

Country-of-Origin (Fred Kuchler, ERS)

A label will not always influence demand enough to make it worth the cost. Market behavior suggests that the costs of country-of-origin labels for beef and lamb are greater than the benefits. The following example illustrates why any proposed government intervention in labeling decisions ought to arise from a demonstrated market failure.

Background

The Conference Report accompanying the Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act, 1999, directed the Secretary of Agriculture to conduct a study on the potential effects of mandatory country-of-origin labeling of imported fresh muscle cuts of beef and lamb. (Muscle cuts include steaks, chops, and roasts, but not hamburger.) Labels would be required on packages purchased by consumers. The Conference Report requested that the study include the impact of new country-of-origin labeling requirements on segments of the food production, processing, and distribution chain (FSIS, 2000).

Mandatory labels would be new activities for some, but not all meat suppliers. According to the Federal Meat Inspection Act, imported consumer-ready packages must already identify country of origin. If imported meat is intended for sale intact to a processor, wholesaler, food service institution, grocer, or household consumer, in the packaging in which it is imported, the country of origin must be conveyed to the recipient (FSIS, 2000).

USDA's study, "Mandatory Country of Origin Labeling of Imported Fresh Muscle Cuts of Beef and Lamb," said that some livestock producer organizations and farmer organizations supported mandatory labels, while importers, meatpackers, food processors, and grocers were opposed (FSIS, 2000). For U.S. farmers to benefit financially from mandatory labels, consumers would have to prefer domestic products to imports. If consumers do prefer domestic products, labels would allow consumers to discriminate between imports and domestic products. As a result, demand for domestic meat products in the United States would rise along with domestic meat prices. Further, domestic products would increase their market share at the expense of imports.⁹ However, if consumers do not generally prefer domestic products, labeling will not confer any financial benefits to domestic producers.

Labeling Costs Outweigh Benefits for Firms Producing Beef and Lamb

If consumers are willing to pay extra for the certainty that their meat was produced domestically, and if labeling is relatively inexpensive, there is a financial incentive to make consumers aware of the different product characteristics. Grocers, meatpackers, and farmers would share the increased revenues and have an incentive to voluntarily label. Why is it that grocery items are not ablaze with country-of-origin labels?

The people who are best informed, and who have the greatest incentive to be informed about the costs and benefits of labeling, are grocers, meatpackers, and farmers. Their voluntary use of labels identifying U.S. products is, at most, rare. Their market behavior suggests that they believe that net benefits of labeling are negative—costs outweigh benefits. There are at least three possible explanations for rarely observing U.S. country-of-origin labels.

Consumers might not care where their food comes from. If country of origin does not influence demand, there is no incentive to label country of origin. That is, domestic beef and lamb producers may not be able to acquire a competitive advantage over importers by alerting consumers to country of origin. Grocers or meatpackers that did provide country-of-origin labels would incur labeling costs but receive no benefit.

Some analysts argue that origin does not matter to U.S. consumers (see, for example, Blank, 1998). A fast-food hamburger could be made from lettuce and tomato from Mexico, a bun fabricated from Canadian wheat, and a meat patty composed of lean meat from Australia and fat trimmings from the United States. Current fast-food restaurant advertising does not mention origin. Instead, it emphasizes price, portion size, flavor, and promotional toys.

⁹ For beef, the distinction between "domestic" and "imported" is not always obvious. Some feedlots import feeder cattle from Mexico, selling meat as U.S. product; and some feeder cattle exported to Canada are reexported to the United States as fed cattle. A labeling regulation might deal with this issue explicitly, but no such regulation has yet been written. Here, we can ignore definition problems. The regulatory definition of domestic and imported would not affect the qualitative results discussed here.

Consumers might prefer the imported product. The lack of domestic labels could mean that consumers want to know the origin of meat products, but view the imported product as superior. In this case, mandatory labeling would only decrease domestic market share. Most imported lamb comes from New Zealand and Australia and is already consumer-ready packaged. Suppliers in both countries have engaged in promotional activities and frequently label their products, highlighting the country of origin. Often, this labeling goes far beyond minimum legal requirements.

Consumers might prefer domestic products, but not enough to cover labeling costs. Even if consumers do favor domestic over imported products, labeling costs may outweigh the benefits from increased demand. Part of the reason benefits are small is that imported muscle cuts are a small fraction of total domestic beef consumption (1-2 percent in recent years (FSIS, 2000)). If labels served to exclude a portion of imported beef, the realized price increase would be relatively small in the short run, and most likely zero in the long run.

Livestock industries are characterized by production cycles lasting several years. Full adjustment to any mandated label requirement would likely also take several years. Physical capital required for beef and lamb production and a stock of animals that is fixed in the short run could eventually adjust to maximize profits under new market conditions. Full adjustment is likely to leave no benefits for producers. The consumers who want labels are the only ones who can benefit from labels over the long run.

To see this, suppose labeling made it possible for farmers to earn above-normal returns. These profits would attract new entrants. Absent any barriers to entry, domestic production would expand, bidding market price down. Under constant returns to scale, new entry would end when production is so large that price returns to its pre-label level. There, above-normal returns would end. Similarly, below-normal returns earned by importers would induce exit until the import price returned to its original level. The only persistent effect of labels is to offer consumers product characteristics they want.

Similarly, ending a requirement for labels would induce exactly the opposite shortrun impacts (Tullock, 1975). Without labels, consumers would no longer be able to distinguish domestically produced beef and lamb from imports, reducing the demand for domestic production. That is, domestic producers would have a strong inter-

est in maintaining the mandate even though they would be operating at normal rates of return. Losing the mandate would be costly in the short run, from their perspective.

Is There a Need for Third-Party Certification?

Country of origin is a credence attribute. Existing government programs, as well as wholesale and retail market conditions, suggest that country-of-origin labels on beef and lamb could be credible to consumers. Problems of verification and certification appear not to be significant reasons for the lack of voluntary use of labels.

USDA's Food Safety and Inspection Service (FSIS) is responsible for labels on meat products. FSIS labeling policy allows fresh muscle cuts of beef and lamb to be identified as "U.S. beef" or "U.S. lamb" so long as the statement is truthful. USDA's Agricultural Marketing Service (AMS) offers a voluntary program to officially certify that livestock, meat, and meat products originate from the United States and are eligible to be labeled as "U.S. beef." The voluntary program certifies that livestock and meat products have been produced from livestock born, raised, slaughtered, and processed in the United States. In effect, USDA has offered to overcome the major stumbling block for labels: verification and certification. To certify U.S. origin, AMS audits production and processing records. FSIS noted that when its report was written, there were no participants in the program (FSIS, 2000).

Labeling product characteristics is not new to the meat industry. Poultry products have been sold for years under company labels. Some beef is sold under brand labels, e.g., Coleman Natural Products, Inc., and Certified Angus Beef. The Nebraska Cattlemen's Association has also tried to develop a label for Nebraska (O'Hanlon, 1998).

For a country-of-origin label to be credible and verifiable, the industries that produce, distribute, and market beef and lamb would have to undertake some new activities. If they continue to sell both domestic and imported products, they would have to segregate domestic and imported products. Segregation is not new to the meat industry. Slaughter plants currently segregate beef carcasses once they have been graded. Grading programs result in some labeling claims that follow products through distribution to the retail level. Carcasses generally move through fabrication grouped

according to grade, being packaged in boxes or bags that are appropriately labeled (FSIS, 2000).

The Government's Role—Weighing the Social Costs and Benefits

Livestock producers associations argued that consumers have a right to know where their food is produced and that consumers want to know where their food is produced. Some livestock producers and producer-related associations argued that consumers prefer domestic beef and lamb for a number of reasons: some consumers believe that domestic food is safer, many wish to support domestic farmers, and many wish to support the pesticide, environmental, and worker protection laws under which domestic beef and lamb is produced (FSIS, 2000).

Is commingling of domestic and imported beef and lamb leading to a situation in which U.S. consumers make choices they would reject if given the opportunity to do so? Would some consumers choose to buy domestic products over imports if given the opportunity to do so? Probably not.

The nice feature of the market mechanism is that efficient outcomes usually occur quickly even if all the sellers do not instantly recognize that consumers want products with particular characteristics. If consumers really wanted domestic products (if they really believed that choosing domestic products increased the safety of meat, supported domestic farmers, and reinforced pesticide, environmental, and worker safety laws), it would take only one grocer to recognize what consumers want. The lines of consumers at the grocery stores that

supplied domestic products and the absence of consumers at all other stores would be a strong signal to all other grocers. Grocery store meat counters would all quickly begin to offer domestic products once one store began profitable discrimination between domestic and imported meat. As grocers asked meatpackers and distributors for domestic products, that demand would be passed back to farmers. Because there are no impediments to voluntary country-of-origin labeling for beef and lamb, the absence of voluntary labels suggests that labels would not lead to different consumer choices.

In addition, the arguments that imported meat is produced under weaker pesticide, environmental, and worker safety laws may not hold. The United States has imported almost all muscle cuts of beef from Canada and almost all muscle cuts of lamb from Australia and New Zealand (FSIS, 2000). These countries enforce their own pesticide, environmental, and worker safety laws.

Unless we can argue that there is a reason that markets do not yield efficient outcomes, there is no way to argue that social costs and benefits differ from their private counterparts. The private sector's choices can be assumed to be best. However, even if labels had the effect domestic producers desire, and if imports were produced under weaker pesticide, environmental, and worker safety laws, labels would not solve the problems cited by the livestock producers. Because beef and lamb, like most agricultural commodities, are exchanged in international markets, the meat excluded from the United States would be sold elsewhere. Other policies might be more effective at redressing international pesticide, environmental, and worker safety problems.