

ADDENDUM



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Nutrition, health and related claims: addendum to update

A benefit cost analysis

Prepared for

Food Standards Australia New Zealand

PART 2

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Background

FSANZ is seeking clarification on the implications of several points raised in recent consultations with industry. Here we have used the updated model used to assess the benefit cost implications of P293 to conduct sensitivity tests around some of the queries raised. We also provide comment on several cost estimates provided by industry by comparing them against model estimates.

Potential increase in cost from pre-approvals

In the model the costs of self-substantiation are included in cost/profit models 1 and 6: new products and reformulations. The costs are based on technical costs of testing and legal fees required. In the updated model these costs are \$14 803 per SKU. These costs apply to all SKUs fitting models 1 and 6.

FSANZ has provided the following information on the costs of pre-approvals.

Pre-approval – application costs – two options:

1. Unpaid – incur no cost but go into the queue.
2. Expedited applications or ECCB (exclusive capturable commercial benefit) incur costs. The minimum cost at present is \$50 000 for 350 hours but we refund unused hours.

Company 2 indicates that costs could range from \$20 000 to \$150 000.

Were we to assume all SKUs in models 1 and 6 were to seek expedited applications and incur an additional cost of \$50 000, the impacts on the overall updated benefit cost analysis after allowing for discounting, opportunity benefits and consumer impacts would be as follows.

- The cost would rise by 9.2 per cent overall.
- The net present value benefit for Australia only would decrease from \$79.8 million (chart 12 in the updated analysis) to \$52.6 million.

Were we to assume all SKUs in models 1 and 6 were to seek expedited applications and incur an additional cost of \$150 000, the impacts on the overall updated benefit cost analysis after allowing for discounting, opportunity benefits and consumer impacts would be as follows.

- The cost would rise by 26.1 per cent overall.
- The net present value benefit for Australia only would decrease from \$79.8 million (chart 12 in the updated analysis) to \$3 million.

Were only a quarter of SKUs in models 1 and 6 to seek expedited applications all results would simply be a quarter of the changes reported above, At a cost of \$50 000, the net benefit would decline from \$79.8 million to \$73 million for instance.

In two submissions received by FSANZ, there is a hint that because all current claims will be rendered illegal, even some that previously (2008) expected *no change*, some of the no change category (which was 77.7 per cent of the sample in 2008) will now require pre-approval. In one submission it is stated that:

Costs for applying to have current product claims added to a pre-approval list could be in the vicinity of an additional \$3 million.

The CIE has no data on the incidence of products in the *no change* category that might currently be carrying a claim and that now would require pre-approval, but which previously would have been assumed to already have sufficient self-substantiation not to require any additional cost to continue making their claim.

Nonetheless, were 1 per cent of the 77.7 per cent falling into the *no change* category to seek expedited applications at a cost of \$50 000, the updated net benefit of \$79.8 million would decline to \$38.7 million. Were the expedited application cost \$150 000, the net benefit would fall negative at -\$43.5 million.

Costs of extending the transition from two to three years

With short product life cycles, extending the transition period from two to three years could lower costs substantially without having much affect on benefits.

The product lifecycle assumed in the model is five years. It could be argued that if the transition period was five years, the marginal costs of any label changes caused by P293 would drop to zero because the food manufacturing companies would have to make a label change in this period anyway. They would do this when developing the replacement product.

In reality, some products last for 10, 20 or more years and others maybe only two years. We have assumed an average and used a high discount rate to account for an average product lifecycle of five years for all existing products. We also assume that SKU's are evenly distributed throughout their product lifecycles. So, were the transition period two and half years, say, only half of the products would be affected. The other half would have come up for renewal anyway and, therefore, impose no marginal cost. We have also assumed that all market changes imposing costs of changing labels, marketing, reformulation or removal of products on manufacturers for existing products are one off. Any of these costs arising from P293 happen once in the first five years and are not repeated. That is, all replacement products have no marginal costs imposed on them.

For new products, and new marketing opportunities the situation is different. Although the product lifecycle is still only five years, replacement products in the new market space created by P293 will carry on in perpetuity. We also assume that new product lifecycles will start within six months of any transition period. The product will last five years and then be replaced by a revamped product in the case of new products. The benefits will therefore carry on in perpetuity. We use a lower discount rate to represent this.

Notionally, given the assumptions above, a two year transition period would nominally capture around 60 per cent of SKUs and the 40 per cent that were scheduled for renewal anyway would face no additional costs from P293. For a three year transition period 60 per cent would escape capture but 40 per cent would get caught. Nominally, this is a 33 per cent reduction in costs: 40 per cent captured instead of 60 per cent.

Simulations with the model show that were we to extend the transition period from two to three years, after accounting for discounts, consumer costs and competing producer opportunity benefits, the real reduction in cost is around 25 per cent. Benefits also decrease due to lesser opportunities for competing producers and fall by around 4 per cent. Benefits to new products and new marketing opportunities are assumed to be unaffected. Overall this causes a 39 per cent increase in the net benefit of implementing P293. The updated net present value benefit of \$83.8 million would increase to \$117 million. The benefit to cost ratio would increase from 1.3:1 to 1.66:1.

Company 1, labelling cost estimates

In the updated benefit cost analysis, the nominal, undiscounted cost of a label change for a \$5 million SKU is \$15 696 (see table 8). Company 1 have provided indicative estimates ranging from \$5000 to \$15 000 per SKU. Ours are above their maximum. That said, ours also includes an estimate of \$3878 per SKU for label write offs caused by redundancy or obsolescence.

Company 1 suggest that given the coverage of the standard, a very large portion of the 30 000 SKUs on supermarket shelves would require label changes. Our previous survey of industry indicated that around 20 per cent would change, with 9.8 per cent of these being voluntary changes to exploit new marketing opportunities.

We note that company 3 suggests that 10 per cent of their labels might require changing. This is roughly consistent with our survey data.

Company 1 do not provide any hard data on the incidence.

Were we to shift 5 per cent of the no change over to require a label change and five per cent to require marketing changes the updated net benefit of \$79.8 million would decrease to \$43.3 million

Company 3, 10 per cent of labels and 250 SKUs

Company 3 states that 250 SKUs would require label changes at a cost of \$2.5 million or \$10 000 per SKU. This is similar to the company 1 estimates of costs for a label change. It is similar to our nominal estimate of \$11 818 per SKU (see table 8 of updated report). Company 3 states that the estimate is before stock write-offs. Our stock write off is \$3878 per SKU.

Company 2, \$4 million for new packaging and \$3 million pre-approval

The \$4 million cost for new packaging appears to be broadly consistent with our estimates. What is not clear is the extent of change, but were it to be spread across label changes and marketing changes, in our model it would imply about 300 SKUs might need changing. Company 2 does not indicate the number of SKU's affected.

The \$3 million for pre-approvals is not inconsistent with the estimates made above. What is unclear is the increase in incidence caused by requiring pre-approval.