



Will China's Food Safety Law Make China's Food Safer?

An analysis of China's new Food Safety Law
and its impact on China's food & beverage
industry

APCO
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April 2009

INTRODUCTION TO APCO

APCO Worldwide is a global consulting firm and a leading provider of corporate advisory, public affairs and strategic communication services in China. We have been serving clients in China since 1989. Today, our China team includes more than 100 employees from a diverse range of backgrounds, including business, government, journalism, academia and civil society. Food & Beverage (F&B) is one of APCO's largest practice areas; our clients include major companies from Europe, Asia and the Americas.

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EXECUTIVE SUMMARY

- China's Food Safety Law comes into effect on June 1, 2009. Chinese regulators hope the law will reduce the number of food safety crises that have occurred in China in recent years.
- The law seeks to clarify and streamline oversight between government agencies by giving the Ministry of Health (MOH) a greater coordinating role and establishing a Food Safety Commission. However, overlapping responsibilities remain, and it is not clear that this restructuring will achieve substantial efficiency goals.
- The law mandates a comprehensive risk monitoring and assessment system to prevent food safety incidents from escalating into crises. This will be expensive and difficult to manage, and it differs substantially from Western "risk-based" assessment procedures.
- Detailed rules are laid out for the development of national food safety standards, greater scrutiny of food additives, import and export activity, and packaging and labeling. This will substantially increase costs for all F&B companies.
- The law is a step in the right direction, but it will likely bring only marginal improvement at best in food safety. The approach taken was based on the perception that food safety problems arise only from inadequate government control and a lack of clear best practices.
- China's F&B sector will remain a complex regulatory environment. This presents significant opportunities for foreign companies to play a role in the development of standards, implementing regulations and other new elements required by the law. Proactive companies can leverage their expertise to strengthen priority relationships with key regulators.
- Food safety crises will continue to occur in China. Foreign companies should prepare robust crisis management strategies, monitor the regulatory environment, develop relationships with stakeholders, and scan both conventional and online media to mitigate these risks.

THE FOOD SAFETY LAW: BACKGROUND AND CONTEXT

On February 28, 2009, the Chinese National People's Congress (NPC) passed the food safety law. It comes into effect on June 1, 2009.

The Food Safety Law had a long gestation period – it took five years of legislative deliberation and several revisions and received more than 11,000 public comments before being finalized. It has a simple aim – to ensure Chi-

na's F&B industry provides safer products to its citizens and export markets.

The law was developed in response to the large number of food safety incidents that have occurred in China in recent years, impacting both the global "Made in China" brand as well as millions of Chinese consumers. Major food safety incidents have probably occurred in China for decades, but it is only a recent phenomenon that China's consumers have demanded greater guarantees of safety in their food supply.

The development of the Food Safety Law is also a natural consequence of China's economic development and need for a modern regulatory framework governing its F&B sector. The challenges faced by legislators reflect the complexity of China's F&B sector; despite rapid economic development, the sector remains disaggregated:

- The agriculture system is composed of hundreds of millions of small farms.
- Of China's half-million food production facilities, 70 percent are workshops with fewer than 10 employees, many of which operate outside the law to survive, to maximize profitability or because they are unaware of regulatory requirements.
- Supply chains and distribution networks are similarly fragmented.

Enforcement has historically been weak, with responsibilities scattered among several -



sometimes competing – government agencies. This has led to overlaps and gaps in responsibilities and a general lack of policy coherence. In its September 2008 report "Advancing Food Safety in China," the World Health Organisation (WHO) described China's food safety regime as disjointed, chaotic, poorly informed and old-fashioned.

THE FOOD SAFETY LAW: A CLOSER LOOK

The law covers a range of issues any modern food safety regulator would expect, including the allocation of regulatory responsibilities, enforcement, standards and legal sanctions.

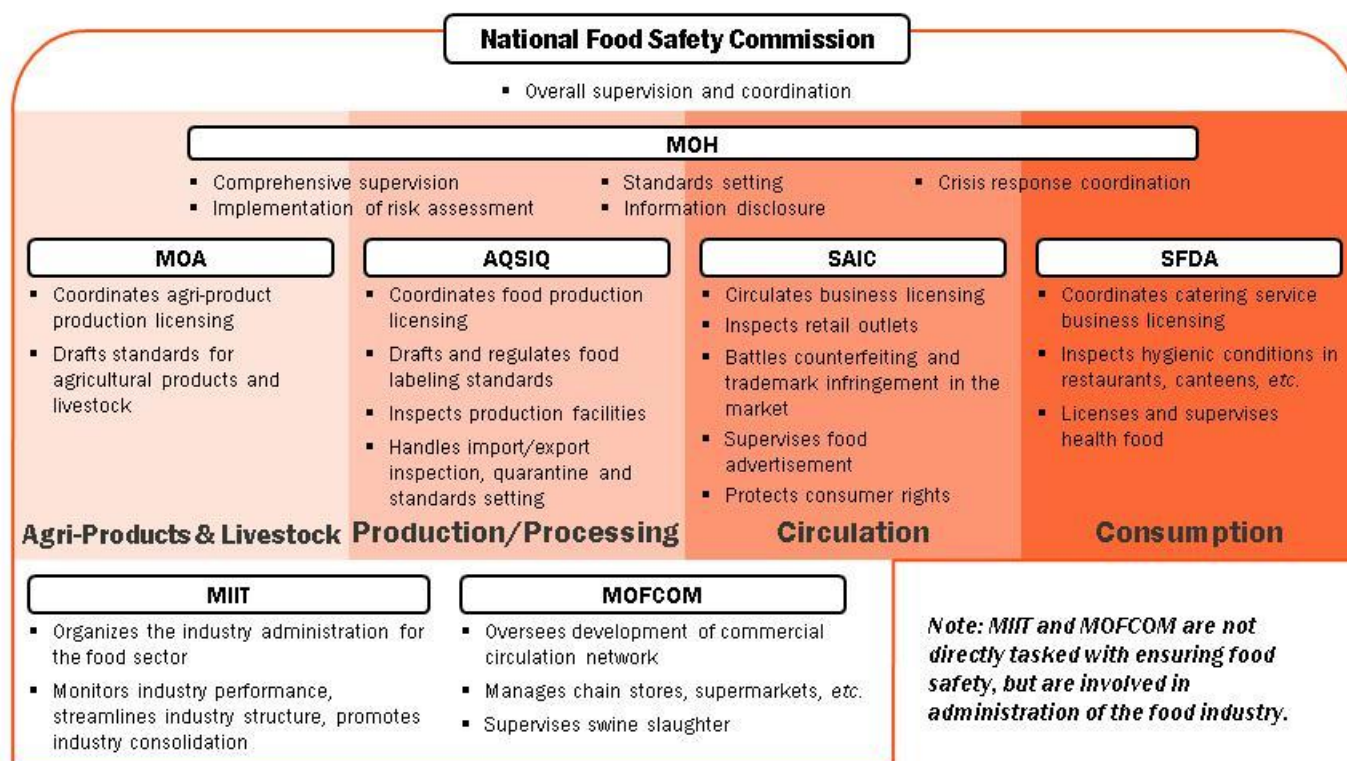
Following the format of similar major Chinese legislation, the Food Safety Law creates a regulatory framework by outlining general

principles. Many concrete details and practical guidance on how such principles should be implemented will be clarified in subsequent "implementing measures," which will be published by the State Council before June 1 this year (draft measures were published for comment in April 2009).

A key difference between this law and common practice under Western regulatory regimes is that it does not adhere to a “risk-based” approach where the most robust or prescriptive remedies are applied only to

those issues or products most at risk of safety problems. Instead, regulators presume all food products are “at risk,” with a consequent increase in monitoring and enforcement costs.

GOVERNMENT AUTHORITIES INVOLVED IN FOOD SAFETY SUPERVISION UNDER THE FSL



GOVERNMENT RESPONSIBILITIES: STREAMLINED BUT NOT FUNDAMENTALLY ALTERED

The law does not provide for fundamental restructuring of the supervision regime in which multiple government authorities oversee different aspects of food safety supervision. This is one of its most criticised features - the organisation chart above and flow chart on the next page illustrate this complex array of responsibilities and relationships spread among seven powerful agencies with roles in food safety supervision.

In addition to the complexity evident in the roles prescribed for central-level authorities, further challenges remain at the provincial and local levels:

- In most provinces, AQSIQ’s responsibility is split between two surrogates – the Quality and Technical Supervision Bureau (TSB), which is responsible for quality in-

spection, and Entry-Exit Inspection and Quarantine Bureau (CIQ), which monitors import and export products. The law does not adequately explain which surrogate will carry out which of AQSIQ’s responsibilities.

- Some local surrogates, although representing central-level authorities, do not carry out the same roles as those of their parent bodies. For example, the Shanghai Health Bureau (SHB) is in a slightly awkward position. In theory it is expected to coordinate any food safety crisis in Shanghai. However, in practice, MOH takes over the coordinating role under such circumstances, giving orders to other agencies depending on the issue, who then delegate their local surrogates to investigate and report the issues to their parent bodies, and only notify SHB. This severely weakens SHB’s ability to effectively coordinate any response.

Although China's disjointed approach to food safety has not fundamentally changed, clearer definitions of responsibility between ministries have been established. This should result in the reduction – but not the elimination – of overlaps and miscommunication. For example:

- MOH is now the sole agency responsible for information disclosure, whereas in the past, all regulators put out public messages, creating confusion.
- Food safety responsibilities at the local level are more clearly defined. County-level governments and above will coordinate the supervision efforts by the surrogates of the central-level enforcement agencies within their jurisdictions.

The deficiencies of such a disjointed supervision system are not lost on Chinese leaders. However, they probably recognize that radical reform may entail sudden risks to consumers due to the fragmented state of the sector and likely bureaucratic infighting. It appears they would rather take a cautious step-by-step approach to address reform of government responsibilities, postponing a full overhaul until the sector itself has reached greater maturity.

MOH TAKES THE LEAD ROLE

While MOH will assume a larger and more visible role under the law by leading and coordinating enforcement efforts, there are con-

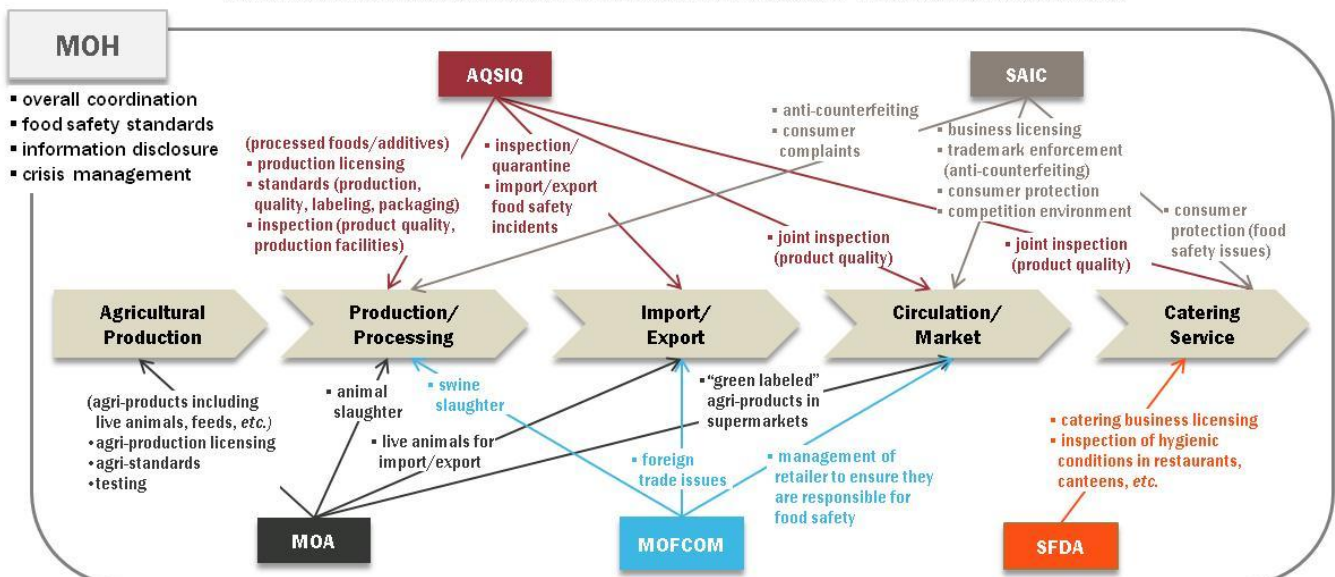
cerns regarding its ability to build adequate technical expertise quickly enough to become an effective coordinator. The prior role of MOH vis-à-vis food safety was limited to inspecting hygienic conditions in restaurants. Furthermore, most MOH officials have a medical background and lack experience handling complex food safety issues. One element in favor of a strong role for the agency is that it is perceived as a neutral arbiter among other agencies, without a vested interest in revenue from fines associated with related supervision.

THE NEW NATIONAL FOOD SAFETY COMMISSION

One of the most visible changes is the establishment of a Food Safety Commission. It will have the clout of a ministry-level agency and act as a high-level consultation and coordination body for all related activities. Although details of the new commission's responsibility and structure are still under discussion, its main task will be to oversee and coordinate efforts by China's multiple food safety agencies, especially during a food safety crisis. The establishment of this body is an attempt to address disjointed and poorly coordinated enforcement efforts in China and is clearly a nod in the direction of recognising the frailties of the current system.

However, the question remains whether its coordinating role is practicable:

FROM SEED TO TABLE: GOVERNMENT AUTHORITIES INVOLVED IN FOOD SAFETY SUPERVISION



- The Commission will likely be staffed by MOH, which will consequently have disproportionate influence over how it is run. Personnel challenges faced by MOH will also affect the Commission.
- The Commission aims to improve coordination at the central level; it has no local-level presence and therefore cannot directly influence local issues, where enforcement is looser.

It remains to be seen whether the Commission will be effective and how it will differentiate itself from MOH and other agencies. In light of the fact that it proved too difficult to form a single, powerful food supervision authority during this round of reforms, this body appears to be a compromise solution. Under future reforms, the Commission could potentially form the nucleus of a single food safety agency.

ADOPTION OF A RISK ASSESSMENT SYSTEM

The Food Safety Law calls for the establishment of a risk monitoring and assessment mechanism, in which potential risks, once reported or identified, are analyzed by government agencies based on best available scientific data.

The assessment result will serve as a reference for standards formulation and supervision. Should a food product be found unsafe, measures such as consumer notification, product recall or standards revision will be implemented. MOH will take the lead in implementing this system, while technical assessments will be undertaken by committees consisting of experts with medical, food and nutrition backgrounds.

Chinese authorities have consistently been blamed by consumers for being unable to discover potential risks before the development of full-blown crises. This system, therefore, seeks to fill this gap in risk-monitoring and early-response capability.

This is not a new approach for China – regulators have been trying, unsuccessfully, to achieve these goals for years. More funding and a greater focus may create some efficien-

cies, but implementation will remain a challenging task:

- China has one of the world’s most fragmented food industries, so the costs involved will be enormous. This contrasts with developed countries, where greater consolidation means that risks are more easily identified and controlled.
- A successful roll-out rests on developing a comprehensive database and sophisticated inspection technologies. However, regulators at present lack sufficient resources, personnel and experience.
- This approach runs counter to international best practices, which have moved away from a “testing and sanction” supervisory system of all industry actors to one that relies on more sophisticated risk assessment and focuses limited resources on “high-risk” products and points in the supply chain.

The longer-term weaknesses inherent in this approach are likely to become apparent only if another major food safety crisis occurs and it is not picked up by this system at a sufficiently early stage.

FOOD ADDITIVES: THE REAL CULPRIT?

Prompted by a string of scandals involving the misuse of additives – e.g., the use of “Sudan red,” a carcinogenic food coloring, in Kentucky Fried Chicken products – regulators have adopted several provisions into the law that tighten the control of additive production and use. An additive is no longer permitted to be used unless a national standard exists and it is listed in a “permitted additives catalogue.” Any new additive must be proven safe through a risk assessment before it can be legalized.

As a result, companies that use or manufacture additives face immediate confusion and near-term challenges complying with the new rules. For example, after June 1, additives that are internationally accepted or based on existing “legal” products but with minor adjustment made in their content, will not be permitted without undergoing new risk assessments. Although a company can apply to

create a new standard, the approval procedure is time consuming, and internationally-accepted risk assessment methods are not always applied.

A FOCUS ON STANDARDS SETTING

MOH will review and integrate various existing industry standards to develop and issue a unified set of mandatory national standards for all F&B products. This approach should help eliminate conflicts between existing standards and provide clearer guidance to enterprises. It will also entail the development of many new standards. In theory, the opinions of the F&B industry, including industry associations, business and consumers, will be taken into account when formulating these standards.

Developing or revising standards for existing and new products will likely require years. There is a risk that regulators will create standards that conflict with existing international standards and/or take a “zero-tolerance” approach to the presence of common pathogens or residues. A lack of harmony between Chinese and international standards will create an extra burden for importers and exporters and potentially increase costs during production and subsequent testing phases.

MOH has reportedly prioritized the drafting or amending of standards relating to the dairy sector, pesticide residues and food additives.

F&B IMPORT/EXPORT

Imported F&B will have to comply with relevant Chinese standards and will be routinely tested at the border. For imported foods that lack a standard, import applications and product samples must be submitted to MOH to allow for a safety appraisal and possible development of a standard. Products exported from China must meet relevant standards and will face random inspections.

China’s stringent application of standards and testing to imported and exported products reflect concern at the highest level that recent food safety incidents reflect poorly on the “Made-in-China” brand. There has been a concerted effort through the Food Safety Law to ensure that only best-practice manufactur-

ers are permitted to export. The government also wants to show domestic consumers that imported food has passed stringent testing.

This will generate extra costs for importers, exporters and regulators, including the likely overload of applications for permission to continue importing a huge range of products that currently lack standards.

PACKAGING AND LABELING

Packaging materials are also subject to the new law. However, related provisions are scant and scattered across chapters, indicating that packaging will likely continue to be more loosely supervised than food production itself.

Labeling requirements are covered in much more detail:

- Food labels must contain a range of information, including product name, date of production, ingredients, producer contact information, shelf life, storage requirements and production license number.
- False or exaggerated claims, as well as statements about disease prevention or treatment functions, are not permitted.
- Products without appropriate Chinese-language labeling or instructions cannot be imported.

These requirements are not new, but they do reflect efforts to further curb irregularities in current labeling practices. There will likely be increased costs associated with this tightening and clarification of requirements.

INCREASED LEGAL LIABILITY AND REQUIREMENTS

Private enterprises now have increased responsibility for preventing food safety incidents. The law states that enterprises must be “responsible for the public,” and must “ensure food safety, accept public supervision, and undertake social responsibility.” Responsibilities include:

- Enterprises are legally required to implement an immediate recall should a product be designated unsafe.
- Detailed operational requirements are laid out for food enterprises throughout their production and operation chains. Requirements cover market entry; internal inspection and quality control; supply-chain management and record keeping for ingredients, additives and raw materials; provision of permits for specified activities; and provision of training and maintenance of health and safety records for employees, among others.
- In addition, marketing activities will be subject to stricter regulation. Celebrities will face joint liability should the product they endorse be found unsafe.

Financial sanctions are also significantly increased: Offenders now face punitive sanctions up to 10 times the value of products implicated, in contrast with the previous limit of three times. This flexibility in maximum fine levels should make fines more meaningful.

This increased array of regulatory requirements and legal liabilities will significantly increase costs for companies and will have a profound impact on the F&B sector. Higher costs will almost certainly lead to consolidation; in fact, this may be the desired outcome of regulators, leading to fewer small enterprises operating outside the law and a greater number of larger and more manageable producers operating at international standards.

WILL THE LAW MAKE FOOD SAFER?

While the new Food Safety Law is positive in that it reflects a new level of attention and resources focused on an important problem for both consumers and enterprises, the law's impact is likely to be minimal for a long time to come.

Fundamentally, the regulatory approach reflected by this law is based on a perception that food safety problems arise from inadequate government control and a lack of clear standards and procedures. Regulators' response with the new law has been "more of the same." This may look good on paper, but

reality on the ground means the new law is likely to fail in its aims:

- The fragmented production system is too vast to allow for meaningful monitoring of all stages of the production process.
- Business ethics and an understanding of the value of a rule-of-law based system are weak.
- Regulators are poorly trained and resourced, while local officials are not appropriately incentivised to promote food safety above economic growth.

In many respects, therefore, the new Food Safety Law represents a lost opportunity to implement a food safety regime that actually delivers safer food to consumers.

A more productive approach might have been for regulators to provide better incentives for food enterprises to improve their own food safety rather than rely on punitive and prescriptive regulation. Broader reform of China's agriculture sector that provides for strengthened property rights and allows the market to set food prices would still provide for industry consolidation, and would enable those enterprises that build reputations for food safety to earn sufficient returns to pay for safer production. The development of vigorous and independent media, and of a more robust and accessible torts-based legal system, would also help create an environment where the downside of being involved in a food safety incident are clearer to food enterprises.

Consequently, the new law is likely improve food safety in China at the margins, but not as much as China's F&B sector so desperately needs, nor as much as if Chinese regulators had taken alternative approaches.

IMPLICATIONS FOR FOREIGN F&B COMPANIES IN CHINA

A GREATER BURDEN ON FOOD COMPANIES

The Food Safety Law has outlined a detailed set of requirements to which all food enterprises must adhere at every step of their operation chains. The costs for companies associated with understanding and meeting these requirements will increase significantly.

CONSOLIDATION IN CHINA'S F&B SECTOR

The Food Safety Law will lead to industry consolidation by eliminating small and inferior-quality companies less able to afford increased compliance costs. Additionally, increased legal liabilities may prompt enterprises to internalize raw material procurement in order to reduce safety risks from external sourcing. Both horizontal and vertical consolidation may therefore accelerate, benefiting large-scale and quality-driven industry players.

In the medium term, foreign F&B companies can expect to see the development of larger and stronger domestic competitors.

EFFECTIVE GOVERNMENT RELATIONS STRATEGIES NEEDED

The regulatory regime has been streamlined, but it remains complex. Some companies may need to interact with up to seven ministry-level agencies, as well as a range of provincial and local stakeholders. **Managers should update their understanding of relevant stakeholders and develop engagement strategies.** A clear understanding of the regulatory apparatus and robust relationships with key institutions will enable companies to better monitor potential issues and inject their views into standards creation, policy development and crisis management when required.

DEVELOPMENT OF NEW STANDARDS

The development of new and revised standards presents both costs and opportunities

for foreign F&B companies. Armed with an understanding of the consultation process, **managers can help – and build relationships with – regulators by sharing related challenges and best practices.**

FOREIGN BEST PRACTICES ARE NEEDED!

The implementation of the law features several new concepts, especially in relation to the risk assessment system. Chinese regulators will welcome advice and training from experienced foreign companies, offering **an opportunity to guide implementation** in a manner that ensures government, industry and consumer benefit. Assistance could range from informal consultation to more formal programs under the rubric of corporate responsibility, improving understanding and institutionalizing government relationships.

FOOD SAFETY CRISES WILL CONTINUE

Food safety crises will continue. **Foreign companies should monitor conventional and social media, develop relationships with stakeholders and influential third-party allies and prepare crisis management strategies in advance.**

Ongoing monitoring and engagement with online media can increase a company's understanding of Chinese consumers, provide early warning for food safety crises and provide an avenue for response if needed. Monitoring mainstream media is no longer enough, as online media tends to report issues faster and more freely.

Many companies will also need to understand more clearly their complex supply chains to mitigate the risk of future issues arising from locally-sourced ingredients and facilitate a more effective response if necessary.

CONTACT INFORMATION

For further information about how APCO Worldwide can help your organization understand China's Food Safety Law and wider F&B political/regulatory environment, please contact:

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