a tariff had been fixed, it could only be questioned in an arduous negotiating procedure and under compensation for the involved parties. Similarly, emergency protection had to be temporary and non-discriminatory, import quotas were generally prohibited and customs procedures had to satisfy elementary concepts of fairness (Winters, 1999: 35-41).

With regard to intellectual property rights (IPRs), such as patents, copyrights or trademarks which could be used as useful protection for monopolies or certain market segments, and hampered technology transfer into developing countries, GATT included Article XX (d) against misleading practices. Nevertheless, the article, being an exemption clause, demonstrated that IPRs were still considered to exist and to represent an exception to free trade (Peifer, 1996:101-105).

### **3. The WTO**

The WTO became the successor of GATT. On 15 April 1994, the WTO Agreement was signed in Marrakech with the negotiations having closed a month earlier (WTO, 1995). The primary achievement of the negotiations was the establishment of the WTO as a parent organisation for the newly institutionalised trade order. All agreements were binding for WTO members, particularly the principles of non-discrimination and MFN. In addition to its multilateral features, the fourth annex to the WTO Agreement contained plurilateral agreements, which were binding to selected parties only.

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<sup>16</sup> It is important to notice that GATT contains exceptions to the MFN principle for custom unions, free trade zones and for developing countries (Houtte, 1995).

With regard to important changes agreed upon as fundamental to the rejuvenated world trade order, the so-called 'single package' approach needs to be emphasised (Jackson, 1996). While previously the contracting parties could single out specific interests, the single package approach forced countries that were interested in signing GATT either to bind to the WTO Agreement as a whole or to refrain. Moreover, the new agreement recognized the relevance of IPRs to conduct fair trade while, previously, GATT had declared IPRs exceptional to the principles of free trade. Hence, the inclusion of IPR as a significant part of fair trade caused important changes in the concept of free trade (Peifer, 1996:106-109).

The WTO thus became an international organisation with legal personality in contrast to the legal status of GATT prior to 1994, which purely operated as a multilateral and provisional agreement under the auspices of a failed attempt to establish an international trade organisation under the Havana Charter in the late 1940s (Beier & Gerhard, 1996:18-21). The Uruguay Round strengthened the institutional structure for the application of improved substantial principles. At this stage, several general characteristics should be mentioned (Jackson, 1996:35-37):

- The WTO can be described as a mini-Charter. It is devoted to the institutional and procedural structure that facilitates, and in some cases is necessary for, effective implementation of the substantive rules that had been negotiated in the Uruguay Round. The WTO is not the international trade organisation which the draft of the Havana Charter had suggested. It is entirely institutional and procedural and incorporates substantive agreements resulting from the Uruguay Round in the annexes of the WTO Agreement.
- A number of birth defects of the former GATT could be 'repaired'. The WTO continues the institutional ideas and many of the practices of GATT though in a more public-friendly and feasible way. For example although the WTO Agreement expressly states that it is guided by "decisions, procedures, and customary practices" of GATT it defines the practice of consensus wholesomely and thereby transfers its status from practical application into a legal procedure.
- The WTO Agreement authorizes a Secretariat, a Director-General and other institutions such as the General Council. Their functions and operational activities are designed in accordance with other international organisations, for instance, member states are obliged to avoid interfering with officials of the WTO.

Moreover, the WTO includes a dispute settlement mechanism and the Trade Policy Review Mechanism.

- The WTO Charter offers better opportunities for future evolution and development of the institutional structure for international trade co-operation. Even though the WTO Agreement is minimalist the provision for explicit legal status and the traditional organisational structure is an improvement. Since the WTO focuses on the institutional side, it also offers more flexibility for future inclusion of new rules or measures, which assists nations to face continually emerging problems of trade between various countries.

### **3.1. Decision-Making Procedures at the WTO**

The governing structure of the WTO differs from previous enactment substantially – though said to be closely designed to GATT prior to 1994. At the top of the decision-making process, a Ministerial Conference is held not less than every two years. Next to these meetings, four councils deal with trade related issues each. Amidst them, the General Council appears to have overall supervising authority, not least because it carries out functions, agreed upon by the ministers. The General Council presumably meets at least as often as the council of GATT did prior to 1994. The remaining three institutions are designed according to Annex 1 of the WTO Agreement. Hence, one council is preoccupied with trade in goods, a second one with trade in services and a third one handles trade-related aspects of property rights.

Next to the councils the Dispute Settlement Body (DSB) supervises and implements the dispute settlement rules that have been set out in the WTO Agreements. Also, the General Council is authorised to perform DSB tasks. Finally, a body for Trade Protection Review Mechanism incorporates a control function. These measures are necessary in order to raise the costs of *détente*, for instance to execute accepted retaliation, i.e. if a country ignored its WTO commitments and raises its rates above MFN rates, every member of the WTO would have the right to claim for compensation, or, in case this is not agreed, to retaliate up to the value of the trade loss. Finally, all WTO members are obliged to inform on any new trade commitments that have been established bilaterally or multilaterally. This prevents secret arrangements and, hence, supports the principle of non-discrimination. In this respect, the

principle of non-discrimination extends to all aspects of the WTO, not just tariffs, and reduces the costs of information transfer.

Some allegations that the WTO undermines state sovereignty have caused and still cause anxiety. As a matter of fact, the WTO indeed works on the basis of an elaborated matrix of decision-making procedures but simultaneously these bound the work of the organisation significantly.<sup>17</sup> In essence, there are five different techniques for making decisions or formulating new or amended rules of trade policy within the WTO: firstly, amendments to the agreements, secondly, decisions on various matters, thirdly, “interpretations”, fourthly, waivers and finally the negotiation of new agreements (Jackson, 1996:35-37).

A careful examination of the WTO Charter reveals that - apart from the inclusion of relevant new issues – the WTO does not have more ‘real’ power than its predecessor. By contrast, the wording of the former GATT treaty was ambiguous and could have been misused – but fortunately was not – in order to extend powers beyond those assigned to the WTO. In view of this shortcoming of GATT, considerable attention has been devoted to the WTO Agreement and certain constraints have been added, such as increasing the voting requirements for certain actions or the provision that a country will not be bound by an amendment that it opposes due to the amendment altering “the rights and obligations of the members”. Moreover, abuse of the waiver authority seems to be almost impossible under the current provisions. Finally, formal interpretations should not be used in a manner that would undermine the Agreement.

With regard to the integration of rules for agricultural trade into the WTO, the first steps were taken at the Uruguay Round. For forty years, agricultural issues had been largely excluded from negotiations and debates within GATT due to a number of waivers that were granted in earlier years at the insistence of the United States. By the mid-1980s, large and growing expenditures on export subsidies and domestic support for farmers combined with the extensive use of non-tariff barriers against agricultural imports had severely distorted the international markets for agricultural goods and had led to a virtual trade war between the EU and the United States, which threatened to spill-over into non-agricultural trans-Atlantic trade. In an attempt to relax the dispute, it was agreed that agriculture would be put on the agenda of the Uruguay Round.

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<sup>17</sup> In a world of increasing interdependence the definition of sovereignty needs to be clarified in any case.

Succeeding negotiations became most difficult and caused time-consuming meetings, culminating in the Uruguay Round, which lasted from 1986 to 1993. With the establishment of the WTO, some agricultural issues were included, others were expected to be included after an unspecified transition period, but a substantial amount did not find their way into new arrangements. To bring closure to the Uruguay Round, it had been agreed that negotiations on outstanding issues would be discussed again in 1999, irrespective of whether a new “Millennium Round” would take place. In November 1999, the WTO ministers met in Seattle but failed to agree upon an agenda for a general round of trade talks. The objective of a new round has not been abandoned yet and attempts are still being made to establish the agenda (Kerr, 2000:123-132).

It is generally accepted that only the easiest agricultural issues were resolved in the protracted Uruguay Round negotiations, not at least because of politicians continually insisting on the right to protect the domestic industry. Although this *détente* situation was incorporated into bilateral and multilateral consultations throughout the history of GATT and the WTO by imposing exit costs when commitments were ignored and cooperation was refrained from, difficult issues remain untouched. Complex questions, such as regulations pertaining to trade in genetically modified organisms, made negotiations become even more difficult, which were already expected to be long and acrimonious.

In a prospective general Millennium Round of the WTO negotiations, concessions in agriculture can be traded off against concessions in other areas of international trade, which will attach a much broader dynamic to the negotiations. Trade-offs made between sectors will probably result in progressive liberalisation in agricultural trade. If negotiations are confined to agriculture, countries will have less ability to move and progress is likely to be slower and, in the end, more limited (Kerr, 2000:123-132). However, cross-sector trade-offs may weaken the impact of sector specific trade organisation and business confederations considerably. With this background in mind, it is now expedient to analyse the additional components of the WTO Agreement in order to understand the significance of the WTO for international trade in wine.

### 3.2. GATS

One of the major goals of the United States in promoting a new round of trade negotiations in the early 1980's was to include trade in services in the arrangements. Washington's plans were opposed by some leading developing countries, such as India and Brazil. In the end, the General Agreement on Trade in Services (GATS) found entrance into the WTO Agreement. Trade in services is defined as the supply of services from the territory of one member to another, in the territory of one member to a consumer of another member, and by a service supplier of one member through commercial presence or the presence of natural persons in the territory of another. Hence, GATS extended the MFN and non-discrimination principles to services. However, GATS is subject to significant exceptions. Members are permitted to specify exemptions from the MFN obligation before entering the agreement. In principle, these exemptions are not to exceed ten years and have to be negotiated continually (Pescatore et al., 1998). Hence, although GATS leans to GATT, it is less rigorous than the latter. Future negotiations will have to wrestle with the problem of how to make GATS become more effective.

### 3.3. TRIPS

In many respects, the inclusion of TRIPS is a novelty within the international trade system. It is not only the most encompassing arrangement, which includes minimum standards of protection, building on existing conventions, in all the main areas of intellectual property, such as copyright, trademarks, geographical indications, industrial designs, patents, the layout designs of integrated circuits, and undisclosed information, including trade secrets, but also deals with substantive standards of protection and enforcement procedures. As part of the WTO Agreement, it has given voice to the Paris Convention for the Protection of Industrial Property and the Berne Convention for the Protection of Literary and Artistic Works by introducing IPRs into international trade law. Moreover, the integration of certain enforcement mechanisms acknowledges the importance of IPRs for national economies and international markets (Correa & Yusuf, 1996).<sup>18</sup> In this respect, TRIPS has become an almost

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<sup>18</sup> In practice many enterprises have realized the growing reliance on high-tech trade and trade with high-value products. Many of these products, including patented pharmaceuticals and agro chemicals, copyrighted computer software, films and videos, and trademarked watches, clothing and perfume, can be copied or reproduced with relative ease in the absence of legal restrictions (Keon, 1997:175-177).

universal IPR agreement (Drexler, 1996:18-19).<sup>19</sup>

The TRIPS Agreement is managed by the WTO and does nothing but incorporate the Berne Convention<sup>20</sup> into the treaty. But the original Berne Convention is still in force and is administered together with the Rome Convention<sup>21</sup> by the World Intellectual Property Organisation (WIPO) (WIPO, 2002). Hence, the negotiations on TRIPS were one of the most important elements of the Uruguay Round, not least because they were to contain specific rules for agricultural trade, notably protection clauses for wine and spirits. It is not surprising that negotiations on the formulation of TRIPS reflected the North-South cleavage. In general, intellectual property was mostly owned by Northern countries, most of them having had comprehensive systems already for the protection of intellectual property in place prior to 1994. In contrast, developing countries owned much less and thus did not need extensive IPR protection systems. Hence, at Uruguay the dispute devolved around Southern countries considering existent IPR mechanisms being sufficient and Northern countries being concerned about piracy, which, as research had confirmed, generally originated in or targeted developing countries. With the establishment of the WTO, the Northern countries' concern was taken into account; however, several exemptions were made to somehow balance the temporary disadvantage for developing countries.<sup>22</sup>

Today, many if not most legal systems monitor the protection of IPRs within their frameworks of competition policies. This practice is essential because competition law ensures that the grant of exclusivity, which is inherent to IPRs, is not misused by being incorporated into cartels and market-sharing arrangements or by other monopolistic practices. Thus, most licensing arrangements are viewed as beneficial to competition, particularly when licensors are not competitors. Furthermore, they introduce new competitors into existing markets and help to diffuse inventions throughout the economy. Nevertheless, a licensing

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<sup>19</sup> However, it has to be noticed that neither new information technologies nor technological improvements related to the transmission of information are covered by the conventions in force (Bercovitz, 1996:145).

<sup>20</sup> This convention dates back from as early as 1886, protecting literary and artistic work and establishing the principle of national treatment.

<sup>21</sup> Established in 1961, this treaty envisages the protection of performers, producers of phonograms and broadcasting organizations and establishes the neighboring right system. Under the Berne Convention these persons could not get protection because the Convention only protects artistic and literary works. Under this regime (which in full is named "neighboring rights on copyright") these works can get ("copyright") protection if they are not a copy of a previous work and if they are the result of a planned activity.

<sup>22</sup> For ratifying TRIPS, developed countries were given a one-year period from the date of entry into the WTO while developing countries were given a five-year transitional period with an added five years for subject matters not having been protected previously. LDCs could realize their IPR obligations within a period of eleven years.

agreement can be used to conceal market-sharing arrangements or it can be incorporated in a scheme to prevent new technologies from entering a specific market (Anderman, 1998:5, 6).

### **3.4. Objectives and Principles of TRIPS**

Additional to the principles of non-discrimination and MFN (Reichmann, 1995), objectives (Article 7) and principles (Article 8) were outlined in the preamble of TRIPS under strong lobbying of developing countries that insisted on the link between the protection of IPRs and the promotion of social and economic welfare. With regard to objectives, a group of 14 developing countries were interested in reducing the distortions and impediments to international trade, in promoting effective and adequate protection of IPRs and in ensuring that IPR enforcement mechanisms did not automatically become barriers to legitimate trade. Furthermore, the developing countries' emphasis of public policy playing a leading role in the development of national IPR systems was expressed by Article 7 as well as in those rules, which either concerned availability, scope and use of specific IPRs, such as copyright, patents, trademarks, etc., or conditions, exceptions and limitations. However, least developed countries (LDCs) only were allowed to exercise maximum flexibility in the domestic implementation of IPR laws and regulations.<sup>23</sup>

In sum, the objectives form an important framework for the interpretation and application of the provisions of the TRIPS Agreement. They provide the overall criteria that guide the adequacy and effectiveness of national legislation for the protection and enforcement of IPRs. As such, they are meant to inspire and furnish the basis upon which IPR legislation should be enacted at the national level. In combination with Article 8, they have equipped developing countries 'with legal bases for maintaining some degree of domestic control over IPR policies in a post-TRIPS environment' (Abdulqawi, 1996:12-14). Accordingly, what is the contribution of Article 8?

In essence, the principles outline measures aiming at the prevention of IPR abuse and fix what may be called the principle of 'public interest'. The latter permits member states to protect

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<sup>23</sup>The distinction between states and developing states is further elaborated upon in Part IV of the TRIPS Agreement, on transitional arrangements, whereby the least developed countries are singled out for special treatment, both in the application of the provisions of the agreement and in the promotion and encouragement of technology transfer.

public health and nutrition and to promote public interest in sectors of vital importance to socio-economic and technological development as long as they conform to the multilateral agreement. Hence, TRIPS obligates members to adopt certain minimum standards<sup>24</sup> and simultaneously attempts to harmonise them with national legislation. What scope for flexibility for the individual state remains?

Exceptions to the minimum standards can be made on the pretext of public interest. Still, basics of TRIPS cannot be undermined because these interests have to be in line with 'TRIPS consistency' or in other words public interest has to be uniform to the provisions of the agreement as a whole. Particularly with regards to the definition of socio-economic and technological development, the consistency clause was necessary in order to somehow control the broad nature of public interests. Therefore, the limitation provides for a yardstick in disputes, albeit general and somewhat vague because it has remained unclear how such measures may be approached. In this respect, Article 8 offers a considerable degree of legislative flexibility to member states. With these basics in mind, it is now possible to reflect on the parts of the TRIPS Agreement that posed a barrier to EU-South African negotiations on trade in wine.

#### **4. The Significance of Geographical Indications**

The Madrid Agreement on the Repression of False or Deceptive Indications of Sources on Goods of 1991 dealt with procedures and seizures on importation in the EU of any product bearing a false or deceptive geographical indication. Additionally, bilateral agreements extended the scope of this provision but the international level was not reached (Kunze, 1997:54–57). During negotiations on TRIPS, the issue was reconsidered and caused tension, this time not between trans-regional blocs but between Europe and South Africa. Indeed, as the South African delegation had argued TRIPS, once it was agreed upon, favoured the European wine industry because it ultimately benefited from any further protection beyond the general standards that had been established already. However, while articles 22, 23 and 24

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<sup>24</sup> The minimum standard is the norm to which all states have to comply in order to participate in international economic transactions. Recent treaty practice emphasizes more and more the non-discrimination principle. Hence, if the treatment of its own citizens does not comply with this minimum standard, the minimum standard will be downgraded for all other states. Similarly, relations are to be maintained in a fair, reasonable, equitable and adequate manner by individuals and states.

of TRIPS demarcate geographical indications, article 24 additionally offers permissible exceptions to the protection mechanism (Abbott et al., 1996:185-187).

Geographical indications are defined as territorial origin of a given quality, reputation or other characteristic which is attributable to the location (TRIPS, Art. 22, §1). An indication of source is constituted by any denomination, expression or sign indicating that a product or service originates in a country, a region or specific place (for instance, “made in ...”). Here, no particular quality of the product is legally required. As a general rule, the use of false or deceptive indication of source is unlawful. An ‘appellation of origin’ is constituted by the denomination of a country, a region or a specific place that serves to designate a product originating there, the qualities of which are due exclusively or essentially to the geographical environment, in other words to natural and/or human factors.

A link to the quality of the product and the locality is required. Generally, the use of an appellation of origin is lawful only for a certain circle of persons or enterprises located in the geographical area concerned and only in connection with the specific products originating therein (i.e. Chianti, Bordeaux). Indications of source and appellations of origin provide exclusive rights that allow for prevention and remedy against the deceptive use of local names and the use of geographical names in connection with a product unrelated to that region (Abbott et al., 1996:185-187). Traditionally, geographical indications fulfilled two main functions:

- The promotion of products having certain characteristics is of considerable benefit to the region or area where the products are manufactured and to the area where they are marketed. Geographical indications protect producers of these regions or areas against unauthorised exploitation of the goodwill created by the quality of the products and the advertising appeal of the respective locality or region by competitors and their products. Entire sectors, such as wine growing, depend upon effective protection of geographical indications.
- Geographical indications are important sources of information for the consumer in an increasingly diverse market as to the origin, quality and reputation of a product. Moreover, the quest for specialised product generates a growing demand for products having an identifiable geographical origin.

The concept of geographical indication essentially originated in Europe where it has mainly been related to agricultural products and foodstuffs, eventually expanding to certain industrial products. In other parts of the world, recognition of rights relating to geographical indications is far more restricted. Hence, law on geographical indication was not uniform; instead, it varied from one country to another. Many products in the 'New World' and 'Third World' bear traditional European names. While some nations specifically recognise such title, others, for instance the U.S., protect the function of geographical indication under general trade mark law, which prohibits deceptive use of geographical names. In addition, these functions can partly be assumed by collective marks and so-called guaranty marks, which assure certain quality of the product bearing such names by the imposition of regulatory controls. Moreover, the field of geographical indications increasingly overlaps with labelling requirements which, imposed or voluntarily, may indicate geographical origin or the quality or methods of production. Finally, the legal relationship between geographical indication and rules of origin, used to define the origin of a product for purposes of tariffs and other trade policies, raises difficult and unsettled issues.

#### **4.1. International Harmonisation**

The field of geographical indications is subject to increasing regional harmonisation, in particular within the EU. The EU Council has issued a regulation on the protection of geographical indications and designations of origin for agricultural products and foodstuffs. The regulation lays down a procedure for the registration of a designation of origin or a geographical indication. First steps toward establishing common international legal rules regarding geographical indications were also taken in the TRIPS Agreement within the WTO. Geographical indications are regularly conferred nationally or internationally following a formal procedure of registration. In some countries such rights exist without registration. In international law, protected geographical names usually are the object of bilaterally agreed lists of protected names. This is how legal security is achieved in distinguishing them from generic names in the countries concerned. In addition, there is one multilateral agreement on appellations of origin administered by WIPO, namely the Lisbon Agreement for the Protection of Appellations of Origin and their International Registration. Only 18 countries, however, were party to the Lisbon Agreement as of April 1, 1999. Under the Agreement, the

contracting states undertake to protect appellations that are registered pursuant to the Agreement. There were 835 registrations of appellations as of April 1, 1999 (Abbott et al, 1996:185-187).

The general definition of geographical indication corresponds to the European Community Regulation on the Protection of Geographical Indications and Designations of Origin for Agricultural Products and Foodstuffs. But, as it neglects simple indications of geographical origin, it does not correspond to a situation existing in most member countries of the WTO. Furthermore, the EU proposal does not provide for any exclusive right to the owner of such geographical indications. Hence, potential conflict is a foregone conclusion.

Despite the significant shortcomings, the political lobby of European wine producers pushed through Article 23 and 24 of TRIPS, which in general covered enhanced protection of wine and spirits, and more specifically ensured Port, Sherry, Chablis, Burgundy, Bordeaux and Chianti a “European background”. While the pressures for special protection of spirits were not as forceful as those for wine, the first mentioned benefited from the final agreement, more precisely Grappa, Ouzo, Schnaps, Bitters and London Gin (Keon, 1997:175-177). According to the relevant sections, how is the protection of geographical indication ensured under WTO rights?

## **4.2. Relevant Articles in Brief**

In Article 23 §1 of TRIPS, member countries are obliged to provide legal or administrative means to safeguard and control abuse of geographical indications (World Trade Organization, 1999). This provision applies even if the true origin of the goods is indicated, if the geographical indication is used in translation or if it is accompanied by expressions such as “kind”, “type”, “imitation”, or the like. In general, member countries do not have to prevent their nationals from making continued and similar use of a geographical indication for wines or spirits unless the usage has been discontinuous and below a time limit of ten years prior to 15 April 1994 (Article 17 §4).

However, according to Article 23 §2, the registration of a trademark for a wine or spirit is to be refused *ex officio* if a member country has ratified a prohibition or if an interested party poses a request. In case of homonymous geographical indications for wines, protection can be

accorded to each indication, subject to the provisions of Article 22 §4 or each member country can determine the practical conditions under which the homonymous indications in question will be differentiated, as long as they conform to the principles of non-discrimination and MFN (Article 23 §2). While these rules are still somewhat transparent, Article 24 §2, §3 and §5 offer the opportunity to deny registration of trademarks on 'other grounds' provided that there is no derogation from the 1967 or Stockholm version of the Paris Convention. Furthermore, member countries can make registration dependent on usage albeit only after a period of three years after the actual application has expired. Finally, each trademark has to be published either before or promptly after registration and only a reasonable opportunity for petitions is able to cancel the latter.

Concerning the exemption section arranged in the agreement, Article 24 §3 provides that in implementing TRIPS and the section on geographical indication, a signatory is not allowed to diminish the protection of geographical indications that existed in the relevant country prior to 1995, hence, the far-reaching protections outlined in earlier agreements, such as the Lisbon Agreement or the EC Regulation, were amalgamated with the WTO Agreement. In case of trademarks conflicting with geographical indications following measures should not prejudice eligibility or validity of registering the trademark.

#### **4.2.1. Towards a Multilateral Register**

The EU has expressively supported a universal notification and documentation of geographical indications on the basis of a recognized multilateral register for geographical specifications for wines and liquor. It has been the task of the multilateral trade system to set up an obligatory register, which directly applies to all WTO members. As a result, the type of bilateral negotiations that the EU has conducted with third countries so far in order to protect European wine and liquor designations would become less important. Under the proposed scheme countries would be obliged to notify their respective products or indications to be entered into the register before a fixed date to be determined (European Commission, 2000c). Presumably, negotiations on a multilateral register will take place in 2003. The multilateral register is currently still a negotiation position favoured by the EU; therefore, bilateral agreements need to be concluded in which European interests can be anchored.

## 5. The Bilateral Solution

In order to come to a solution for the protection of designations with trade partners, the EU has followed a strategy of requesting bilateral agreements with the relevant countries. The mechanism of protection supported in this type of agreement is based on a list system. The lists are arranged according to product groups for instance “wine and liquor”. They contain the geographical specifications of each contracting state. The specifications are protected by regulations in each contracting state. The principle of “state reservation” applies. This means that a name may be used in the area of another contracting state, the protecting country, but only for goods from the country of origin and only in accordance with laws and regulations in the country of origin, in other words, protection of the substantive items on the list in another contracting state. The protecting state depends on the protection of the pertinent right in the country of origin.

This bilateral strategy has several advantages in comparison to a multilateral scheme. Firstly, the scope of the list differs from the protection in the Lisbon agreement, insofar that it is not limited to a certain category of geographical specifications, but takes into account all geographical indications of origin of the member states. Secondly, the scope and the modalities of the obligation to protect are not determined by the law of the protecting country but by the law of the country of origin (Knaak, 1995:642-647). Partly, these aspects contributed to the EU’s interest in a bilateral designation protection agreement with South Africa. Other aspects were the prospects for expansion of the protection to traditional designations, for a positive list of all protected designations, for a prohibition of generic references relating to geographical destinations of origin, for concrete rules for the use of homonyms of geographical designation, for *ex-officio* action (not only on demand), for the invalidation of trade marks that were registered before 1 January 1996, containing protected geographical specification or consisting of such specifications (European Commission, 2001). However, reconsidering the already mentioned conflict potential concerning geographical indications it is not surprising that disputes between the EU and South Africa exist. Some examples might illustrate the consequences resulting from the gap between theory and practice.

## 5.1. Geographical Name Calling

The present dispute over geographical indications becomes most evident in the so-called Cape copyright wars.<sup>25</sup> Well known by tourists and if asked allocated to the most Western coastal region of South Africa, wine from the Cape does not necessarily derive from the Western Cape region. At least in European shelves it could be confused with, for instance, Cape Clairault or Cape Mentelle, both located in the Margaret River vineyards of Western Australia. Are Capetonians now urged to launch a multi-million dollar campaign to copyright Table Mountain like the Swiss did with Eiger and Jungfrau? At least they need to be far more precise in future about where certain wines reside.

For years now, Brussels has been compiling a world register of wine terms, which specifies geographical origins, wine styles, alcohol strengths, vintages, wine varieties and vineyard names. In short, the fine print, which is to be standardized on all wine labels on the EU shelf from 1 January 2003, will be meticulously circumscribed by law. Furthermore, a recent EU memo already reserves “pre-existing trademarks”, which are expressions, i.e. Ruby, Tawny, Vintage or Amarone and certain bottle shapes, i.e. Bocksbeutel or Flute d’Alsace. From the European point of view, these developments only concretise what is anchored in TRIPS in any case. But, having followed the grappa, port and sherry debate at present, it has become clear that widespread disagreement over the terms of trade still exists. It seems as if Brussels continues to shift the goal-posts in the widening wine war between the old and new worlds.

The intended implementation of new rules and regulations is likely to stir up even more controversy. Wines bearing the indication ‘Western Cape’ have been allowed in Europe for many years and even the EU-South Africa Wine and Spirit Agreement provides for its use as a wine-growing region or sub-region dedicated to South Africa. However, through a ‘clerical error’ on the side of the Department of Agriculture the location ‘Western Cape’ was omitted from the list of geographical indications, which was specified in an annex to the EU-South African Agreement in order to complement Brussels’ register. Necessary steps for rectification have been taken; nevertheless, Bergsig Estate of Worcester was forced to recall a consignment of 300 cases of Cape port destined for the U.K. The situation is bizarre. Bergsig, which has been one of the first wine producers to phase out the use of the term port, is not

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<sup>25</sup> The examples presented in this section derive from Graham Howe’s article “Cape Copyright Wars” in *Wines of South Africa*, 4 July 2002.

allowed under the new EU regulations to sell ruby, vintage and late bottled vintage on the U.K. shelf – already the usage of the word Cape on their new label is forbidden (Howe, 2002).

The South African Port Producers Association (SAPPA) have recognized that they need a professional lobbyist in Brussels in order to persuade the EU of the traditional style of port production in South Africa and to introduce a new generic name for port originating in South Africa and Australia. In the meantime SAPPA refuses to comply with confusing regulations (Spahni, 2001).

Similar to the Cape incident, the dispute over Cognac exemplifies the absurd side of implementing a multilateral register covering spirits.<sup>26</sup> A first success of the EU's campaign to recapture geographical indications that have fallen into common usage outside European borders concerns Cognac. The liquor will be free from homonymous local brands by 2005. The ruling of a Brazilian court last January clearly went in favour of the Bureau National Interprofessionnel du Cognac, in a case pressed by the French trade association after Brazil's adoption of a new law on IPRs. Brazil and all other developing country members of the WTO had to tighten up domestic protection of IPRs in the case of geographical indications related to wine and spirits, in order to comply with the Agreement on TRIPS. What the plaintiff did not get though, was an outright ban of the use of the generic term Cognac. Article 24, TRIPS Agreement, the French were reminded in court, allowed for the presence, on the domestic market, of homonymous generic names as long as they do not mislead consumers about the true origin of the drink and as long as negotiations, which aim at phasing out this practice, will continue. The TRIPS Council, which is holding these talks, will convene during the first week of April.

Various other incidents could be mentioned but already by now it should be clear that the process of establishing a multilateral register for geographical indications will be desperately slow. In this respect, it is not surprising that the TRIPS Council is still pondering whether it should go for the compulsory and legally binding system put forward by the EU. The stakes are high because huge value can be added to wines and spirits produced in renowned geographical indications, which could also be understood as collective brands in this context. However, South Africa and the EU have signed the Agreement on Trade in Wine embedded

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<sup>26</sup> This section paragraph is based on Pierre Spahni's article "Name Calling" *Harpers Wine and Spirit Weekly*, 30 March 2001.

in the TDCA and agreed upon certain rules with regards to the protection of geographical indications. To what extent does this Agreement acknowledge the interests of both trade parties and what prospects does the Agreement hold?

## 6. The TDCA in Perspective

Prior to the TDCA, South Africa enjoyed special status in the cooperation agreements between the EU and the ACP countries which are the Lomé Convention and the Cotonou Agreement. But, since certain aspects of its economy are more similar to a developed economy, South Africa has been excluded particularly from the general trade arrangements and protocols and does not benefit from access to the European Development Fund (EDF). In light of these conditions, the EU decided to conclude a bilateral agreement with South Africa for an unspecified duration (European Union in South Africa, 2000).

Since 1 January 2000, the TDCA governs trade relations, financial aid and development cooperation as well as many other fields such as socio-cultural cooperation and political dialogue between South Africa and the EU. It is supplemented by four additional agreements, which are the Science and Technology Agreement, the Wine and Spirits Agreement, the Fisheries Agreement and the Cotonou Agreement. Officially, the TDCA between South Africa and the EU has been declared a milestone in fighting poverty and re-integrating the post-apartheid state into the global economy (EU/General Secretariat of the Council, 2000). There is no denying the fact that the Agreement reflects the importance attributed to economic development. But, subliminally, the TDCA also 'rewarded' the South African government for its market liberalisation programme and indicated the European interest in expanding on its position as main trading and investment partner of South Africa.

The key element of the TDCA is the creation of a free trade area covering European and South African markets. Thus, market access has been significantly simplified, more precisely, 90% of the already existing trade between the two partners is covered by the Agreement. In short the FTA comprises the following components (ibid.):

- Asymmetric timetable: Owing to the restructuring of the South African economy, the EU will open up its markets faster and more extensively than South Africa.

The EU will liberalise around 95% of its imports from South Africa within ten years, whilst the respective figures on the South African side are around 86% in twelve years. Similarly, gradual liberalisation is envisaged for industrial products.

- Protection of sensitive sectors: Certain products are excluded from the free trade agreement in order to protect the vulnerable sectors of both parties. They are mainly agricultural products. Wine and spirits are subject to a specific agreement.
- Integration of South Africa into the world economy: The creation of the FTA aims to end South Africa's economic isolation following the apartheid regime by helping to promote economic growth. Thereby, the FTA complies with the rules of the WTO.
- Intellectual property: The agreement makes provision for urgent consultations concerning the protection of intellectual property as well as concerning technical assistance.

### **6.1. The Wine and Spirits Agreement in Perspective**

As a supplement to the TDCA, the Wine and Spirits Agreement is intended to encourage and promote trade in wine which has been produced in South Africa and in the EU. The Agreement came into force in January 2000, though provisionally until the parties have confirmed the completion of the necessary procedures for implementation. Meanwhile, the tariff quota for imports of South African wine into Europe has been opened retroactively and the period for the phasing-out of the names "port" and "sherry" has been under way since 1 January 2002. In total the Agreement will cover the following issues:

- The quota for South African wines will increase from 320 000 hectolitres to 420000 per year. Furthermore, the EU has established an annual duty free tariff quota of 35.3 bn litres of wine imported from South Africa and each year from 2002 to 2011 a fixed volume of 6.72 bn litres will be added to the basic volume of the annual quota.<sup>27</sup>
- Geographical indications, including appellations of origin, will be protected. The Agreement provides better protection for appellations of origin for the EU than

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<sup>27</sup> Council Regulation (EC) No 2793/1999 of 17 December 1999 on certain procedures for applying the Trade, Development and Cooperation Agreement between the European Community and the Republic of South Africa as well as Council Regulation (EC) No 120/2002, amending Regulation (EC) No 2793/1999.

under TRIPS. South Africa will gradually phase-out the use of EU terms like “Chianti”, “Port”, “Sherry” and “Ouzo” within a period of twelve years concerning its domestic markets and within five years concerning its export markets.

- The parties will mutually accept oenological practices. Accordingly, new practices introduced by one of the parties will be accepted in future on the basis of strict requirements such as health, consumer protection and the preservation of good wine making practices.<sup>28</sup> However, a safeguard clause permits one of the parties to suspend the authorisation for processes provisionally or to restrict the prescriptions for practices. This clause may be invoked if the process endangers, e.g., public health.
- The parties will mutually recognize licences issued by the exporting party.
- The EU will provide € 15 mn of aid covered by the TDCA for restructuring the South African wine and spirits industry (EU-LDC Network, 2002).

The Wine and Spirits Agreement applies to wine that was already mentioned in the 1983 International Convention on the Harmonised Commodity Description and Coding System. With regards to wine that has been produced using oenological practices or processes not envisaged by the Agreement, it allows to market such products until stocks are exhausted. Similarly, products that are described and labelled in a manner that does not conform to current regulations have permission to be marketed by wholesalers or producers within a period of three years and by retailers until stocks are exhausted. The Agreement does not apply to wine that is in transit through the territory of one of the parties, or which originates in the territory of one of the parties and which is consigned in small quantities between those parties.

### **6.1.1. Description and Presentation of Wine**

The agreement provides for the reciprocal protection of names and other provisions linked to the description and presentation of wine. This involves the protection of names that refer to the member states of the EU or to South Africa as well as geographical indications. An annex to the Agreement lists those indications that have been protected either by the EU or by South Africa. For both parties the possibility exists to use a geographical indication or very similar

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<sup>28</sup> The agreement highlights the authorised oenological practices and processes. These include *inter alia* specifications concerning the addition of certain substances such as tannin.

indications equally. In such a case, a joint committee will be formed to give an opinion. The indication will be protected 'twice' if the name is traditional, has been applied consistently and the origin of the wine is clarified. With regard to indications of a place situated outside the territories of the parties, the same provisions apply. A joint committee is set up to give an opinion in such cases. However, specific provisions have been made concerning the ban on using the names "Port" and "Sherry".

### **6.1.2. Specific Provisions for Port and Sherry**

South African and European producers use the names "Port" and "Sherry" alike. This posed a problem during the negotiation of the Agreement. Provisions that aimed at resolving this problem were adopted in the annex to the TDCA. They entered into force in January 2000, at the same time as the TDCA. Therefore, South Africa has to phase-out the use of the names "Port" and "Sherry" after a transitional period of five years until they will no longer be used for exports into the EU. With regards to trade partners within the Southern African Customs Union (SACU) the transitional period covers eight years while the names may be used for twelve years as far as trade within South Africa is concerned. The limitation excludes trade relations with member states of the South African Development Community (SADC) other than the SACU member states.

## **Chapter Four**

### **1. Which Way to Prosperous Trade Relations?**

Having briefed the Wine and Spirits Agreement, it is important to analyse the range of opportunities that the Agreement offers to EU-South African trade relations. With regards to Brussels, the gain of the Agreement is rather clear: while the EU already holds a stake of 83% of South African wine exports to the EU, the FTA now offers access to increasing quantities of duty-free South African wine. On top of this, port and sherry are now legally protected trademarks of European member states. But, what about South Africa? Having expanded already on European interests in geographical indications and on the policy of agricultural subvention, what have been South Africa's interests in agreeing to the Agreement? Why did it finally give up promising product names such as "sherry" and "port"?

#### **1.1. National Interests: South Africa Considered**

The whole of South Africa's production chain of grapes and wine is competitive and export growth has steadily increased from 1988 onwards. When South African wine re-entered the international market, sales boomed by more than 200% (Paton, 2002). Accordingly, it is not evident if the trade agreement is the cause for further export growth. As a matter of fact, analysts tend to indicate an additional increase of about 9% only, which means that the Agreement brings about moderate growth but not to the extent promised for the South African wine industry. Hence, what, if not export growth, could have been the motives of the South African government to sign the trade agreement? In fact, two important strategic considerations guided the decision-making regarding whether to sign the Wine and Spirits Agreement.

First, the South African government gained guaranteed access to a niche in the European wine market. The abandonment of common names allows an extra 10 million litres of wine to be exported duty-free (Paton, 2002). In addition, the tariff reduction is estimated to be worth about 40 million rand (ibid.). This will free sources for new investment. Already, the last

aspect leads to the second strategic consideration which the South African government could realise when signing the Wine and Spirits Agreement.

South Africa faces growing pressure from increasing volumes produced by other New World wine producers. According to Su Birch, CEO of WOSA, the South African wine industry has to completely transform in order to build a strong quality image (Birch as quoted by Fastmoving, 2002). Apparently, the South African government seemed to be well aware of the lack of a confidence or confusion notably on the following aspects:

- Employment conditions of farm workers;
- Matters particular to South Africa, i.e. the success of land reform, and other instruments of transformation, i.e. black empowerment;
- Environmental factors, a challenge that the South African industry has not targeted yet by its programme of integrated wine production;
- Traceability of products particularly with regards to the issue-areas of genetically modified products and protection of designations of origin.

Having been granted 15 million euros assistance as compensation for South Africa losing the right to use these product names, the government ensured not only funds to encourage black participation in the industry but also funds to create new names and thereby to give South African wines a new image. Certainly, the trade-off of names such as “Sherry” or “Port” reflects a high opportunity cost but particularly the aspect of creating a new image with European funds seemed to have convinced representatives of the South African wine industry that the agreement has been a breakthrough in building a brand South Africa (Fastmoving, 2002). Moreover, the EU’s recognition and valuation of wine-making practices has a spill-over effect onto the international arena because it is not only a psychological boost for the South African wine industry but also a motif for international confidence-building.

## **1.2. The International Perspective**

Since the emergence of democratic South Africa in May 1994, the international community has been uncertain about the appropriate development status that the country should obtain. Should the emerging market economy still be classified as ‘developing country’ or should

South Africa be considered as an ‘industrialized country’? There is no denying the fact that the South African economy suffers from its heritage of apartheid, that it is characterized by massive income and living standard disparities. It is also a country whose economy is in need of major structural reform, if sustainable development is to occur, in particular as far as the agricultural sector is concerned. However, the gigantic size of the South African economy, with a GDP of some US\$120 billion, is for instance three times the size of the largest among the African, Caribbean and Pacific (ACP) economies. The country possesses a large industrial capacity, developed financial and services sectors and a sound infrastructure and communications network. And last but not least, South African agricultural products, especially wine, are already in direct competition with the EU producers.

Truly, South Africa is an emerging market economy, which is like its compatriots, such as China or Brazil, in need for justifying when it turns into a recipient of official development assistance. Having been already excluded from the access to the European EDF, Pretoria was under pressure to guarantee the benefits, which result from being internationally recognized as a ‘developing’ country. Hence, the European commitment to assist the South African economy’s restructuring at least in part saved the image of being ‘developing’ and signalled the international community South Africa’s dependence on ODA particularly with regards to the agricultural sector. From this point of view, the TDCA and the Wine and Spirits Agreement suited well Pretoria’s Strategic Plan for South African Agriculture (SPSA). Furthermore, the EU commitment towards South Africa signalled other global players that the country holds potential for prosperous trade relations and certainly encouraged the AGOA between the United States and South Africa.

## **2. Recent Developments in the South African Wine Industry**

The impressive increase of exports sales has been largely driven by the re-entrance of South Africa into the world economy, by the weakness of the domestic currency (the Rand has lost approximately 45% of its value against the U.S. Dollar over the last five years) and by aggressive and sustained marketing (Bomersheim, 2000). Despite shortcomings, South Africa has been working to revitalize its image and has earmarked close to \$1 mn for generic promotion of wine in export markets. Furthermore, the industry is trying to manage a shift from the predominantly white wine cultivars and establish an international reputation for

Cabernets, Pinotages, and Pinot Noirs. According to Wines of South Africa (WOSA), the South African industry will more than double its 1999 exports until 2004 by re-defining the industry's orientation in matching international demand with innovation and high quality and by promoting the proliferation of industry accolades on the world stage. The industry is additionally backed by a state research body, the Nietvoorbij Institute of Viticulture and Oenology as well as other organizations that work to keep the industry on the cutting edge of technology.

In South Africa samples of all wine including those destined for export are sent to Nietvoorbij and have to undergo detailed tasting tests and chemical analysis in the laboratories before licences are granted. An official seal is given to each bottle by the Wine & Spirit Board, which verifies the claims made on the label regarding origin, vintage and grape variety. Also in view to the promotion of brands, South Africa does not fall behind its European competitors (USDA, 2002).

Still there is potential for future success: while the main selling point of South African wines in Europe is currently the low-price segment, a future strategy, which focuses on brand management, is likely to transform budget products into brands in their own right (Wade Trade News, 2002). Therefore, local producers are motivated to develop brands that create a recognisable South African identity to accentuate their uniqueness and shift their focus from the mainstream to the higher end of the market, also in view to elevating the country's image as a wine producer.

### **3. Opportunities of the Wine and Spirits Agreement**

On 5 September 2002 the nomination of the directors of the South African Wine & Brandy Company (SAWB) meant the dawn of a new leadership structure and indicated the transformation of South Africa's wine and brandy industry in order to become more competitive on a global scale. From now on, Danie de Wet, Izak Visagie and Jan Scannell form the executive committee of SAWB. Scannell, who is MD of Distell, South Africa's largest liquor producing wholesaler, will also act as chairman until an independent

chairperson is chosen from outside the direct stakeholder groups.<sup>29</sup> However, being one of the initiators it is likely that he will further promote close collaboration with all relevant government departments and the full support of the SPSA.<sup>30</sup>

The CEO will run a small full-time office to handle the management and administration for various functional units, at this stage identified as market development; research and technological development; human resources development; business intelligence services; and socio-economic empowerment. Funding of the SAWB office will be shared by stakeholder groups.

SAWB itself is likely to become the head of numerous existing industry organizations or their functions, which will eventually be drawn together. Most probably, SAWB activities embrace generic marketing of South African wine on foreign markets as currently performed by Wines of South Africa, research functions as performed by Winetech and industry information as performed by SAWIS (Kruger, 2002).

The remaining question is whether South Africa will benefit from TDCA and the Wine and Spirits Agreement in the long run. Indeed, recent data indicate a positive development of the South-African-European relationship. After the realisation of the TDCA in 2000, trade between the two partners performed well. The EU wine imports into South Africa showed an increase of 20% and South African wine exports grew by 35%. In this respect, the FTA might help to gradually reduce the rates of duty, to establish and maintain a regular dialog, to foster close policy co-operation in the field of development, cultural exchange and know-how or high-technology. Moreover, the TDCA contributes to stabilise peace and democracy in the post-apartheid state and to integrate both elements into the world economy. At the same time, basic conditions for trade and investment will be improved. In turn, this will lead to an upgrade of welfare and progress, which is necessary for South Africa's economic development.

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<sup>29</sup> The directors – nominated from the ranks of the four direct stakeholder groups – are: 1.) wine farmers: Danie de Wet, Jannie le Roux, Pieter Hugo, Abrie Botha, Sharon February; 2.) cellars: Izak Visagie, Kobus Joubert, Kobus Louw, Petrus van Rensburg, Herman Cruywagen; 3.) labour: Nosey Pieterse, Baronese Claasen, Barry Stemmet, Trevor Hufke, Anthony Hendricks; 4.) trade: Jan Scannell, Tshidi Seane, Dr Willem Barnard, Hermann Böhmer, Riaan Kruger.

<sup>30</sup> SPASA is the product of co-operation between the Government, Agri South Africa and the National African Farmers' Union (NAFU), following a request by President Thabo Mbeki for the different role players to adopt a unification strategy.

Concerning the ‘compensation’ payment for abandoning particular brands, it is important to recognize the EU’s substantial development assistance to South Africa since 1996, totalling \$1.085 billion. Until 2006, an additional \$885.5 millions will be donated. South Africa is the country in Africa with which the EU executes its most extensive co-operation programme. (Correspondence EU/South Africa, 2000) The investments are concentrated on the health sector, targeting particularly tuberculosis and HIV/Aids. Moreover, as indicated already, the compensation will promote South Africa’s integration into the world economy and thus it will contribute to strengthen the basis for a democratic society and a constitutional state, which is able to cope with poverty and unemployment. Financial aid, therefore, contributes to a sustainable development of the country. Arguably, the trade-off of geographical indications is bearable under the auspices of overall increasing trade, which is likely to stimulate the economy and provide for growth and international competitiveness.

### **3.1. Other Trade Prospects**

The World Wine Trade Group (WWTG), formerly called the New World Wine Producers’ Forum, met in Cape Town between 1 and 3 July 2002 in order to address trends and policy developments in global wine trade. Sixty senior government and wine industry delegates from the Argentine Republic, Australia, Canada, Chile, New Zealand, South Africa and the United States of America attended the meeting. Representatives from Brazil and Uruguay attended as observers.

In pursuing its objective of removing unnecessary trade restrictions, the WWTG discussed elements of a labelling agreement that would benefit consumers and facilitate trade in wine.<sup>31</sup> It was agreed that the technical working group would continue this work and present a draft labelling agreement at the next meeting. Furthermore, the WWTG expressed concern over the EU demand for wine labelling regulations and questioned the consistency of new regulations within WTO rules. A follow-up meeting of the WWTG will be held in the Argentine Republic later this year (Joint Statement, 2002).

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<sup>31</sup> The Mutual Acceptance Agreement on oenological practices has already been signed by Australia, Canada, Chile, New Zealand and the U.S..

#### 4. The Impact of Globalisation on Wine Markets

Globalisation is the product of many forces – technology, communication, transport, competition in trade and services, and investment flows over national borders, all of which are creating a global market where the cost of production will eventually converge over time. More precisely, economists refer to ‘internationalisation’, which is the growth in international trade in goods, services and the various forms of capital,<sup>32</sup> relative to national output or expenditure. Globalisation is not new to the world’s wine markets, but its influence over the past decade has increased dramatically. In focusing retrospectively on the period since the late 1980s, it points to the rise of the industry’s export orientation and quality upgrading in the ‘New World’ and to the consequent competitive pressures on the ‘Old World’ concerning key import markets.

While globalisation in the world wine market has been very positive for stakeholders in much of the ‘New World’, it has presented and will continue to present some serious challenges to producers in the ‘Old World’ in both Western and Eastern Europe. Moreover, because of a dramatic expansion in New World vineyard plantings in the latter 1990s, the latter regions too face new challenges as the grapes from those recent plantings add significantly to the stocks of wine available for sale.

Virtually all industries and households are affected by the latest wave of globalisation, even though the term connotes different things to different people. On the one hand, economists think of it rather clinically as simply the lowering of transaction cost of doing business across space, and therefore a ‘good thing’ because it conserves resources. On the other hand, for a vocal minority in many countries, one or more of the perceived consequences of globalisation is considered a ‘bad thing’. People in those anti-globalisation groups may be concerned about such things as homogenisation of marketed products, a growing dominance of multinational corporations, or the disappearance of small firms with their individualistic goods or services.

When applied to wine, they worry that what for centuries has been characterised as largely a cottage industry, with its colourful personalities and wide variety of wines that differ from year to year because of the vagaries of weather or the wine farmer’s experimentation, will

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<sup>32</sup> Human, physical, knowledge

soon be difficult to distinguish from any other high-tech industry with a small number of large firms pushing standardised products into the big markets rather than providing for local markets.

The nature of the world market however should not hide strong ‘regionalisation’ or localisation developments in the wine industry. The biggest policy influence in this development has been the EU’s CAP. With the imminent expansion eastwards of the EU, it will be the wine policy within the CAP of an enlarged EU that will impact most significantly over the next few years (Noev & Swinnen, 2001).

#### **4.1. Interconnectedness and Interdependency**

Mergers and acquisitions within the global wine industry are happening almost daily at present due to firms preparing strategically for the increased competition expected over the next few years and due to new plantings taking up into production. For example, what was known as Mildara Blass of Australia was acquired by the Californian firm Beringer and has been transformed into Beringer Blass. Southcorp, also of Australia, has its own vines and operates in a joint venture on California’s Central Coast. Furthermore, after having merged with Rosemount, it has entered an alliance with California’s Robert Mondavi (Anderson et al., 2001).

While Western European firms are investing in Eastern Europe, South America, Australia, New Zealand and China, Australian firms are investing in North America and Europe, and US firms are investing in France and South America (ibid.). This should not be surprising, given the growth in cross-border mergers and acquisitions in other sectors, but it is a significant development for the wine industry. The wines industries concentration statistic show that concentration has been happening much more in the ‘New World’ than in the ‘Old World’ (Table 4).

**Table 4: Concentration of Companies - Old World versus New World, 2000**

	<b>Top 5's share of national wine production (%)</b>	<b>Average wine sales of top 5 firms (mn US\$)</b>

<b>Old World</b>		
France	13	330
Italy	5	125
Spain	10	190
<b>New World</b>		
United States	73	750
Australia	68	310
New Zealand	80	na
Argentina	50	97
Chile	47	90

Source: Rabobank, 2003

Presumably this is because in EU countries the dominant form of industrial organisation is the producer co-operative, most of which are very small and yet they produce the majority of output (Table 5). This difference adds to the challenges that are currently confronting the 'Old World'.

**Table 5: Prevalence of European Wine Cooperatives**

	<b>Number of Cooperatives</b>	<b>Members ('000s)</b>	<b>Market Share (%)</b>	<b>Sales (mn €)</b>	<b>Sales/Coop (mn €)</b>
<b>France</b>	870	121	52	4.57	5.3
<b>Italy</b>	607	208	55	n/a	n/a
<b>Spain</b>	715	167	70	650	0.9
<b>Portugal</b>	90	55	49	220	2.4

Source: Anderson & Norman, 2001

One final point on globalisation trends has to do with international technology transfer. It is accelerating not only with the spread of multinational firms but also through individual viticulturalists and winemakers exporting their services through spending time abroad as consultants (Williams 1995).

For many centuries wine has been very much a European product. Even today, more than three-quarters (being the sum of Western- European, Central and Eastern Europe exporters) of the volume of world wine production, consumption and trade involves European producers

while the rest involves just a handful of ‘New World countries’, which have largely been subject to European colonialization (Table 6). The table shows that 52.4% of production, 40% of consumption, 82.5% of exports and 7.4 % of imports emanates from Europe. In the late 1980s, Europe accounted in value terms for all but four percent of wine exports and three-quarters of wine imports globally. Since however that time the world’s wine markets have experienced a profound structural change. In particular, California and several countries of the Southern hemisphere<sup>33</sup> are beginning to challenge European dominance in international markets.

The rapid growth in wine exports over the past decade is ironic, in that it coincides with a slight decline in world wine production and consumption. Over the 1990s global wine production fell at 0.5% per year, and yet global wine trade rose by 5.3% per year in volume terms and 7.2% in nominal US dollar value terms (Table 7). Traditionally the wine producing countries were its own consumers – with only about one-tenth being involved in cross-border sales. Within the New World, the contributors to the high rates of export growth are various. Australia’s exports grew rapidly because its production growth was much faster than its consumption growth. By contrast, in North America the growth of production was much slower (Table 7).

Of the world’s top ten wine exporters, which account for 90 per cent of the value of international wine trade, half are in Western Europe and the other half are New World suppliers. Europe’s economies in transition from socialism account for much of the rest. Of those top ten, Australia is the world’s fourth largest exporter of wine, after France (alone accounting in 1999 for more than 40%), Italy (18%) and Spain (10%). The share of France has dropped ten percentage points since the late 1980s, which with smaller drops for Italy and Germany have ensured that the shares of Australia and other New World suppliers have risen substantially in key import markets (Table 8).

**Table 6: Regional Share of Production and Consumption**

	<b>Production volume (%)</b>	<b>Consumtion volume (%)</b>	<b>Exports (%)</b>	<b>Imports (%)</b>
<b>Western European Exporters</b>				

<sup>33</sup> Australia, Argentina, Chile, New Zealand, South Africa and Uruguay

<b>1988</b>	52,4	43	82,5	7,4
<b>1999</b>	56,7	36,2	74,2	9,2
<b>Western Europe others</b>				
<b>1988</b>	7,1	16,6	8,5	62,8
<b>1999</b>	7,5	19,9	6,6	59,9
<b>European Economies in Transition</b>				
<b>1988</b>	16,5	15,2	5,3	3,7
<b>1999</b>	10,2	16,1	2,7	2,5
<b>North America</b>				
<b>1988</b>	6,7	9,4	1,1	18,5
<b>1999</b>	7,5	9,8	3,6	17,7
<b>Latin America</b>				
<b>1988</b>	11	10,6	0,4	1,1
<b>1999</b>	9	8,6	5	2,6
<b>South Africa</b>				
<b>1988</b>	3,1	1,3	0,1	0
<b>1999</b>	2,8	1,7	1,4	0,1
<b>Australia &amp; New Zealand</b>				
<b>1988</b>	2	1,6	1,4	0,9
<b>1999</b>	3,2	1,8	5,8	0,9
<b>China &amp; Japan</b>				
<b>1988</b>	0,5	0,8	0	3,2
<b>1999</b>	2,3	3,6	0	5,6
<b>World Total (%)</b>				
<b>1988 - 90</b>	100	100	100	100
<b>1997</b>	100	100	100	100
<b>World Total (billion litres)</b>				
<b>1988</b>	27,6	24,7	6,7	6,7
<b>1999</b>	28	24	14,5	14,5
<b>Growth rate (% p.a.)</b>	-0,5	-0,1	7,2	7,2

Source: Anderson &amp; Norman, 2001

**Table 7: Volume, Value, Production and Consumption 1988-1999<sup>34</sup>**

	<b>Export Vol. (%)</b>	<b>Export Value (%)</b>	<b>Production growth rate (%)</b>	<b>Consumption growth rate (%)</b>
<b>W- Europe</b>	4.4	5.8	-0.7	-1.6
<b>Europe Other</b>	1.4	5.5	-1.1	1.5
<b>North America</b>	16.8	18.2	2.7	0.4
<b>South Africa</b>	32	33.8	0.4	2.2
<b>Australia</b>	15.6	19.3	5.3	1.2
<b>World Total</b>	5.3	7.2	-0.5	-0.1

Source: Anderson & Norman, 2001

At one extreme are the traditional producing countries of France, Italy, Spain and Portugal with 5, 6, 8 and 10 per cent of their cropped area under vines, respectively. Having had the opportunity there to cultivate grapes for more than two millennia and given the financial support provided by the EU in recent decades, it is likely that virtually all suitable land in Western Europe is already covered by vineyards. Hence their only hope for growth concerns quality improvement that is expanding premium wine grapes at the expense of non-premium ones. Normally that means lowering vine yields, thus, quality upgrading will lower the aggregate volume of wine produced. It is also likely to lower the price of premium relative to non-premium grapes and wine.

At the other extreme the New World wine producers, with the United States and Australia each having only 0.2% of their crop area covered by plantations, are barely above the ratio for China. Argentina, Uruguay and South Africa also have vines accounting for less than 1% of their crop area. Hence in those countries, which have ample land with suitable climates for expansion, the main influence on vineyard area is the expected long-term profitability of grapes relative to that of alternative uses for the land. With increasing affluence comes an increasing demand for many things including product variety. Certainly homogeneous wines are wonderfully easy to mass-market to newcomers to wine drinking through such outlets as supermarkets.

<sup>34</sup> The unit in which all categories (volume, value, production, consumption) are measured is the percentage per year from log-linear regression equations.

**Table 8: Wine Intensity of Cropping - 30 Largest Producers**

Rank	Volume of wine production (mill hl)	Area of grapevines, ('000 ha)	Share of total crop area (%)
1. France	67	914	4,7
2. Italy	58	909	8,0
3. Spain	33	1180	6,4
4. United States	21	374	0,2
5. Argentina	16	208	0,8
6. Germany	12	106	0,9
7. Australia	9	123	0,2
8. South Africa	8	115	0,7
9. Portugal	8	262	9,7
10. Romania	7	253	2,6
11. China	5	240	0,2
12. Chile	5	149	6,5
13. Greece	4	129	3,3
14. Hungary	3	127	2,5
15. Austria	3	50	3,4
16. Brazil	3	60	0,1
17. Bulgaria	3	109	2,4
18. Russia	2	77	0,1
19. Croatia	2	59	3,7
20. Moldova	1,9	149	6,8
21. Uzbekistan	1,5	132	2,7
22. Serbia/Mon.	1,4	79	2,0
23. Mexico	1,4	41	0,2
24. Switzerland	1,3	15	3,4
25. Macedonia	1,2	29	4,5
26. Uruguay	1,1	11	0,8
27. Slovenia	0,9	18	5,8
28. Ukraine	0,7	122	0,4
29. New Zealand	0,6	12	0,4
30. Cyprus	0,6	20	13,9
<b>WORLD</b>	<b>280</b>	<b>7864</b>	<b>0,53</b>

Sources: Anderson &amp; Norman, 2001

However, over time, many consumers will look for superior and more varied wines. They will begin to differentiate between grape varieties, between not just countries of origin but regions within them, and with the help of wine critics, between brands and the various labels within a brand. That preference for heterogeneity on the demand side, and the infinite scope for experimentation by vignerons on the supply side, ensures that there will always be small and medium producers alongside the few large corporations in the wine industry. Undoubtedly the forces of globalisation together with the boom in premium wine grape supplies will lead to more mergers, acquisitions and other alliances among wineries within and across national borders.

## **4.2. Controlling Multinational Corporations**

In the past, the main deterring factor that prevented European wine companies from investing in South Africa was the uncertain economic and political future. The free trade zone between South Africa and Europe agreed upon in the year 2000, the substantial development assistance of 885.5 million Euro and eventually the Wine and Spirit Agreement, have all helped South Africa to achieve greater political and economic stability. A number of European wine companies have invested in South Africa, buying farms, merging with South African wine companies, or buying up South Africa enterprises. A European-based wine company investing in South Africa will have two wine harvests in one year, harvesting in South Africa in the northern spring and in the EU in autumn (State of Affairs, 2001b).

The new market opportunities recently made available are seen to be in part defeated by the anti-competitive conduct of private actors or governmental measures which seek means to protect national production from foreign competition (European Commission, 2000). Indeed, there is a perception that, as governmental trade obstacles are increasingly dismantled by multilateral efforts particularly in the World Trade Organisation (WTO), judicial measures and practices of enterprises distorting international trade and investment flows and restraining access to markets, sometimes with governmental support, are becoming more common than before. The protection of IPR and designation of origin may in certain cases lead to trade obstacles and restrictive business practices or quasi – monopolistic positions.

There seems to be a heightened degree of international consensus that cartels should be detected and prosecuted. Particularly the OECD countries are experiencing at present an unprecedented wave of merger activity (WTO, Annual Report 1997).

In considering international markets and competition, the key challenge becomes apparent that legal systems are still national in principle while markets in many cases extend beyond national boundaries. If markets are broader than territorial boundaries, are national laws and their enforcement sufficient to deal with the market issues of the global economy? To what extent can harmonisation of laws, regulations and administrative practices help to alleviate the concern and to avoid blockages? Is there a reasonable prospect for a world competition order?

International competition rules against restrictive business practices that have trans-border effects are necessary both from a trade policy perspective and from an antitrust perspective. Seen from a perspective of trade policy, restrictive business practices distort international trade and counteract trade liberalisation. Seen from an antitrust perspective, they restrain international competition and cause conflicts of extraterritoriality, because governments, which aim at protecting competition from external restraints, resort to an extraterritorial application of national antitrust laws. This normally leads to resistance by foreign governments claiming the respect of their national sovereignty.

So far, unilateral, bilateral and multilateral efforts have been insufficient. Successful regional models of competition policy cannot be directly transferred to the multilateral level. On the other hand, a universal “supranational” substantive competition code containing provisions for an “international competition authority” apparently is not a realistic short or medium term option. Consequently a new proposal containing elements for the conception of a global competition order needs to be developed. These elements could comprise: binding minimum standards and framework principles, including non-discrimination, “positive comity” and schemes of “systems competition” as well as a legal mechanism of dispute resolution. Apart from trade and investment, the development of a competition order would be another field where co-operation between South Africa and the EU would be mutually beneficial.

## **Chapter Five**

### **1. Conclusions**

As far as agriculture is concerned the EU is the world's largest importer and second largest exporter. Although the EU arranges multilateral trade negotiations within the framework of the WTO and applies the MFN principle to other members of the WTO, the Union preferably negotiates bilateral trade agreements like many other members of the WTO. More than two thirds of the EU's total imports originate from such agreements. With regards to the TDCA and the Wine and Spirits Agreement, South Africa belonged to those countries which did not have preferable access to European markets due to its 'qualified' status under the Lomé Convention and later the Cotonou Agreement (Newsletter, 2000).

#### **1.1. The TDCA: A Critical Assessment**

The negotiations with South Africa have been very important for agriculture as the EU-SA FTA has been the first agreement which the EU signed with a third party by fully integrating the WTO obligation of covering all trade transactions within the same agreement. On 11 March 1999 the European and South African governmental representatives gave the green light for the TDCA. In the field of agriculture the trade agreement aims to reduce tariffs of a wide spectrum of agricultural goods. Within ten years 95% of South African agricultural exports to the EU are to be liberalised while the SA will reduce tariffs on 86% of EU exports to South Africa within twelve years (European Commission, 1999).

South Africa has agreed to apply the paragraph of geographical indications to countries that are not members of the Southern African Development Community (SADC) within five years while trade with SADC countries that are not part of the Southern African Customs Union (SACU) will be affected within eight years.<sup>35</sup> Despite South Africa's efforts SADC members have not been mentioned in the FTA. In contrast, the five member states of SACU, which

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<sup>35</sup> Angola, Botswana, Democratic Republic of Congo, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe are SADC members while Botswana Lesotho, Namibia, South Africa and Swaziland are additionally members of SACU.

play a central part in SADC due to their close economic relations and elaborated compensatory mechanisms, are explicitly integrated. While South Africa will allegedly be at the forefront to realise export opportunities to the EU, European goods will have access to the markets of all five nations.

In the worst-case scenario, cheap subsidized agricultural exports of the EU will flood South Africa's markets as well as those of other SACU member states. This will seriously threaten small farmers who are not subsidized. It is questionable whether SACU industries will resist increasing imports of goods made in the EU. This cul-de-sac has already affected SADC countries where Zambia and Malawi, for instance, opened their markets to foreign goods and suffered disastrous effects on their local industry and labour market. In this case and many others, the EU and the World Bank neglected to encourage regional actors to develop trade and investment strategies which could be integrated into the structural adjustment programmes. Considerations on how regulating mechanisms or special aid programmes could intercept the deindustrialisation process of the economically weaker countries were not made.

However, it needs to be acknowledged that the bilateral agreement between the EU and South Africa, including the Wine and Spirits Agreement, paid attention to the latter aspect as the EU will continue its development assistance from 2000 to 2006 with a fixed amount of 885.5 million Euros, which will add upon about 1.1 billion Euros already made available between 1986 and 1999 (European Commission, 2001). The EU hopes that South Africa will develop into the region's motor for economic growth. The EU expects South Africa to play an active and leading role on the continent as far as conflict management and the acknowledgement of human rights are concerned. Nonetheless it has been of particular importance to create a new basis for trade relations.

To sum up, the FTA sounds more or less fair play to both parties at first glance but when taking a closer look this picture changes. As a matter of fact the EU had to reduce its tariffs already significantly due to GATT. Hence, the EU only needs to implement an additional 3% reduction to reach the agreed upon level of 90% while South Africa needs to reduce by 46% within four years. Likewise the agreement does not pay attention to South Africa's trade partners in SACU, which will lose market shares to European competitors. It is thinkable that a series of industries in South Africa and its neighbouring countries will collapse under the unequal competition, which in turn causes a rapid increase in the already high unemployment

rate. Furthermore, the members of SACU might lose at least a third of their revenue from tariffs, thus, they will have difficulties to avoid budget deficits (Informationsblatt, 2000a).

## **1.2. Reflections on the Wine and Spirits Agreement**

The FTA between South Africa and the EU integrated the additional agreement on wine and spirits. Categorized by group of products a register is attached to the agreements which contains all geographical indications of each party and which are protected by the conditions of the Agreement. In comparison to the existent register of the WTO its bilateral equivalent has two main advantages. Firstly, the register between the EU and South Africa is not restricted to certain categories of geographical indications, which means that indications of origin and geographical indications not yet identified can be added if necessary. Secondly, the law of the country of origin and not the one of the country to be protected determines the rules for protection. Similar to the Lissabon Agreement, the Wine and Spirits Agreement prevents a modification of geographical indications and origin exerted by the country which aims for protection. Thereby, the bilateral register is saved from being undermined by dislocating mechanisms and brand usurpation (EU-LCD News, 2002).

Nevertheless, the core of the problem having caused trade frictions between the EU and South Africa lies in the usage of the brand names of “port” and “sherry”. In South Africa port wine and sherry has been sold for more than a hundred years. Regardless this fact, Portugal and Spain have recently claimed exclusive brand usage to profit from negotiations which aim to put a multilateral agreement on geographical brand names into place. It is clear that the underlying tone of this claim reflects the EU’s interest in preparing the fundament for forthcoming negotiations with the USA and Japan within the framework of TRIPS (Kneifel, 1999).

As already explained in earlier paragraphs the negotiations between the EU and South Africa have been particularly difficult because South Africa was understandingly unwilling to give up its rights of using the brand names “port” and “sherry”. With its signature in January 2002 South Africa agreed to withdraw the usage of the brand names from all export markets within the next five years. The domestic market has a grace period of twelve years. During this period the alternative brand names will be mutually accepted. In turn the EU has committed to offer South Africa a toll free contingent (with respect to the current trade level) amounting to

32 million litres of wine as well as financial assistance amounting to 15 million euros and aimed at the restructuring of the South African sector for wine and spirits (Correspondence EU/South Africa, 2000).

### **1.3. Effects of the Trade Agreements**

Since the lifting of sanctions South African wine exports have exploded and exports continue to grow annually. In 1996 South Africa exported 135 million US dollars of wine. In 2001 South African wine exports reached more than 230 million US dollars – most destined for Europe. Export sales have been driven by: the lifting of sanctions against South Africa, the weakness of the domestic currency, aggressive and sustained marketing and the proliferation of industry accolades on the world stage. The industry is also backed by a state research body, the Nietvoorbij Institute of Viticulture and Oenology, and other organisations. They work to keep the industry on the cutting edge.

There is no denying the fact that the prospects of signing the Wine and Spirits Agreement in cooperation with the FTA have stimulated the already prospering trade relations. The export volume of the South African wine industry increased by 24% in 2001, which is three times the growth rate between 1997 and 1999. At the same time it is not a secret that the EU is South Africa's largest market, accounting for 83% of South African wine exports. Great Britain, the Netherlands, Scandinavia, Germany, Belgium and Switzerland receive 90% of exports meanwhile the British market alone has increased by 27% in recent years (Spahni, 2001). It seems that South Africa has manifested a competitive advantage on the basis of "first comes first served" vis-à-vis its competitors in view to the still outstanding negotiations of the EU with other members of the New World wine group.

Massive growth in export demand has left the South African industry wrestle with insufficient production; the industry can hardly satisfy the demand. The rapid growth in the industry has opened opportunities for investment in the industry and created opportunities for suppliers of cooerage products (Bomersheim, 2000). The wine industry becomes more and more important for the South African economy. The agricultural sector contributes to less than 5% to GDP only while the wine industry does not even account more than 5% to the sector. Nevertheless, the wine industry makes up more than 8% of South Africa's export volume and is an important job provider with about 200,000 employees, which is a salient aspect in view

to South Africa struggling with an unemployment rate of about 30%. Additionally, the wine industry has become more and more important for tourism. Wine tourism currently stimulates growth in the tourism industry and plays an important role in marketing tourism.

### **1.3.1. Trends: South Africa**

Institutions play an important role in the ordering of economic activity, and a key factor in determining international competitiveness. One of the main consequences of the historical legacy of the South African wine industry has been and still is uncertainty about its future institutional structuring. Institutional change is being fostered in an attempt either to escape the past or to meet the challenges of the future, and it is often difficult to discern which of these motives is the strongest. The case of the conversion of KWV from a cooperative to a corporate business in 1997 illustrates this dichotomy. Whereas the board of KWV argued that these steps were taken in order to position the company as a major player in the export market, the government accused them of trying to privatise state assets.

South Africa's agricultural sector policy aims at achieving three main objectives:

- Redressing the inequalities and injustices arising from the apartheid policies of the past
- Ensuring a more just and equitable distribution of income in the industry
- Enhancing the international competitiveness of the industry by promoting the South African image

These main objectives are represented in the 'Vision 2020 Strategic Agenda'. Traditionally, the large players in the industry have been the 'producing wholesalers'. This tradition has changed considerably in recent years, for instance, reflected in the apparent withdrawal of Gilbey's South Africa from the wine business and in the merger of Stellenbosch Farmers Winery and Distillers Corp. which formed Distell. Ultimate control over Distell and KWV lies in the Rembrandt group of companies, hence, further changes can be expected. Another institutional innovation of the past years has been the emergence of medium-scale exporting concerns. These have been formed by the conversion of former co-operatives, i.e. Simonsvlei; by a new enterprise formed by existing co-operatives, i.e. Stellenbosch Vineyards; by strategic alliances formed between private producers, i.e. Winecorp; and by new enterprises,

i.e. Vinfruco. The rapid institutional change that has characterised the industry in the past decade has come about as a result of strategies to adapt to the new trading environment. One of the key features of this environment has been the ability to exploit new opportunities in the global market, and more institutional changes can be expected as the industry consolidates its position as a global player (Vink et al. 2001:15-18).

### **1.3.2. Trends: EU**

The biggest policy influence on wine business in the post World War II era and the current process of globalisation has been CAP. In short, it comprises a continued drive to steer production towards quality and better adjustment to demand through measures for the restructuring and conversion of vineyards; an effort to maintain the balance between demand and production by extending the ban on vine planting in a flexible enough manner to accommodate the growth of production for which demand is rising; the stimulation of the competitiveness of the European winegrowing sector and help with facing increasingly open international markets and finally the possibility for producer organisations to be recognised by member states.

As already explained in chapter two, the reform CMO has been executed in the context of Agenda 2000 and the general reform of CAP (European Commission, General Directorate for Agriculture, 2000b). The purpose of the reform was to stabilize the balance between supply and demand, to adopt production to current developments of the wine market and to become more competitive in the long run. The aim is pursued by financing the restructuring of a large part of wine plantations, an approach which guarantees the production of popular wines of domestic and foreign markets. After GATT terminated the protection against thirty parties and a steadily decreasing demand concentrated on quality the reform of CAP was salient to survive.

## **1.4. Personal Statement**

The development of the world market for wine and spirits seems to deter on the costs of classical wine economies such as France, Spain, Italy and Germany. In turn, the winners are South Africa, Australia and New Zealand. Free trade is no longer characterised by pure

deregulation only – an assumption that still prevails literature. Instead it needs to be created under considerable regulatory efforts. The WTO including GATT, GATS, TRIPS and TRIMS reflects a history of bureaucracy in the international trade system. Free trade is based on competition that has to concentrate on quality, on an effective promotion strategy, on image creation and on customer-oriented brand management – not on political rules and regulations. If rules are made they have to mirror the needs and wants of the customer and not the ones of wannabe global players. While current developments promote the intellectual property of first-world countries, a more client-oriented approach would hamper the realisation of over-protectionism of intellectual property and offer sustainable benefit for poorer countries.

From a personal point of view, it will be South Africa who is the winner after all. The country will become one of the motors of the international wine industry in times of globalisation. The exceptional and successful strategy, which some members of the New World wine group have chosen vis-à-vis the European competitor, will arguably shift market shares to the expenses of the latter. Accordingly, the South African stakeholders face a strategic fit, which has mainly developed due to customers being offered easy access to wine production and marketing facilities, due to the guarantee of constant quality, due to a permanent availability, due to the customer recognizing brands and due to the fact that all these aspects add value and create a positive image of the South African wine industry.

In addition, the Australian concept, which bases on the control of the complete value-added chain from the grape to the bottle and which has been imitated by South Africa, will ensure optimal quality and production security. In conclusion, the South African wine industry has not achieved competitive advantage toward foreign competitors by minimizing costs in the cheap wine market segment but by a consequent client-oriented marketing strategy targeting the middle and high price segment. Moreover, although the country belongs already to the most modern cultivating countries in the world the European commitment to financially support the South African wine industry promises to create new promotion concepts for “port” and “sherry” and to encourage new plantations which will increase the South African competitiveness on the cost of European wineries (Nickenig, 2001).

The TDCA and its additional agreement on wine and spirits will become a burden for future negotiations of the EU, particularly with regards to other members of the New World, such as Australia. Already, the market share of the EU in an international context decreases due to

increasing quality standards and due to the quiescence policy and protectionism of the EU. If the EU wants to manoeuvre the increasing pressure of the New World, it urgently needs to ignite its export motor with new and innovative initiatives. Likewise the wine industry policy as part of the union's agricultural and development policy needs to become more aggressive and should not be sacrificed to the aims of the EU's policy of foreign aid (Nickenig, 2002). Europe must learn to react more flexible and faster to global trends of the wine economy. It needs to abandon its traditional approaches, which ensured success in the past but is overhauled for the future.

Nonetheless, it needs to be acknowledged that the TDCA and the Wine and Spirits Agreement laid the foundation for creating a win-win situation and mutual beneficial cooperation in form of trans-border acquisitions, joint ventures and fusions in near future. Current export figures indicate that the agreements are a future investment for both parties and suit the very industrial strategy may it be image creation or assuring global competitiveness. However, from a personal point of view South Africa is one step ahead in creating a sustainable competitive advantage. Hence, the European wine industry should look closer to the promotion strategies of their South African counterpart and would do better to imitate the client-oriented marketing strategy.

## **Glossary**

ACP	Africa, Caribbean and Pacific countries
CAP	Common Agricultural Policy
CMO	Common Market Organization
DSB	Dispute Settlement Body
EC	European Community
EU	European Union
EDF	European Development Fund
FTA	Free Trade Agreement
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross domestic product
GNP	Gross National Product
IMF	International Monetary Fund
IPR	Intellectual Property Right
ITO	International Trade Organization
IPR	International Intellectual Property Right
KWV	Kooperatiewe Wijnbouwersvereniging van Zuid Afrika Beperkt
LDC	Least Developed Country
MC	Ministerial Conference
MFN	Most-Favoured Nation
NWWG	New World Wine Group
OECD	Organization for Economic Cooperation and Development
RDP	Reconstruction and Development Plan
RDR	Return Digital Receiver
SADC	Southern African Development Community
SACU	Southern African Customs Union
SAPPA	South African Port Producer Association
SAWB	South African Wine & Brandy Company
SFW	Stellenbosch Farmers Winery
SPSA	Strategic Plan for South African Agriculture
TDCA	Trade Development and Co-operation Agreement
TRIPS	Trade Related Aspects of Intellectual Property Rights

UNCTAD	United Nations Conference on Trade and Development
VDP	Verband Deutscher Weinexporteure
WIPO	World Intellectual Property Organization
WTO	World Trade Organisation
WOSA	Wine of South Africa
WWTG	World Wine Trade Group

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