RESEARCH REPORTS

Changing Labeling Regulations: Implications for International Food Marketing

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Introduction

Globalization of food markets, at least among developed economies, represents increased trade and investment opportunities for food firms. International trade agreements including the European Community 92 (EC-92) initiatives, the General Agreement on Tariffs and Trade (GATT), and the North American Free Trade Agreement (NAFTA) are some of the overall policy instruments to open trade among Western nations. These agreements have been negotiated to comprehensively deal with reductions in tariffs, quotas and other readily identifiable trade barriers. However, revised regulations used to implement these agreements could become nontariff barriers to trade as trade distorting as the regimes they replaced. Food marketing firms entering new international markets must increasingly consider labeling, quality, and technical regulations used to implement these broad trade policies.

The purpose of this paper is to discuss evolving food quality and labeling regulations in the European Community (EC) and North America (United States and Canada). The discussion focuses primarily on the marketing implications of regulations relative to: 1) market opportunities and non-price competition; and 2) quality regulation as a barrier to foreign products.

Principle of Mutual Recognition in the EC

The European Community's policy governing food safety and consumer protection is based on the 1979 "Cassis de Dijon" sentence of the EC Court of Justice defining the "Principle of Mutual Recognition." Under this rule, each EC country cannot prevent the import of a good legally produced and sold in other member countries, even though the product cannot be legally produced in the importing nation according to the importing nation's rules.

The consequences of Mutual Recognition may be synthesized as follows: 1) this principle was an important tool used to achieve freer trade within the EC by the end of 1992 in the absence of uniform EC wide regulations; and 2) since strict rules in some member nations can be undercut by more permissive regulations in another state, the principle presents risks of lowered food quality and safety. To meet these exigencies, the EC has issued further regulatory directives for food quality and safety dealing with: 1) labeling; 2) organic product definition; and 3) quality differentiation (denomination of specificity, denomination of origin and geographic indication).

Labeling Regulations

The European Council issued two directives regarding labels: N. 79/112 (applied in Italy as DPR 18/5/82 n.322) and its modification n.395/89 (applied in Italy as D.L. 27/1/92 n. 190). These regulations aim to avoid creating barriers to free trade due to different rules within the EC and variations in competitive conditions among producers located throughout the EC nations. Labels are required to inform consumers concerning food product characteristics (nature, quality, composition, quantity, origin, method of processing, etc.). Labels are prohibited which attempt to differentiate a product from other similar products based upon claims of characteristics common to both products. Claims on labels pertaining to prevention or treatment of diseases are also prohibited.

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This research report was presented at the thirty-fourth annual meeting of the Food Distribution Research Society in Covington, Kentucky, October 20, 1993.

Organic Food Products

EC label regulation 2092/91 deals with organically produced foods. Labels on organic foods must: 1) convey that "organic" refers to controlled methods of agricultural production; 2) avoid references to quality warranties or claims of better nutritional and/or quality characteristics; and 3) indicate that the product has been produced or imported by a certified organic firm. Each state must organize control and provide for certification of organic products through both public and private organizations. The last rule (controls by private organizations) was adopted by Italian regulation (May 25, 1992, n.338).

Food Quality: Denomination of Origin and Geographic Indication

Quality differentiation is defined by regulations n.2081 and 2082 of 1992 with the dual purposes of providing producers with tools to enhance the value of products while providing consumers with clearly stated information concerning origin and processing methods. The regulations provide three designations.

1. *Denomination of origin* (DOP) applies to agricultural and food products denominated with the name of the region or country where: a) they originated from; b) their quality is related to; or c) they are produced and processed (including the raw products used as ingredients).

2. *Geographic indication* (IGP) is similar to DOP but applies to a broader region and denotes products that contain raw ingredients from areas outside the geographic area designated. To obtain a DOP or IGP, a product must follow a "production practices order" that defines the characteristics of the product and methods of production. This registration form is granted to associations of producers and/or processors by the EC Commission that determines control by each EC nation.

3. *Denomination of specificity* certifies that the product is unique and has one or more characteristics that differentiate it from other similar products.

Harmonized Safety Standards for Imported Products

Directive 92/59, February 8, 1993, harmonizes the rules covering control of product safety for all EC imports. This regulation requires each EC state to control an imported product's conformity to EC regulations in the absence of specific rules for that product.

Implications of EC Quality Regulations

The notion of food quality in the EC is currently based upon the Principle of Mutual Recognition (Swinbank). This principle, in the absence of unified, EC-wide regulations has numerous marketing implications. For example, in Italy yogurt is required to be made from fresh milk only, while in Germany yogurt can only be made from powdered milk. These two products, even though they may have different levels of nutritional quality and consumer appeal, can now compete in the same markets. Another example is pasta. In Italy, pasta can only be produced from hard wheat, but in Northern Europe soft wheat is permitted to be used in pasta making which implies a decrease in quality in the view of most Italians.

The potential response by food manufacturers, who face more stringent regulations in their home market which limits their competitiveness in other EC nations, is threefold. First, they might seek to relocate their manufacturing facilities to an EC state with less stringent rules. Second, they might lobby the home government for repeal of the national legislation responsible for impeding their competitive position with other EC nations. Third, the home manufacturer may lobby its home government to press the EC to adopt harmonized EC standards which protect the home country's products.

Regulations on denomination of a product's specific geographic origin and processing method were adopted to inform the consumer and to enhance the value of differentiated products. According to the aim of this regulation, quality is understood to depend upon particular characteristics of region and technique of production. The economic risks to producers due to such regulation may be identified as follows: 1) market myopia, particularly in identifying changes in demand; 2) difficulty in adoption of new technologies of production; and 3) difficulty in realizing economies of size. This regulation implies differing consumer demands for various qualities that may present barriers to entry in markets by other EC processors.

The consumer's image of food products is extremely important. The consumer is more and more distant from actual production. It therefore becomes necessary to create linkages and establish communication. Consequently, labeling and denomination of origin represents a type of warranty concerning technique and environment of production. In particular, promotion of products in niche markets, such as implied by denomination of specificity, involves generic promotion by producers in the territory. On the other hand, the differences between products depend more on individual consumer tastes and preferences than from analytical characteristics.

United States Regulations

U.S. regulations concerning the overall food supply include grades and standards, food labeling, and sanitary regulations. These regulations evolved as public policy for the primary purpose of guaranteeing the U.S. population a safe and adequate food supply. A secondary goal of these regulations is to supply sufficient information to consumers so that intelligent purchasing decisions can be made thereby facilitating efficiency in the processing and marketing of foods.

However well intentioned as public policy for domestic purposes these regulations may have originally been; these same regulations may be viewed by the United States's major trading partners, such as the EC and Canada, as trade restrictions. This could be avoided if all trading nations adopted a uniform set of minimum specifications which are scientifically based. The following sections provide a brief overview of regulations and the roles they play in U.S. food marketing.

Grades and Standards

Grades and standards for agricultural products are market facilitating functions. Grades and standards partially overcome diversity in agricultural production. In the short run, grades and standards are used to sort a large array of heterogenous production into homogeneous lots for which individual consumer demands exist. Such activities allow buying and selling on a specification basis and increases the accuracy of market price reports and marketing efficiency.

Federal grades and standards fall into three broad categories of being: 1) mandatory; 2) permissive (recommended but not compulsory); and 3) tentative (offered, but subject to change before becoming permissive or mandatory). Only in a few instances have mandatory grades been used at the retail consumer level. These are usually referred to as grade labeled products in the United States. The most notable examples are eggs and beef where product grading implies certain quality attributes to the final consumer.

In other instances grades and standards sometimes appear on various products but are not as widely recognized by consumers. In most of these cases brand names and trademarks serve the role that grades might have played. This applies to both fresh and processed food products.

Nutrition Labeling and Education Act

The Nutrition Labeling and Education Act (NLEA) of 1990, mandated nutritional labeling for most foods. Furthermore, authorization to use various content claims on food labels must be approved by the U.S. Food and Drug Administration and comply with the enabling legislation of this act. The labels become mandatory in May 1994 but various regulations concerning health claims and other label claims became effective in May 1993.

These new regulations will require nutritional labeling on most processed food products, however, it will be on a voluntary basis for many raw food stuffs. There will be some notable exceptions. Products that will not require the nutritional labeling will be those produced by extremely small businesses and foods destined for away from home consumption such as in hotels, restaurants, hospitals, and other institutions.

The new food labeling requirements require that information be provided on total calories, calories from fat, total fat, saturated fat, cholesterol, sodium, total carbohydrate, dietary fiber, sugars, protein, vitamins A and C, calcium, and iron. Other nutritional labeling, permitted on a voluntary basis, will cover calories from saturated fat, polyunsaturated fat, monounsaturated fat, potassium, soluble fiber, insoluble fiber, and other essential vitamins and minerals. The nutrients that must appear in the new nutritional label format under "Food Facts" were selected based upon health concerns and reflect various priorities regarding dietary recommendations within the United States.

The nutritional information required for foods marketed within the United States will be based on a specified serving size. However, this size will not be left to the discretion of the food manufacturer. In the future it will be specified in both common household and metric measures. It will be the amount of the product usually eaten at one time.

Nutrient content descriptions will also be regulated by the NLEA. As an example, the term "free" means that the product contains no amount of, or only a trivial, or physiological inconsequential amount of, one or more of these food components: 1) fat; 2) saturated fat; 3) cholesterol; 4) sodium; 5) sugars; and 6) calories. For example, to be calorie free implies fewer than 5 calories per serving under the new regulations. Sugar free and fat free both mean less than .5 g per serving. Other standards will be imposed in terms of dietary or nutrient descriptors such as light, less, reduced, good source, high lean, and extra lean. In each case a quantitative minimum or maximum is specified under NLEA.

Health claims about the relationship between nutrients and the risk of disease or health-related conditions will be allowed for the first time. These claims may be verified through third party references and must meet the requirements for authorized health claims. Various words such as "may" or "might" will

be acceptable but statements about the degree of health risk reduction will not be permitted.

Marketing Implications of NLEA

The implications of the NLEA for domestic food marketing are rather minimal. Food processors will incur the costs to develop the new labels, but all food processors will be affected to relatively the same degree.

These new labeling and nutrient content regulations may represent trade barriers between the United States and its major trading partners. The new label law may present a barrier to firms exporting to the United States. If foreign firms choose not to provide the information on their labels then they will not be permitted to sell their products in the United States unless they fall under an exemption. The degree to which various exporters of foods in the United States are willing to cooperate in meeting these new labeling requirements will be based upon the costs that they will incur relative to potential benefits. In some cases, the new legislation may present major trade barriers to firms interested in exporting food products to the United States.

Canada's Regulatory Review

In recent years, the Canadian agri-food industry has experienced profound structural changes. Today, fewer, larger, and more specialized farms, food processing, and marketing firms dominate Canada's food industry. The more open trade environment between Canada and its trading partners has also prompted the food industry to take steps to become more internationally competitive. Within this environment, the Canadian federal government called for a complete review of all regulations and the entire regulatory process in 1992. The broad objectives of the review were to: 1) identify regulations that were not efficiently and effectively serving an important purpose; 2) foster efforts to encourage competitiveness of (healthy and safe) Canadian products in both domestic and export markets; 3) rationalize the design and enforcement of regulation; and 4) promote a cost sharing approach based on the "beneficiary pays" principle.

The premise of the review is that the role of government is to provide public goods, such as protection of consumer health and safety whereas private industry has a more important stake (and responsibility) in product inspections and control. Regulation should be reduced in non health and safety related areas such as packaging, labelling, and grading. Regulations should be retained in order to protect consumer health as well as animals and plants. Increased roles for industry and local governments in regulating these areas could be indicated.

The Canadian government's adoption of a "user-pay" approach to regulation indicates that the direct beneficiaries of a specific regulation should also pay for it, whereas the taxpayers should be responsible for providing public goods. Introduction of "sunset clauses" as a method fixing an automatic termination date for each regulation and requiring a new review process to extend regulations for another term are also proposed by the review.

The Review Process and
The Competitiveness Test

The ensuing review process systematically examined all existing regulations, individually or in clusters, to validate and improve, or kill, each of them. Three main criteria guiding the review process included: 1) concern for competitiveness; 2) reduction of regulation; and 3) ensuring an efficient administration of regulation. Other dimensions of the validation process included: 1) consideration of possible regulation obsolescence; 2) determination of the beneficiaries of the regulation; 3) analysis of impacts on interprovincial and international trade; 4) consistency of interest between general public and consumer welfare; and 5) the need for the regulation to be environmentally sustainable and consistent with societal values and ethics.

The competitiveness test (i.e., the determination to what extent a specific regulation affects competitiveness) was perhaps the single most important dimension of the review process. Competitiveness was defined as the sustained capacity to profitably gain market share. The factors that were formally considered in this test addressed a number of broadly, and indeed modernly, defined marketing dimensions relative to competitiveness. Competitiveness was not defined as the achievement of a quick profit but rather a more responsible, long term, strategy considering not only economic efficiency but also human resources development, consumer values and environmental sustainability.

Recommended Strategic Directions

Specific attention was devoted to enforcement of regulations for imported products. Enforcement efforts are not to be motivated by unnecessary discrimination between imported and domestic products. Streamlined, integrated import regulations, and promoting more consistent treatment across commodities is the Canadian goal. Efforts to promote and ensure compliance also resulted in calls for the decriminalization of certain regulatory violations. Introduction of the "Administrative Monetary Penalties" which can be

levied quite promptly, have potential to be more effective than a lengthy court battle in correcting violations.

Further recommended changes were identified in each area of the following regulatory activities.

Food Safety Change emphasis from organoleptic and/or end product inspection to monitoring critical control points along the production process.

Animal and Plant Health Continue management of disease and pest control programs, prioritize national and public good, apply the "beneficiary pays" principle.

Grading Shift to voluntary programs, incorporation of user fees, increased auditing and monitoring, encourage consistency across commodities and encourage alternative grading programs development by the industry.

Composition Standards/Standards of Identity Continued regulation and increased use of international standards (CODEX Alimentarius).

Labelling Development of a "single-window" for all labelling requirements, consistent treatment of domestic and imported products and full cost recovery.

Package Sizes Develop alternatives to standard container size regulations and allow industry and consumers to adapt to less regulation.

Certification Provide certification whenever required by foreign buyer and explore alternate methods of certifications (certified independent agencies).

Registration, Licensing, Arbitrations Continue registration, licensing, and label approval for health, environmental or occupational safety reasons while focusing on efficacy and the "beneficiary pays" principle.

Conclusions

The effects and limits of food regulation can be outlined as follows: 1) regulations become obsolete and need to be changed or eliminated periodically; 2) regulations affect producers, distributors and consumers; and 3) regulations affect competition among countries. In particular, food marketing is a dynamic process in which market changes are more frequent and swift than changes in public policy and associated regulations used to implement these policies.

The proposed new regulations for food packaging, labeling, and sanitation (health) in North America and the EC all have a common objective of providing better information to consumers, protecting health, and fostering competition among producers. The first two objectives cannot be questioned since both contribute to the overall welfare of society. The major limitation is not in the concept but in the simple fact that each country is developing such regulations independently. This individuality or uniqueness may create international trade barriers.

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