Uncorking the economics of terroir

Wine production is particularly sensitive to geography. **Michael Veseth** muses on the rental value of a Grand Cru and the threats faced by the vineyards

TERROIR IS a French word that signifies a wine's special sense of place. Wines from the great vineyards and important regions are said to possess *terroir* if they reflect in some way the land and people that created them—if they have a taste of place. Industrial commodity wines (McWines you might call them) are pretty much *terroir*-free.

Terroir is not just a fancy term to uncork when sniffing, swirling and slurping in the company of your oenophile friends, it has important political and economic implications. Adam Smith wrote in *The Wealth of Nations* that wine grapes more than any other fruit reflect their growing conditions (he didn't use any fancy French words to describe it) and that wines from certain exceptional vineyards consequently sold for very high prices. *Terroir* has a market value in addition to its sensory value, Smith suggested. I think he knew that this meant that the owners of those vineyards earned profit from the natural scarcity of the fine wines their land produced.

I wonder if Adam Smith would have predicted the lengths that the owners of these great vineyards would be forced to go to defend their *terroir*-derived rents? It seems that there is no end to the threats they face: fraud, foreign competition and now global climate change.

The valuable rents that accrue to the owners of famous châteaux and regions have naturally attracted wine cheats and their deceptive practices. Sad to say, there are many formulae for wine fraud. You can fake the wine (cheaper wine from another source) and fake the bottle and label. Voilà, you have a rare and expensive commodity that, because it is so dear, may never be opened. Benjamin Wallace has recently written a book that uncorks this sort of wine crime: *The Billionaire's Vinegar: The Mystery of the World's Most Expensive Bottle of Wine*.

Growing rich in their sleep

Vineyards MD Christian Seely says investing in the right vineyard can still bring lucrative returns as the global market for fine wine continues to expand—according to industry voice *Drinks International*. "Terroir is the key to making money from a vineyard" according to Seely, and investors should "resist the temptation" to buy into "cheap" and "obscure" places. As the New Zealand properties & investment firm Parkburn Vineyard boast: "own a Vineyard and get an excellent return on your investment without ever having to plant a vine, rub a bud or pick a grape."

Wine fraud need not be so extreme, however. It is relatively easy for a winemaker to multiply profits by blending in some cheap wine from another region to make the limited production of fine wine fill a few more bottles. Dark red wine from North Africa, for example, was for years added to lighter French products. The result was both more cases of 'French wine' and a product that was better suited to the French market. Much of the inexpensive 'Chinese wines' that you will see if you visit that country contain only a little juice from China-grown grapes and a lot of cheap wine from other places.

In one famous 1985 fraud case, an Austrian winemaker added automobile antifreeze to wine to make it sweeter, stronger and, as you might expect, lethal. The reputation of Austrian wines has not yet fully recovered. And reputation is what's at stake here. Wine buyers pay extra for the reputation associated with certain fine wines. If the reputation is undermined by fraud and adulteration, the profits disappear.

French wine growers addressed the fraud threat by creating the AOC (*Appellation d'origine contrôlée*) system, which is found today in various guises in most winegrowing countries (see box). AOC rules originally specified that all wines with a particular designation had to be made from grapes grown in a specified area—eliminating or at least discouraging the North African scam. In the 1930s, however, when bad economic times produced wine fraud of all flavors, the rules were expanded to include not just geographic limitations but also restrictions on virtually every element of the winemaking process.

The Institut National des Appellations d'Origine (INAO) was created to police this system. The INAO currently regulates 470 wine and spirit designations, and 40 AOC cheeses and other food products including meat, poultry and olive oil. I purchased a set of professional wine-tasting glasses a few weeks ago and discovered that they had been manufactured to meet a strict INAO standard. The INAO rules from grape to glass!

The basic AOC system has now been integrated into European Union law and even World Trade Organization agreements. The rent-producing designation of fine wine regions is now recognised as a valuable type of intellectual property, worthy of permanent protection. Score one for the *terroiristes*.

Fraud isn't the only threat to prestigious Old World winemakers, however. Globalisation has twisted the world of wine and redistributed the rents. On one hand the creation of a more global market for fine wine has increased the rents of the most famous producers, especially the great Bordeaux and Burgundy estates. Prices have risen through the roof as demand for fine wine in Asia has grown and a global winner-take-all market has emerged. Château Latour 2005 sells for more than $1000 per bottle, if you can find it! Globalisation has magnified the rents associated with these must-have collector wines (see box).

But globalisation cuts both ways and the competition from abroad has also undercut the returns on lesser vineyard properties and generated a worldwide surplus of inexpensive wine. In Europe, EU distillation policies have supported winemaker incomes for many years. Surplus wines, thin and acid, from marginal vineyard areas, are bought up at public expense and turned into industrial alcohol.

Recent EU reforms promise to remove these subsidies and force European winemakers to compete head-to-head with New World products. Rents will inevitably be redistributed in this process and it will take some time to see where the dust finally settles. New Zealand underwent a similar wine reform regime twenty years ago: protectionist barriers were removed, and growers were paid to grub up acres of unprofitable vines. The short term result was severe—cheaper wines from Australia flooded in and winegrower incomes fell. In the long run the results have been spectacular, however. Winegrowers replanted
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Michael Veseth is Robe
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