The Business Costs of Mandatory Country-of-Origin Labelling

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Foreword

LEI Wageningen UR was commissioned by the Dutch Ministry of Economic Affairs to conduct a study that would assess the costs of the clause on country-of-origin labelling in the EC Regulation on the Provision of Food Information, which is due to come into force on 1 December 2014. DG SANCO and the Ministry of Economic Affairs needed deeper insight into the implications of this Regulation prior to this date. This insight is provided in this report.

The study was supervised by a committee made up of Jos Goebbels (Central Organisation for the Meat Industry), Jan Bijloo (Dutch Dairy Association), Hidde Rang (Product Boards for Livestock, Meat and Eggs), Marianne van Gemert-Falkena (Ministry of Health, Welfare and Sport), and Denise Lutz, Renze Brouwer and Gerard Goudsmits (Ministry of Economic Affairs).

The study was conducted on the basis of information supplied by a large number of businesses (see appendix). We would like to thank them for their input and for their willingness to work with us.

Background of the study

At the end of 2011, the European Commission published its new Regulation on the Provision of Food Information to Consumers (EC no. 1169/2011). In this Regulation there is a clause that creates an opening for the introduction at a later date of mandatory country-of-origin labels for one or more product groups. The prospect was greeted with concern from businesses and interest groups who feared the extra financial burden it might impose. Dutch businesses are afraid that mandatory labelling detailing the country of origin and place of provenance could be very costly. It involves much more than simply stating the name of a country on a label. It is also about separating the product flows from different countries and continuously anticipating a changing mix of ingredients. Accordingly, repeated requests came from external organisations such as Friesland Campina, the Dutch Dairy Association, the Central Organisation for the Meat Industry, the HPA (product board for arable crops), the FNLI (foodstuff industry federation) to the Ministry of Economic Affairs to adopt an active approach that would draw attention to the extra obligations and costs that might be incurred if DG SANCO were to introduce mandatory country-of-origin labelling. It was decided that, before the new EC Regulation came into force, an extensive study would be commissioned to assess the impact of country-of-origin labelling and to gain a clear picture of the costs to businesses. A period of two to three years was reserved for this purpose. DG SANCO had recently appealed to the Member States to come up with information on the costs. And the Ministry of Economic Affairs has asked LEI to assess the potential implications of country-of-origin labelling on businesses in the Netherlands.

Aim of the study

The aim of the study was to gain insight into the effects of the pending regulations on country-of-origin labelling.

It's a case-based study, where we have selected cases that (i) were complementary to two adjacent studies[1], (ii) would possibly have far-reaching effects and (iii) have a reasonably large market for the products. Two product groups, subdivided into five products were duly selected:

- Products with milk as an ingredient: herb cheese, fruit yoghurt, and butter;
- Products with meat as an ingredient: sliced cold meats and meat-based snacks.

The case of the sliced cold meats was quantitatively extrapolated as far as possible. A different approach was used for the other cases, which were assessed qualitatively in terms of the effects that the new Regulation would have on businesses.

Method

The effects were determined by interviewing representatives of the businesses concerned (see list in Appendix 1). Different approaches were applied. Various producers of fruit yoghurt, herb cheese, and butter were asked to participate in a workshop. Several producers of snacks also came together. Seven producers of sliced cold meats were asked about the potential effects. The results were then analysed and presented again to them.

All the businesses were asked the following questions:

- Which raw materials are used for these products?
- Where do they come from?
- Why are these raw materials sourced from different countries?
- What will change for the business when it is obliged to state the country of origin of the different raw materials on the label? (i) What activities will change? (ii) How often will changed activities take place in the production process? (iii) What extra costs will these activities bring?

The research team endeavoured to identify as many cost drivers as possible in order to draw a comparison across the products. The findings of the study *Herkomstetikettering – mogelijke non-tariffaire belemmering?* were also used. The extra costs of country-of-origin labelling for a number of products were then estimated along with the underlying causes. This delivered a sketch of the cost drivers of seven products and enabled a general picture to be compiled.

The findings were presented in a way which ensured that individual companies could not be identified. An overall picture was drawn for the product or products in question.

Conclusions

Ten relevant cost items resulting from country-of-origin labelling on sliced cold meats

<u>Higher costs of raw materials and greater losses</u>

1. Raw materials will cost more because they cannot (or can no longer) be sourced on the basis of a price/quality ratio as main argument.
2. Specific note should be taken of the fact that it is impossible or, at least, difficult to return residual flows to the production process. It is, after all, perfectly conceivable that these residual flows will come from a process that uses a batch of raw materials from country-of-origin A, while the next process uses a batch from country-of-origin B.
3. In addition, raw materials which are residual flows from other partners in the chain will probably be less available for use if they have to be stamped and separated according to

[1] The study *Herkomstetikettering – mogelijke non-tariffaire belemmering?* (Country-of-origin labelling – a potential non-tariff barrier?, Berkhout *et al.*, 2012) and the EU study *Origin labelling of pig, poultry and sheep & goat meat,* headed by W.H.M. Baltussen.

country of origin in the next stage in the production chain. This will push up the costs for the producer of the residual flows and may make the sale less worthwhile or not worthwhile at all.

4. The need to enter information manually at different places will increase the probability of mistakes and non-use. This will be compounded by the fact that companies tend to exercise extra caution by withdrawing the products from the market that were produced immediately 'before and after' the mistake.

Higher production, storage and transport costs

5. Storage and transport costs will rise because more storage space and more batches will be needed. Storage space will have to be reserved for each country. Sometimes there will be physical limits to the expansion options, which will again push up the costs.
6. Fewer products per storage/transport unit will increase the unit costs.
7. The production costs will rise because production processes will be less efficient. Production processes will have to be halted more often so that machines can be 'cleaned' of products and raw materials when the country of origin changes.

Higher costs of information collection and processing

8. The extra administration tasks will require additional manpower: more people will be needed to update the information in the labelling systems.
9. The registration costs will rise: new registration systems and new computer capacity will be needed (e.g. a new server to process the vastly increased volume of information).
10. The labelling costs will rise:
    a. Bigger labels will be needed to provide space for the extra information.
    b. Pre-printed labels alone will not suffice. Additional printers will be needed on-site to print the latest information on the labels. Pre-printed labels are currently purchased months in advance and display the design specified by the customer. These labels contain factual information but they are also the business card of the product. That does not apply to the extra information – which is in plain black and white.
    c. It will no longer be possible to use pre-printed cardboard boxes in the catering sector. Labelling will also have to be applied here with the subsequent extra costs and changeover times.

    It should be noted that the labels will also be bigger as a result of other legal requirements besides country-of-origin labelling. From 1 January 2014, labels will be bigger in any case. So country-of-origin labelling is not solely responsible for this effect though it will still be a contributory factor. That said, more information will still have to be printed on the labels, so they will have to be bigger.

Quantification

Table 1 presents a rough estimate of the additional costs for a number of products.

Table 1: Estimated additional costs of country-of-origin labelling for production costs in percentages

Fruit yoghurt	1%
Herb cheese	Not known – the price of cheese could rise by 3%, there are no estimates for the herb component or components
Butter	0.5% to 0.75-1%
Sliced cold meats	1-5% to 20%[2]
Snacks	15-25%

[2] 1-5% for pure sliced cold meats, 20% for composites.

Peas	Not known, but 0.4 – 1.2 euro cents per jar/can
Salad mixes	Not known

The quantification indicates that the additional costs will increase according to:

i. the number of raw materials in a product;
ii. the number of countries where the raw materials are sourced.

The effects are greater for mixes of raw materials. In such cases, some businesses cannot even piece together a mental picture of what has to be changed and they described the regulations as ‘unworkable’. Classic examples are herb cheese, salad mixes, sliced cold meats and snacks, which are based on a mix of raw materials.

Other effects
Other effects were mentioned besides the economic implications.

- Businesses will be more vulnerable. It will be more difficult to spread the risk of, for example, animal diseases by sourcing raw materials from different countries.
- Sustainability will suffer. People foresee smaller batches, half-full trucks and less efficient logistic systems, which will adversely affect sustainability, the climate and energy consumption.
- Less high-quality re-use of residual flows in two areas in particular:
    - By-products from the production process that fail to meet the consumption criteria are usually fed into the next round of the process, again as raw material. This will not be possible if the next batch comes from a different country.
    - Businesses often increase the economic value of their residual flows by selling them. However, if mandatory country-of-origin labelling is introduced, the purchaser will demand a label that shows the country of origin of these residual flows – which, of course, will also have to be delivered in separate batches. As this will generate extra costs for the seller, it is open to question whether it will be worthwhile to deal with residual flows in this way.
- The interviewees said that smaller businesses will be more heavily hit than large companies if the additional costs cannot be converted into higher prices for the consumer. Small businesses will suffer more under the impact. However, those who operate mainly on local and regional markets will only be slightly affected – if at all – by the costs of country-of-origin labelling.
- Disrupted market forces: businesses will buy their raw materials from a limited number of companies. This practice will fly in the face of the EU free-market philosophy.

Finally,

The study showed that mandatory country-of-origin labelling will generate higher production costs for businesses. Although this increase may not seem very big, it is important to bear in mind that margins in the food industry are already small. Also, it is uncertain whether these additional costs can be recouped in the market. Businesses are not convinced that consumers are willing to pay for information about origin. And recent research[3] has shown that the Dutch consumer, at all events, attaches no added value to this kind of labelling and is not prepared to pay a higher price for it. Businesses have expressed a preference for a voluntary arrangement: when an opening for country-of-origin labelling appears in the market they can respond of their own accord.

[3] Confirmed in the report *Voedsel labelen met land van herkomst: leuk, maar geen voorwaarde; Onderzoek onder Nederlandse consumenten* (Labelling food with the country of origin: fine, but not a precondition, 2012) by Van Haaster-de Winter, M.A. van and A. Ruissen.

APPENDIX 1: COMPANIES INVOLVED

<u>Products with milk as an ingredient</u>

- Mr. R. Habraken (Friesland Campina)
- Mr. J. Bijloo (Friesland Campina)
- Mrs. T. Hidding (Rouveen Kaassepcialiteiten)
- Mr. G. Krijgsman (De Graafstroom)

<u>Products with meat as an ingredient</u>

Sliced cold meats

- Mr. Erik Vliek (Zwanenberg Food Group)
- Mr. Roland de Haan (Stegeman)
- Mr. J. de Haan (Jos Slippens)
- Mr. F. Egberts (Henri van de Bilt)
- Mr. R. de Jong (Nico Sluis)
- Mr. K. Smits (DGS)
- Mr. B. Verhoek (Zandvliet Vleeswaren)

Meat-based Snacks

The AKSV 'Commissie Kwaliteit en Milieu':

- Mrs. J. de Vries (De Vries Snacks)
- Mrs. W. Cox (Mora Producten)
- Mrs. D. Velthuis (Royaan)
- Mr. A. van de Kolk (Bonfait)
- Mr. P. Roozen (Ad van Geloven)
- Mr. V. Sanders (King Cuisine)
- Mrs. M. Kroesbergen (Piet de Wit Snacks)
- Mrs. K. Koppen (AKSV)
- Mrs. M. Zandbergen (Beckers Benelux)
- Mr. D. van de Berkmortel (Qizine)
- Mr. I. Croonen (Favory Convenience)
- Mr. R. Talsma (Smilde Foods)