Signaling Wine Quality with Price: 
An Analysis of Wine Regions in the U.S.

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Abstract

For experience goods such as wine, uninformed consumers rely on clues to infer the good’s quality. One of the most important quality clues is the price. The extensive economic and marketing literature on price as a quality signal commonly refers to price-quality correlation coefficients. The equilibrium in a perfectly informed market place is typically characterized by a perfect correlation between price and quality; deviations from this equilibrium are sustainable only in the short run. However, if consumers are imperfectly informed, prices do not always indicate true quality. Consequently, price-quality correlations take on values lower than one.

Previous studies have shown that for a new product, when only a few buyers are informed, price-quality correlations are low. However, as the knowledge about the product increases over time, the prices’ ability to serve as a misleading quality signal decreases. As a result, price-quality correlation coefficients grow.

This paper is aimed at analyzing to what extent wine prices in various regions in the U.S. serve as true quality signals. The underlying hypothesis is that wines from young and relatively unknown wine regions (such as Texas or Walla Walla) exhibit low price-quality correlations while those from established and well known regions (e.g., Napa, Sonoma) are characterized by higher coefficients. Over time, as information proliferates into the market, the correlation coefficients should grow in both markets.

For price and quality information, we draw on Wine Spectator data from 1983 to 2008 for the following wine growing regions: Napa, CA; Sonoma, CA; Sierra Foothills, CA; Carneros, CA; Central Coast, CA; Mendocino, CA; South Coast, CA; Finger Lakes, NY; North Fork, NY; Walla Walla, WA; Yakima, WA; New York State, Oregon, Washington, Virginia, and Texas. To gauge the existing information level on wines from a certain region and year, we refer to the number of reviews published in the Wine Spectator. Preliminary results show that wine prices are closely correlated with quality in well-established wine regions more than in little known ones.