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MISSION AUTHORIZED

Comments of the Bureaus of Economics,
Consumer Protection and Competition
of the Federal Trade Commission*

Submitted to the
Food Safety and Inspection Service,
Department of Agriculture
In Response to a Request for
Comments on its Proposal to
Amend the Cooked Sausage Standard
Docket No. 85-009E
[51 FR 42239, 52 FR 2416]
Attention: Ms. Linda Carey
Room 3168
South Agriculture Building
Washington, D.C.

22 JUN 1987

* These comments represent the views of the above named Bureaus and do not necessarily represent the views of the Commission or of any individual Commissioner. The Commission has, however, voted to authorize the staff to submit these comments.

I. Introduction

In its Notice of Proposed Rulemaking, the Food Safety and Inspection Service (FSIS) has requested comment on its proposal to amend the standard of identity for frankfurters and cooked sausage products.¹ The proposed amendment would give producers flexibility to substitute added water for fat. This flexibility would enable manufacturers to produce low fat cooked sausages that are moist enough to be palatable. FSIS has also solicited comment on whether there is a "market failure that creates a need for the frankfurter standard and on the benefits and costs to industry and consumers associated with eliminating the standard."

The FSIS proposal represents an improvement over the current, more rigid, standard. However, we also believe that if there is a market failure, then a mandatory disclosure of fat content² would be preferable to both the current and proposed standards. In the case of cooked sausages, disclosure is likely to provide greater net benefits than an identity (or "recipe") standard because provision of the information appears generally to be inexpensive and because consumer tastes vary.

We begin our main comment (in section II) with a statement of why the FTC staff has an interest in this matter. Then, in sections III and IV, we discuss the types of potential market "failures" that recipe standards were

¹ The existing standard limits fat and added water content to 30% and 10% respectively. The proposed standard would still limit fat content to 30% but would permit fat plus added water content to total to 40%. Details of the current and proposed standards are given below in sections VI and VII.

² Under some circumstances, mandatory disclosure of protein content could be beneficial. See footnotes 29 and 34 below.

intended to redress, and their root causes. Assuming that an unregulated market would fail, Section V assesses the relative costs and benefits of identity standards and mandatory disclosure requirements and considers the conditions under which each approach would be preferable. Following this general inquiry, we discuss the current and proposed cooked sausage standards in sections VI and VII, respectively. Our conclusions are summarized in section VIII.

The issue of whether recipe standards are effective goes far beyond the current proposal relating to cooked sausages. More than 30 years ago, it was estimated that over 50% of consumer expenditures on food went toward products covered by FDA or USDA identity standards.³ Since that time many new standards have been added and few withdrawn, so identity standards apply to hundreds of billions of dollars of food products each year.⁴ Identity standards, though they may provide benefits, may also reduce innovation and competition in the food industry. If such standards are no longer necessary or if less costly alternative remedies can be found, then their elimination or replacement could provide important benefits to consumers.

³ In their article "Like Mother Used to Make: An Analysis of FDA Food Standards of Identity", Richard A. Merrill and Earl M. Collier cite an estimate published in 1954. See Columbia Law Review, 1974, p. 561.

⁴ Consumers spent over \$474 billion on food (including restaurant expenses) in 1985. Economic Report of the President, 1986, p. 268.

II. FTC Staff Interest

The FTC's interest in food standards and labeling stems from its general statutory obligations to promote competition and to prevent false and deceptive advertising. Under sections 5 and 12 of the Federal Trade Commission Act (15 U.S.C. 45 et seq.), which prohibit false, deceptive or unfair practices in or affecting commerce, the FTC has jurisdiction over the advertising of food, and has concurrent jurisdiction with FDA and USDA over the labeling of food. The FTC also has statutory authority to enforce a number of laws that mandate disclosure (Federal Cigarette Labeling and Advertising Act, the Truth In Lending Act, the Energy Policy and Conservation Act [appliance labeling]), has itself promulgated disclosure rules (Octane Rating, R-Value Rule, Care Labeling) and enforces several laws relating to standard-setting (the Wool Products Labeling Act, the Magnuson-Moss Warranty - FTC Improvement Act). In implementing its responsibilities, the FTC staff has developed considerable economic expertise in understanding the roles of advertising and labeling in providing consumers with reliable product information and in the roles that might be played by disclosure or standards in situations where the market will fail to provide adequate information without regulation.⁵

⁵ FTC staff's research includes W. Jacobs et al., "Improving Consumer Access to Legal Services: The Case for Removing Restrictions on Truthful Advertising" (1984); R. Bond et al., "Effects of Restrictions on Advertising and Commercial Practice in the Professions: the Case of Optometry" (1980); Bureau of Consumer Protection, FTC, "Drug Product Selection" (1979); A. Masson and R. Steiner, "Generic Substitution and Prescription Drug Prices: Economic Effects of State Drug Substitution Laws" (1985); M. Frankena et al., "Alcohol Advertising, Consumption, and Abuse" (1985); M. Lynch et al., "Experimental Studies of Markets with Buyers Ignorant of Quality Before Purchase: When Do 'Lemons' Drive out High Quality Products?" (1986).

III. Potential Market Failure

A recipe standard prescribes that certain ingredients in minimum or maximum proportions be present in a named product, includes a list of optional ingredients, and may also prescribe the way in which the ingredients may be manufactured and combined. A product may be sold under the name designated by the identity standard if, and only if, it conforms to the standard. Moreover, the sale of any food which "purports to be" or is "represented as" the standardized food is prohibited unless it conforms to the standard.⁶

Recipe standards (such as cooked sausage standard) appear to have been motivated by three concerns. The main concern was with deceptive "economic adulteration."⁷ It was feared that unregulated producers would substitute new and cheaper ingredients in traditional foods, and "pass them

⁶ See section 403(g) of the Federal Food, Drug and Cosmetic Act of 1938. For example, for many years prior to the passage of the this Act, Quaker Oats had marketed a product named "Quaker Farina Wheat Cereal Enriched With Vitamin D." In 1938, the FDA adopted two standards: "plain farina" and "enriched farina." Quaker's product did not conform to either standard and its production and sale were prohibited since it purported to be enriched farina, despite the fact its product was wholesome and truthfully labeled. Quaker appealed all the way to the Supreme Court and lost [Federal Security Administrator v. Quaker Oats Co., 318 U.S. 218 (1943)].

⁷ For a clear, and very interesting, account of some "adulteration" problems encountered in the early part of this century, see Carl Alsberg, "Economic Aspects of Adulteration and Imitation," Quarterly Journal Economics, November, 1931, 1-33. Alsberg (a chemist) had been Chief of the Bureau of Chemistry at USDA, the group responsible for enforcing the 1906 Food and Drug Act. He later was the first Director of the Food Institute at Stanford University.

off" as traditional staples to unsuspecting consumers.⁸ This concern will be elaborated more fully below.

A second and closely related concern was that producers might add new ingredients to traditional products and that these products might ultimately prove to be unsafe, even if the producers were not attempting to pass off their products as something they were not.⁹ Whatever was true in the past, safety considerations no longer provide a rationale for recipe standards. Prior to 1958, the burden was on FSIS or FDA to show that a suspect untested ingredient was "poisonous or deleterious." In 1958, however, Congress amended the Pure Food and Drug Act to require manufacturers to obtain prior approval for all food additives, whether for standardized or non-standardized foods.¹⁰ Although the existence of a recipe standard is now irrelevant to preventing the use of inherently unsafe ingredients, a standard may still be relevant in limiting the use of ingredients which are safe when consumed in moderation, but which pose a health risk to some consumers when consumed in larger amounts. Fat, for example, is an important source of metabolic energy, and certain fatty acids are necessary for good health. Excessive fat consumption, however, is widely believed to increase the risk of heart disease.

The third concern was that producers would add insignificant amounts of

⁸ See H. Thomas Austern, "The F-O-R-M-U-L-A-T-I-O-N of Mandatory Food Standards," Food Drug Cosmetic Law Journal, September, 1971, pp. 380-382 and passim. (reprinted from the Dec. 1947 issue).

⁹ Merrill & Collier point out that although Congress conceived of food standards primarily as a means of combatting economic adulteration, in practice "it is difficult to distinguish sharply between pocketbook and health interests of consumers" op. cit., fn. 14, p. 564.

¹⁰ Collier & Merrill, op. cit., p. 600.

nutrients or other seemingly desirable ingredients and then exaggerate their importance and deceive consumers into paying premium prices greatly exceeding the value of the extra ingredients.¹¹ This argument seems to have little current relevance for justifying recipe standards, since it assumes that manufacturers could label and advertise additives in a misleading fashion despite FSIS, FDA and FTC regulations that prohibit false and deceptive claims. In any event, the argument has no relevance to fat and added water, which are not ingredients manufacturers would want to exaggerate.

Under current conditions, then, recipe standards must be assessed as a means of combating the potential failure of the market to prevent two types of problems: (1) the deceptive sale, under traditional names, of products that are in fact cheap imitations, and (2) the sale of products that, unknown to the buyer, contain high concentrations of ingredients that may pose increased health risks for some consumers. Absent a cooked sausage standard, or alternative remedy, consumers might unknowingly buy sausages with more than 30% fat. If consumers could not detect the additional fat, producers would have an incentive to substitute fat for meat, since fat is cheaper than meat. Consumers who regard more fat as a "bad" might suffer injury not only to their health but also to their wealth, if less fatty sausages could be supplied at the same or a lower price.

IV. Causes of Potential Market Failure

Both of these concerns require that buyers be ignorant of the presence or quantity of undesirable added or substituted ingredients.

¹¹ Collier and Merrill, *ibid.*, pp. 597-599.

Although buyer ignorance of some product characteristics before, or even after, purchase can lead to market failure, in many cases explicit and implicit private contracts have evolved that overcome such buyer ignorance. These include seller or brand name reputation and seller warranties. So long as buyers can and sometimes do learn the overall quality of an item they have purchased from a known seller, and sellers need good "word of mouth" or repeat business to survive, reputation can overcome problems that would otherwise arise.¹² Also, new (and established) sellers can attract trial customers by offering "money back if not satisfied" or other guarantees.

However, not all characteristics can be assessed through experience in this way. For example, consumption will not reveal that an ingredient added to help preserve a traditional food may also increase the risk that the consumer will some day develop cancer, and it might not reveal that one brand of hot dogs contains more fat than another. Though manufacturers often disclose and tout the desirable credence qualities of their products, one would not expect them to advertise negative characteristics directly.

¹² Economists divide product characteristics into three categories. "Search" characteristics are those that can be verified by sensory inspection; "experience" characteristics can be verified in the course of normal use or consumption; and "credence" characteristics are those that can only be discovered by costly, special examination. For the first two, see Phillip Nelson, "Information and Consumer Behavior", Journal of Political Economy, March/April 1970, 78, 311-329. For credence characteristics, see Neil Borden, The Economics of Advertising, Irwin, 1942, pp. 33, 425 and 429 and Michael Darby and Edi Karni, "Free Competition and the Optimal Amount of Fraud", Journal of Law & Economics, XVI (1), April 1973, 67-88.

For some recent economic theories of the role of reputation in experience good markets, see Benjamin Klein and Keith B. Leffler, "Non-Governmental Enforcement of Contracts: The Role of Market Forces in Guaranteeing Quality," Journal of Political Economy, August 1981, 89, 615-641, and Carl Shapiro, "Consumer Information, Product Quality and Seller Reputation," Bell Journal of Economics, Spring 1982, 13, 20-35. For an economic theory of warranties, see Sanford J. Grossman, "The Informational Role of Warranties and Private Disclosure about Product Quality," Journal of Law and Economics, December 1981, 24, 461-484.

They may do so indirectly, however. If products with less of a negative characteristic can be manufactured, then some firms may produce them and advertise their advantage ("no preservatives," "less fat in our franks"). Nevertheless, if the negative characteristic cannot be varied (cholesterol in eggs), and if there are no close substitutes, then the market will probably fail to provide sufficient information.¹³ Incentives to build a good reputation might remedy a market failure caused by credence characteristics, but only if a significant number of consumers take the time and trouble to become informed concerning them.

In summary, if the market suffers from the two potential problems discussed above, then the root cause of both is lack of consumer information. Market failure is most likely to occur with respect to credence characteristics, particularly those that are intrinsic to the product and so difficult or impossible to vary. Under these conditions, some form of government regulation may have benefits for consumers that exceed the associated costs.

To some degree, the fat content of sausages may be a credence characteristic. Consumers may not be able to distinguish, by taste or appearance, between sausages with very different fat contents.¹⁴ The

¹³ See Robert Pitofsky, "Mandated Disclosure in the Advertising of Consumer Products", and Richard Posner, "The Federal Trade Commission's Mandated-Disclosure Program: A Critical Analysis," and their dialogue, in Business Disclosure--Government's Need to Know, edited by Harvey Goldschmid, New York: McGraw-Hill, 1979, 311-376. For a thorough discussion of the peculiarities of the market for consumer product information, see Howard Beales, Richard Craswell and Steven Salop, "The Efficient Regulation of Consumer Information," Journal of Law and Economics, XXIV(3), Dec. 1981.

¹⁴ Some USDA surveys showed that "high levels of fat contribute little to taste value. Other factors such as seasoning appear to be of greater importance," according to testimony of Dr. Leighty, then Chief of the

average fat content of frankfurters rose from 19% in 1937 to 20% in 1950 and to 33% in 1969.¹⁵ Protein content fell from 20% in 1937 to 14% in 1950 and to 11% in 1969.¹⁶ According to one writer,

"The trend to increased levels of fat was accelerated by new processing techniques imported from Germany and the discovery of new fat emulsifiers by Oscar Meyer and Company. These developments made it possible to incorporate vastly increased amounts of fat (some products tested had as much as 51% percent), without disturbing the appearance or taste of the sausage. Because sausage production is a competitive industry, sausage makers who cut production costs by increasing the fat and lowering the meat content forced other firms to follow suit."¹⁷

The above is essentially a description of a type of market failure known as a "lemons" market by economists.¹⁸ Because consumers cannot distinguish between high and low fat hotdogs, they will not pay premium prices to those

Technical Services Branch, USDA, Public Hearings on Fat Content of Cooked Sausage, June 18, 1969. Quoted in Harrison Wellford, Sowing the Wind, Grossman, 1972, p. 93. Surveys and test tastes commissioned by two meat trade associations suggested, however, consumers had differing preferences and that some of the observed variation in actual hotdog fat content (from 14% to 51%) was due to manufacturers trying to satisfy different tastes. For more detail on this hearing, see Wellford, pp. 87-96.

¹⁵ Figures (rounded to the nearest whole number) taken from a Memo from R.H. Alsmeyer, Head, Consumer & Marketing Standards Group, USDA, to W.J. Milnor, Acting Director, Technical Services Division, USDA, November 29, 1968. As quoted by Wellford, op. cit., p. 89.

¹⁶ ibid., p. 90.

¹⁷ ibid., p. 90.

¹⁸ See George A. Akerlof, "The Market for Lemons: Quality Uncertainty and the Market Mechanism," Quarterly Journal of Economics, August 1970, 84, 488-500, and M. Lynch, R. Miller, C. Plott and R. Porter, Experimental Studies of Markets with Buyers Ignorant of Quality Before Purchase: When Do "Lemons" Drive out High Quality Products?, Report to the Federal Trade Commission, September, 1986.

producers who in fact provide lower fat hotdogs. The end result is a market with only high fat content hotdogs selling at competitive prices.

It is clear, however, that the lemons model does not fully apply to the cooked sausage market. As mentioned above, both in the past and to some extent now, frankfurters with differing fat contents have been and are offered on the market. An informal survey of local supermarkets showed that, of those labeled, most meat franks contained about 30% fat, that is, the maximum amount allowed under the current standard. This is what one would expect to observe in a lemons market.¹⁹ However, the supermarkets also carried chicken and turkey franks. Manufacturers of chicken and turkey franks, which are not subject to a recipe standard, generally provide a complete nutritional disclosure on their package labels, advertise their products as "lower fat," and state that their products have at most 20-25% fat compared to the 30% fat standard for meat franks. Clearly, these producers believe that lower fat provides a competitive advantage for their products and they voluntarily provide fat content information about their own products relative to those of their competitors.²⁰

¹⁹ There was one exception. Eckrich "Lean Supreme Jumbo Franks" contained 23% fat. Compared to the same company's "regular" franks, their lean franks contain about 4 more grams of meat and 4 less grams of fat per 56.7 gram frank. Contrary to what one might expect, the lean franks were lower in price than the regular franks. Prices, for "beef franks" with identical fat and protein contents, varied substantially from \$1.58 to \$2.49 per pound at the same outlet on the same day (April 30, 1987; Giant, Arlington). Thus, some consumers are willing to pay a premium for some brands of hotdogs even though their nutritional content is the same as store brands. In a pure lemons market, no one pays a premium because no one can distinguish the quality of one brand from another.

²⁰ Although FSIS does not require nutritional labeling even when a low fat claim is made for chicken franks, labels still must be approved for use. Some of the voluntary disclosures may have been influenced by FSIS labeling requirements for meat franks, even though they do not formally apply. We also note that chicken franks are substantially cheaper than meat franks. Prices varied between 89 and 99 cents per pound in the same store

Thus, although there is some evidence that a completely unregulated cooked sausage market might fail because of credence aspects, the evidence with respect to the existing market is mixed and scanty. There does not appear to have been any extensive study of this market either prior to the 1969 recipe standard or thereafter. Nor has there been any careful study of how the absence of a recipe standard affects the operation of the chicken frank market. It is clear, however, that the perception that the unregulated sausage market would or had failed played an important role in generating the current regulations.

Even if we knew that an unregulated cooked sausage market would fail due to lack of consumer information about fat content, the question of how best to remedy the failure would still require resolution. A recipe standard as currently used is one possibility, but there are other possibilities as well. These include mandatory disclosure requirements or a regulation allowing manufacturers to choose between conforming to a recipe standard or providing disclosure. Recipe standards and mandatory disclosure requirements clearly have different costs and may produce different benefits. We next discuss circumstances under which one or the other may be more efficient.

V. Recipe Standards or Disclosures?

Recipe standards have advantages relative to disclosure requirements in situations where it is difficult or expensive to provide consumers with relevant information, and where consumer preferences are known and are similar for all consumers. On the other hand, when disclosures are

and on the same day that meat franks varied between \$1.58 to \$2.49 per pound.

relatively easy to make and consumer tastes are varied and changing, disclosures may provide important benefits that cannot be attained with recipe standards.

A. Comparative Benefits

The main advantage of a recipe standard relative to disclosure is that a standard saves consumers the time and effort it takes to learn how to use the information disclosed and the time it takes to read and compare disclosures. A standard can eliminate "undesirable" foods (those that knowledgeable consumers would not buy) when it is difficult or expensive for consumers to become knowledgeable. Disclosure may be expensive either because consumers would have to educate themselves to use it or because it is physically difficult to make the disclosure. Many consumers understand the significance of caloric intake for body weight, and many are aware of a positive relationship between cholesterol and heart disease. Fewer, presumably, would be aware of the increased risk of cancer from natural toxins, such as hydrazines in raw mushrooms, or safrole in cinnamon leaf, nutmeg and pepper.²¹ Effective disclosure in the latter cases might require educational messages in addition to simple content disclosure. Disclosure may be physically difficult for foods sold to be consumed away from home. For example, ingredient or nutritional disclosure on the sausage package will not be seen by a person who buys a hot dog at a ballpark, nor by a customer who consumes unpackaged foods in a restaurant.²²

²¹ See Richard Wilson and E.A.C. Crouch, "Risk Assessment and Comparisons: An Introduction," Science, v. 236, April 17, 1987, pp.267 - 280.

²² If reputation is not a sufficient incentive for concession owners at ballparks or restaurant owners, then recipe standards may prevent the deceptive sale of food consumed away from home. However, a general recipe

Recipe standards might also have advantages over disclosure if consumer tastes are known and vary little. If a substance is known to be harmful even in very small concentrations (e.g., arsenic), then clearly a standard that prohibits its use in any recipe is more efficient than mandating its disclosure. Or, if (to take another example) no consumer would knowingly buy a sausage with more than 30% fat (at a price that covers costs), then a standard that mandates a maximum fat content of 30% would save consumers the time and trouble it would take to compare recipes across sausage brands to avoid such sausages. Of course, it would not take long for producers to learn what the standard setter is presumed to know: namely, that sausages with more than 30% fat do not sell. So disclosure would also be a viable remedy in this case.

If tastes vary, disclosure may provide important benefits that a recipe standard will not. For example, suppose consumers have different preferences for fat in sausages, and are willing to trade-off fat for money at different rates. An obvious advantage of disclosure over a standard that imposes a ceiling of 30% on fat content is that, with disclosure, consumers would be able to buy cheaper but fattier sausages, if they wished to do so. A less obvious advantage is that disclosure might enable consumers to buy low fat sausages that might not be marketed under a recipe standard. Under a recipe standard, consumers may not be aware of the fat content of any given brand of sausages unless the manufacturer discloses it. If no manufacturer chooses to disclose fat content, then all sausages might contain

standard seems to be an inefficient way to deal with a problem that only occurs when the consumer does not see the package label. A more efficient solution would be to apply the recipe standard only to food consumed away from home.

the maximum 30% fat, since these will be the cheapest to produce.²³ Thus, as compared to a recipe standard, disclosure may benefit consumers whether they prefer more or less than the maximum fat allowed by the standard.

More generally, use of recipe standards requires that regulators decide on which food characteristics are desirable, on how such characteristics should be traded off against each other or against undesirable characteristics (fat may taste good and provide nutrition, but too much may be unhealthy), and on how all characteristics should be traded off against money (fat is cheap). Moreover, since consumer tastes vary, the regulator must also decide which consumer tastes should be satisfied and which not. As ingredient prices, technology and tastes change, the standard setter must re-evaluate all these decisions. These are formidable problems. A standard setter will always be forced to adopt an arbitrary "bright line" standard such as "cooked sausages should never contain more than 30% fat."²⁴ Such an arbitrary standard will lead to the loss of valuable product diversity, unless the standard is so loosely set that few knowledgeable consumers would want to purchase products that did not comply with the standard.

Disclosure regulations, in contrast, enable informed consumers to trade off desirable and undesirable characteristics according to their individual

²³ If some consumers are willing to pay as much, or more, for lower fat sausages, one would expect some producers to voluntarily disclose their product's (low) fat content. It is not known if, and to what extent, producers advertised their products as "lower fat" during the 1950 to 1969 period in which the fat content of hot dogs increased by 50%. A careful study of this period could shed much light on whether and how a market failure might require some regulatory remedy.

²⁴ Standards for similar products may be very different. For example, though "hot dogs," "franks," etc., may contain no more than 30% fat, "Polish sausage" may contain up to 50% and "smoked sausage" has no fat content limitations whatsoever.

preferences.

B. Comparative Costs

The major costs of recipe standards are: (1) they may decrease or retard desirable innovation, and (2) they may be expensive to administer. Mandatory disclosures, on the other hand, will not retard appropriate innovation and entail little administrative cost. Their major costs appear to be the foregone benefits of whatever messages would have appeared in their stead and, perhaps, the cost of better quality control for manufacturers.²⁵

Recipe standards may reduce innovation and retard the rate at which innovations are introduced.²⁶ When a recipe standard applies, a firm that has found a new and cheaper way to manufacture an equally nutritious product covered by a recipe standard cannot market it until the old standard has been amended or revoked or a new one promulgated. This may entail a long and arduous process, especially if the effort is opposed by firms that expect to be injured by a change in the existing standard.²⁷ Ice cream manufacturers, for example, who sought to amend the recipe to allow non-

²⁵ The latter cost depends, in part, on the amount of sampling variation permitted relative to the average percentages disclosed on the label. We have no information on whether this is a significant problem for cooked sausage manufacturers.

²⁶ See Merrill & Collier, *ibid.*, pp. 602-603, and Steven Golden, "The Effects of Government Policies on Technical Innovation in the Food Industry: A Industry Perspective," in Critical Food Issues of the Eighties, edited by M. Chou and D. Harmon, Pergamon, 1979.

²⁷ The "safe and suitable" approach used by FDA in the breaded shrimp standard, among others, reduces the cost of lost innovation by allowing manufacturers flexibility with respect to new ingredients, which they may use so long as they are safe and appropriate. See Robert Schaffner, "The Effects of Government Policies on Technical Innovation in the Food Industry: A Government Perspective," in Critical Food Issues of the Eighties, edited by M. Chou and D. Harmon, Pergamon, 1979.

dairy substitutes for milk in ice cream were opposed by the Dairy Association. Ingredient producers may have a vested interest not only in preserving existing standards, but in creating new standards that require the use of their ingredients. The Dairy Association has (unsuccessfully) petitioned to amend the pizza standard to require real as opposed to ersatz cheese in frozen pizzas.

The cost of promulgating or changing recipe standards may be large both for the taxpayer and for the firms involved. Mandatory disclosure standards also entail costs (e.g., the loss of information that would otherwise have appeared on the label), but these costs may be small compared to those incurred for recipe standards. For example,²⁸ in 1958 Proctor & Gamble (P&G) began to market a new peanut butter called "Jif." Unlike the two leading peanut butter brands of the time, "Skippy" and "Peter Pan", Jif contained a blend of hydrogenated non-peanut oil in addition to peanut oil. The new mixture made Jif highly smooth and spreadable and P&G hoped this innovation would attract a large market share. In 1959, the FDA proposed, for the first time, a recipe standard for peanut butter. The proposed standard would have precluded the marketing of Jif under the name "peanut butter." A legal battle involving the three major manufacturers and the FDA ensued. The case was finally finished eleven years after the original FDA proposal. The case ended in a victory for P&G; Jif was peanut butter, but "Skippy" and "Peter Pan" were not. The two leading firms had to reformulate their successful products.

In summary, recipe standards have advantages in remedying information problems in situations where informing consumers is very costly and where

²⁸ Merrill & Collier, op. cit., pp. 585-591.

consumer tastes are very similar.²⁹ However, disclosure regulations provide potentially important benefits that are not likely to be available under a recipe standard. Moreover, recipe standards entail costs in terms of reduced innovation and high administrative costs that are not entailed by disclosure regulations. Therefore, the use of recipe standards should be limited to cases where disclosure is clearly not sufficient or where it is infeasible.

We turn now to the question of whether the cooked sausage standard should be amended or replaced by a disclosure requirement.

VI. Current Cooked Sausage Standard

FSIS regulation 319.180 deals with red meat "cooked sausage" products, including frankfurters, franks, furters, hot dogs, wieners, viennas, bologna, knockwurst, and similar products³⁰. It provides that such products contain at most 10% added water, and at most 30% fat.³¹ The "added water" is water that is mechanically added to the product.

In addition, FSIS has issued various administrative labeling policy

²⁹ As previously indicated, where a substance is known to be significantly harmful, then a standard that bans its use is clearly more efficient than a mandatory disclosure of its presence.

³⁰ "Franks" that are not red meat products are not covered by this standard. FSIS has a separate "chili frank" standard. There is no "chicken frank" standard.

³¹ Indirectly, the standard also requires that sausage products contain at least 11.5% protein. Meat or meat byproducts and certain other sources of protein must account for at least 57.5% of the sausage (binders can be as much as 3.5%). The regulation constrains the type of meat that may be used in such a manner that the ratio of protein to water must be at least one to four. Thus the sausage must contain at least 11.5% protein. Package labels may show a smaller protein percentage because of downward rounding.

memoranda that establish guidelines for cooked sausage products³². Under present guidelines, a product that conforms to the standard can be called a "lite" frank if it contains at most 22.5% fat.³³

If the manufacturer substitutes water for fat (thus exceeding the 10% maximum added water allowed under the standard), then he cannot call the product a "frank" or a "low fat frank", or even describe it as a "low fat frank with 15% added water." If he wants to use the word "frank", he must label the product "imitation frank". Alternatively, he can make up a name for the product (such as "lite link"), and describe it on the label. For example, he might call it a "beef, water and isolated soy protein product". The American Meat Institute (AMI) claims (understandably) that "such nomenclature is unreasonably burdensome and has acted to inhibit the marketing and sale of new, innovative products."³⁴

VII. The Proposed Rule and Alternatives

The present standard permits the manufacture of franks with less than 30% fat, but AMI asserts that the 10% added water limitation makes it difficult to produce a low fat sausage moist enough to be palatable at an

³² In the remainder of this comment we will (in most cases) use the term "frank" to substitute for the more inclusive term "cooked sausage".

³³ Similar guidelines exist for "low salt" and "very low salt" franks. The fat of a frank can only be reduced by substituting meat for fat or by substituting mechanically added water for fat. The current standard permits the first, but not the second. As noted above, Eckrich markets a lower fat frank, which conforms to the current standard and contains more protein than their regular frank.

³⁴ See the discussion of AMI's petition by FSIS, 51 FR 42239.

acceptable cost. The FSIS proposed standard would require cooked sausage products to contain at most 30% fat and at most 40% fat and added water combined. Thus, water could be substituted for fat at the manufacturer's discretion. The proposed new standard would permit manufacturers to produce palatable lower fat franks containing the same amount of protein, without having to market them under a pejorative name. Most agree that the availability of palatable and equally nutritious but lower fat franks is desirable. Since the proposed standard will encourage desirable product variety, it is superior to the current standard.

AMI proposes that FSIS promulgate a new and separate standard for "lite" cooked sausages, rather than allow more flexibility under a single standard.³⁵ Under their proposal, FSIS would set "bright line" standards of 22.5% maximum fat and 11.5% minimum protein content for lite franks.³⁶ The AMI proposal would also encourage the production and marketing of low fat, palatable and equally nutritious franks, since it would allow manufacturers to substitute mechanically added water for fat. Lower fat franks, containing the same amount of protein as under the current standard, could be produced at the same cost as regular franks. Therefore, the AMI proposal also represents an improvement over the current standard.

On the other hand, the AMI proposal would not relieve the current difficulties of producing low cost franks with fat content in the range

³⁵ Currently there is no "lite" sausage standard, but FSIS does have an administrative guideline for the use of the word "lite" on the label. See above, p. 18.

³⁶ The AMI proposed standard would allow producers to mechanically add water up to 20% of the product's weight. Since the ratio of protein to naturally contained water is about one to four in meat, the 11.5% minimum protein content implies that at least 57.5% (11.5% protein plus 46% natural water) of the sausage will be meat or meat byproducts. If the fat content is 22.5%, then mechanically added water will be 20%, or double the amount allowed under the current standard. 19

between 22.5% and 30%. Such franks would not conform to AMI's proposed "lite" standard, and to be palatable they would require more added water than allowed under the current standard. Such franks would conform to the FSIS proposed standard, and could have the fat content on their labels, but still could not use the words "lite" or "light" under the AMI proposal.³⁷ Therefore, the FSIS proposal allows for greater frank variety than the AMI proposal. Moreover, accepting the AMI approach seems to suggest that FSIS should initiate a new rulemaking each time a different "lite" or low calorie bright line standard is proposed for any product under its jurisdiction. Surely less expensive alternatives exist.

While the FSIS proposal appears superior to the AMI proposal, even the FSIS proposed standard will entail reduced product variety, reduced innovation, and substantial administrative costs. These costs will be incurred despite the lack of detailed evidence that, without a standard, the cooked sausage market would fail to provide the variety of franks that consumers are willing to pay for. In our view, if any regulation is required to prevent a market failure, mandatory disclosure of fat content would provide consumers larger net benefits than the FSIS proposed standard.³⁸

³⁷ Under current FSIS policies, franks with fat content in the 25% to 30% range, would not be allowed to use the terms "lite" or "light" on their labels.

³⁸ As we noted above, the current standard indirectly sets a minimum protein content for franks. Absent the standard, if consumers were unaware of protein content, firms might produce lower protein franks because they are cheaper to produce. Since protein is a desirable characteristic, we might expect firms to disclose protein content voluntarily. Some do now. It is possible, however, that consumers who were previously unaware of the low protein content of franks would react adversely to all franks once disclosure is made. In that case, no manufacturer would voluntarily disclose protein content. Thus, one could conceivably make a case for the mandatory disclosure of protein in addition to fat content.

An alternative remedy that might be worth consideration would be to give producers the option of either meeting the revised FSIS standard, or making a clear and conspicuous disclosure of fat content. Makers of products that conform to the standard would not have to make the disclosure. Firms that choose to depart from the presumptive standard could market non-conforming products if they made the disclosure.

VIII. Conclusions

The standard proposed by FSIS is superior to the current standard in that it would encourage the production and marketing of franks that are as palatable and nutritious as those conforming to the present standard and that contain less fat. Although the proposed standard is an improvement, our analysis indicates that disclosure may be better than any recipe standard. Mandatory disclosure of fat content appears to be a sufficient remedy to prevent any market failure that may exist due to consumer ignorance. Such disclosure also seems superior to any of the proposed standards. It would encourage valuable product variety and innovation and would probably reduce administrative costs. It would also facilitate consumer search and choice among cooked sausage products by providing an easy way to compare the content of various products. In particular, disclosure would more effectively facilitate shopping for low fat sausages than would a recipe standard. Another alternative, worth consideration, is to give producers a choice of either meeting the revised FSIS standard or disclosing fat content.