Trade liberalization in the presence of domestic regulations: Likely impacts of the TTIP on wine markets

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Abstract: The United States and the European Union have embarked on ambitious negotiations to create a comprehensive free trade agreement known as the Transatlantic Trade and Investment Partnership (TTIP). The agreement, if reached, will promote trade between the two regions by liberalizing trade barriers including tariffs and other non-tariff barriers. Agricultural markets receive relatively high levels of support and protection in both regions, and therefore are sensitive to the discussions surrounding the TTIP. In particular, wine is the highest valued agricultural product traded between the United States and the EU, and any reduction in trade barriers from the TTIP has the capacity to generate additional trade in this sector. We carefully develop parameters to characterize the effects of tariffs (which differ for bulk and bottled wine) and domestic regulations in the wine industry; domestic policies in the EU are tied to wine and grape production (such as planting restrictions of specific varietals in the EU) while in the United States domestic policies largely apply to wine consumption (regulations concerning distribution and sales). Our simulation model examines the price, trade, and welfare effects from reductions in each of these policies, and from reductions across all policies. Results show that even modest reductions in tariffs would have much larger trade and welfare implications than would reductions in domestic regulations.

Keywords: EU-U.S. Free Trade Agreement, Simulation model, Trade, Wine.

JEL classification: Q13, Q17

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**Introduction.** The United States and the European Union have embarked on ambitious negotiations to create a comprehensive free trade agreement known as the Transatlantic Trade and Investment Partnership (TTIP). The agreement, if reached, will promote trade between the two regions by liberalizing trade barriers including tariffs and other non-tariff barriers. Agricultural markets receive relatively high levels of support and protection in both regions, and therefore are sensitive to the discussions surrounding the TTIP. In particular, wine is the highest valued agricultural product traded between the United States and the EU, and any reduction in trade barriers from the TTIP has the capacity to generate additional trade and will lead to changes in welfare among stakeholders in this sector. Economists have devoted some attention to the global implications from potential reductions in subsidies and tariffs for agricultural commodities as both have been included on the negotiating agenda of the WTO (Bagwell and Staiger 2001), but there is very little research that examines these issues for the key products that are expected to be impacted by the TTIP.

**Policy environment.** Similar to other agricultural commodities, EU-U.S. trade in wine is affected by a range of barriers including tariffs and non-tariff measures (such as requirements on labels describing appellations and enological practices). Both regions apply tariffs, yet in both regions tariffs differ for bulk and bottled wine. In addition, a range of domestic regulations are applied to wine markets; these regulations are largely applied to wine and grape production practices in the EU (Meloni and Swinnen 2013) and to the consumption of wine in the United States (Rickard 2012). All of these policies will be closely examined as part of the TTIP discussions, and the purpose of this paper is to understand how reductions in each policy will affect EU-U.S. trade in wine.

**Methodology.** The collective economic effects of these policies have not been studied closely, in part, because the policies are complicated and are not easily modeled. Here we adopt a two-step framework to examine the effects of policy reform in EU and U.S. wine markets. First, we carefully develop parameters to characterize the effects of tariffs for bulk and bottled wine, domestic policies in the EU that affect wine and grape production (i.e., planting restrictions and other types of supply control on specific varietals), and domestic regulations in the United States that impact wine consumption (i.e., regulations concerning wine distribution and sales). In the second step of our framework, we employ these parameters in a partial equilibrium model and then simulate how changes in EU and U.S. trade barriers will affect wine markets. Results from the simulation analyses are subsequently used to calculate welfare measures for the key stakeholders. Following Alston, Norton, and Pardey (1995), a set of equations is used to describe the supply, demand, and international market clearing conditions for six differentiated wine products (bulk, premium bottled, and super-premium bottled wine in the EU and in the United States). Adding
sub-regions and allowing for more product variety would shed light on the impacts across a wider range of stakeholders; however, this would require much further parameterization of the model and many of the additional parameters that would be needed are not known with any degree of certainty.

**Results.** We simulate the effects of a 50% reduction in import tariffs and the removal of domestic support measures (or domestic regulations) applied to EU and U.S. wine markets. The exogenous policy changes for tariffs used in our simulations are based on published rates. The exogenous policy changes for domestic regulations are based on the parameters we calculate in step one of our framework; here we also consider a range of plausible parameters to check the robustness of our baseline simulation results. Our simulation model examines the price, trade, and welfare effects from reductions in each of these policies, and from reductions across all policies. Overall, our results show that removal of domestic regulations in the U.S. would lead to a greater gain in net welfare compared to removal of domestic regulations in the EU, and the economic effect is strongest for the premium bottled wine products. This result is driven, in part, by the fact that U.S. domestic regulations are applied further downstream (i.e., applied to wine markets) whereas EU domestic regulations are applied further upstream (i.e., applied to markets for wine grapes) and the effect of the EU policies are dampened in wine markets. However, our results also indicate that even modest reductions in tariffs would have much larger trade and welfare implications than would reductions in the domestic regulations in the EU or in the United States.

**Conclusion and Policy Implications.** Our findings suggest that tariffs are the most important trade barrier in the TTIP negotiations for wine trade between the EU and the United States. Furthermore, because tariff reductions have been included in previous trade agreements and reductions in domestic regulations are not always included, there may be greater willingness to consider further tariff reductions as part of the TTIP negotiations. Therefore the net impact on producers and consumers in the wine sector would be greatest from a trade policy negotiation strategy that maintained a focus on tariffs rather than redirecting reform efforts to domestic regulation concerns.

**References.**


