

Kosher Certification as a Model of Private Regulation

Third-party certification has benefits over both government regulation and unregulated markets.

BY TIMOTHY D. LYTTON

Frequent outbreaks of food-borne illness and an endless parade of new food labels that misrepresent processed foods high in fat and/or sugar as “natural,” “fresh,” and “healthy” highlight the shortcomings of government food regulation and the inadequacy of industry self-regulation. By contrast, kosher food certification by independent private firms is highly reliable, assuring compliance with religious standards of food production and preventing deceptive marketing. The success of kosher food certification offers a model of independent, private certification that could improve food safety and labeling and point the way toward regulatory reform in other areas such as finance and health care.

The successful development of the kosher food certification system is no small matter. Kosher food is big business. There are more than 10,000 kosher-producing companies in the United States alone, making over 135,000 kosher products for over 12 million American consumers who purchase kosher food because it is kosher. Only 8 percent of kosher consumers are religious Jews; the rest choose kosher food for reasons related to health, food safety, taste, vegetarianism, lactose intolerance, or *halal*. The U.S. kosher market is worth over \$12 billion in annual retail sales and more products are labeled kosher than are labeled organic, natural, or premium.

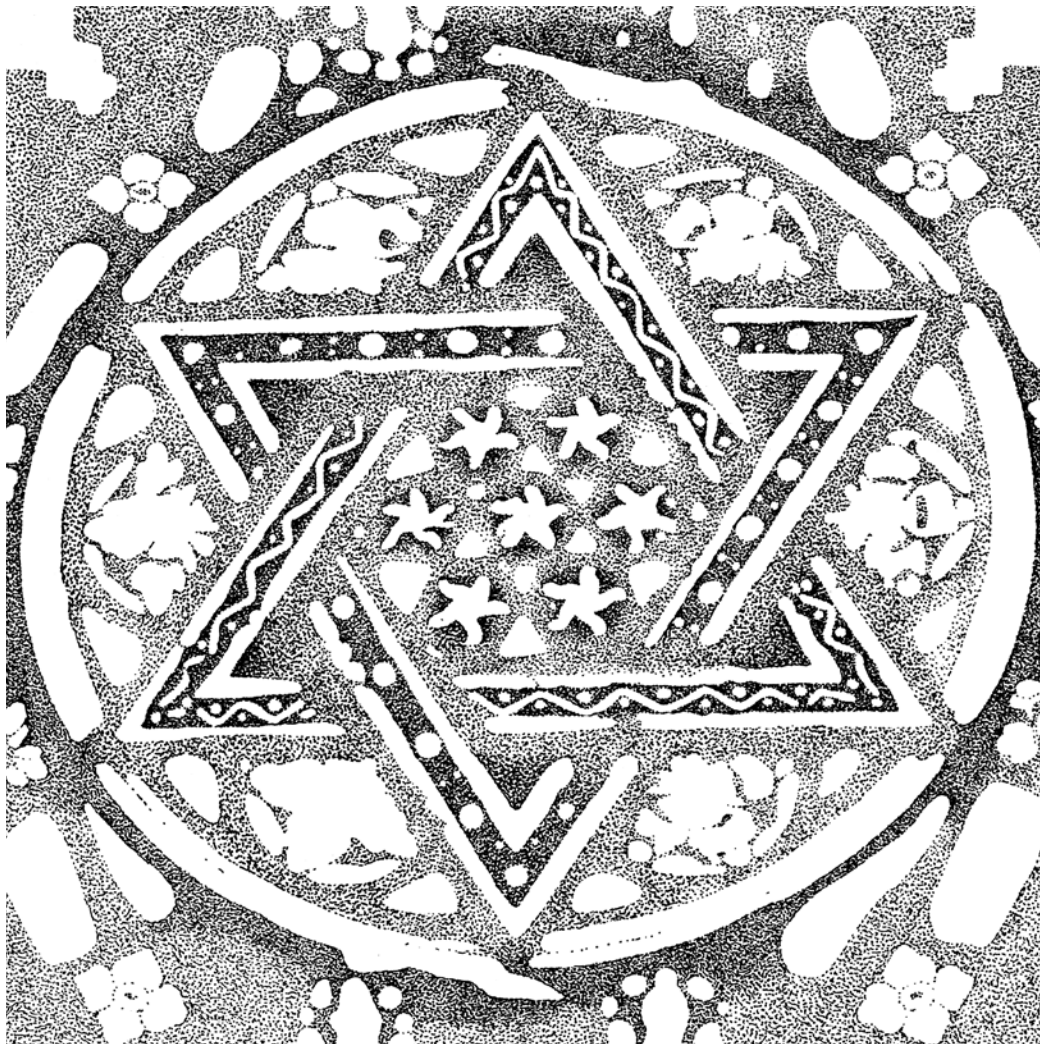
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The Rise of Private Certification Agencies

Kosher food certification in America was not always so reliable. Fraud and corruption plagued U.S. kosher meat production from the mid-1800s to the mid-1900s. The New York City Department of Markets estimated in 1925 that 40 percent of the meat sold as kosher in the city was actually nonkosher. Industry associations and consumer groups estimated that rate as between 50 and 65 percent. Beyond consumer fraud, the industry was notorious for price-fixing schemes, racketeering, and even murder for hire.

The traditional means of regulating kosher trade in the Old World had been centralized communal control backed by government power. Local community councils possessed legal authority to issue exclusive licenses to slaughter and sell kosher meat within their jurisdictions. But religious liberty and free markets in America rendered that approach unworkable.

By the mid-1800s, most Jewish communities in America contained a diverse mix of immigrants from different cultural backgrounds who founded rival synagogues within the same locality. Individuals could easily disregard the directives of congregational authorities by simply joining another synagogue or founding a new one. Moreover, in America, Jewish communal authority was not an extension of civil government and community leaders had no coercive power to enforce uniform kosher standards or restrict the sale of goods.



Kosher certifiers aggressively market their services to food manufacturers as a low-cost, highly effective marketing strategy. This effort was pioneered by Rabbi Alexander Rosenberg, the “guru” of kosher marketing, who assumed leadership of the Orthodox Union (OU) kosher certification service in 1950. Rosenberg explained to leading food industry executives that kosher consumers were a small but highly influential demographic because they were concentrated disproportionately in major metropolitan markets. By increasing a company’s market share in those major markets, the company’s products would achieve better positioning on store shelves, where all consumers, not just kosher consumers, would be more likely to see and buy them. A marketing manager at Duncan Hines recalls that Rosenberg taught him that

The problem of kosher fraud was too big for government regulators. Six full-time kosher inspectors in the New York City Department of Markets and 10 in the New York State Kosher Enforcement Bureau by the late 1930s were insufficient to oversee the 18,000 kosher food establishments in New York City.

Reform finally came to the American kosher food industry with the rise of private kosher certification agencies. The emergence of industrially prepared and packaged foods presented new opportunities for kosher certifiers outside of kosher meat production and changed the economics of kosher certification. Kosher meat production is labor intensive and therefore relatively slow. The resulting high unit cost of producing kosher meat led many slaughterhouses and retail butchers to fraudulently substitute nonkosher meat while still charging the premium for kosher. By contrast, kosher certification of industrially prepared and packaged foods requires an initial inspection of the production facility and periodic inspections that range from weekly to annually, depending upon the nature of the production. Given the fast rate of modern industrial production, those costs are spread across tens of thousands, or even hundreds of thousands, of production units. This lower unit cost greatly reduces incentives for fraud.

“the whole grocery business depends upon shelf space.” As a result of OU certification, according to the manager, sales of the company’s cake mix among ordinary consumers rose 40 percent in two months. Menachem Lubinsky, a leading kosher market analyst, estimates that somewhere between 2 and 20 percent of a typical product’s sales are attributable to kosher certification, which can mean millions of dollars for a leading brand.

What Makes Kosher Certification So Reliable?

Several features of the market for kosher certification account for its reliability. First, sufficient consumer demand for kosher certification gives food manufacturers incentive to pay for reliable, independent inspection of their production facilities. Consumers seek the assurance provided by kosher certification and companies that fail to obtain certification risk losing market share.

Second, brand competition among certifiers based on reliability has led to increasing expertise and accountability. Efforts to build brand value in response to competition have led kosher certification agencies to provide professional training for their personnel in Jewish law as well as food chemistry and technology,

and to impose strict ethical codes. Agencies have also instituted new forms of quality control that include multiple layers of oversight and improved information management. Brand sensitivity has produced a culture of prompt and thorough responses to consumer complaints.

Third, interdependence among certifiers gives rise to additional oversight. The value of an agency's kosher certification of a food ingredient—for example, vanilla extract—depends on its acceptability to other agencies certifying products that include the ingredient downstream in the production process—for example, ice cream or cookies. This means that upstream certifiers must meet standards set by downstream certifiers.

In turn, downstream certifiers are vulnerable to mistakes by upstream ingredient certifiers, which have the potential to render nonkosher all products made with improperly certified ingredients. Downstream certifiers carefully monitor upstream certifiers to ensure that their standards are acceptable and their inspection routines reliable. Since agencies typically certify different products at different stages of the production process, they operate both upstream and downstream relative to each other, creating a network of interagency oversight. Agencies are also interdependent in the sense that public scandal caused by one agency tends to undermine public confidence in kosher certification generally, which gives agencies additional incentive to monitor each other and exclude those that fail to meet industry standards.

Fourth, concentration of market power in the hands of a few large certifiers makes it easier to coordinate the development and enforcement of industry standards. In kosher certification, a group of leading agencies known as the “Big Five” controls more than 80 percent of the U.S. market. They established a trade association as a forum for information sharing, deliberation, and standard-setting for the industry. While the association has no formal enforcement powers, it facilitates the communication of reputational information, which is a key source of pressure on agencies to conform to industry standards. Any agency that fails to conform to these standards risks losing accounts to competitors. There are currently more than 300 kosher certifiers in the United States, and competition is fierce.

Fifth, a corps of active and vigilant consumers provides additional oversight, gives certifiers quality-control feedback, and puts teeth in reputational sanctions. The 8 percent of kosher consumers who are religiously observant and eat only kosher food are highly motivated to monitor the reliability of certification. They call agency hotlines to report improperly labeled products—for example, products with a *pareve* label (indicating the absence of any dairy products) that nonetheless list dairy ingredients on their packages, packages with agency symbols that appear to be counterfeit, or items that contain ingredients that the consumers

suspect are not kosher. Many of these consumers closely monitor agency publications for alerts concerning improperly labeled products or unreliable certifications, and they disseminate that information through social networks. Since certification agencies' brand value depends upon their reputation among vigilant consumers, agencies have a strong incentive to avoid mistakes and misconduct, and to report them promptly when they occur.

Aside from these five market conditions—consumer demand, brand competition, interdependence, concentration of market power, and vigilant consumers—kosher certification agencies have developed a shared sense of mission that counteracts incen-

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tives to cut corners and promotes cooperation between competing certifiers. Each agency seeks to cultivate among its personnel a religious commitment to the agency's goals of providing reliable kosher certification.

In addition to this shared sense of mission, social networks provide a medium for trust and reputation that supports reliable private certification. At trade association meetings, participants from different kosher certification agencies socialize and pray together. The rabbis who manage these agencies also frequently hold positions of authority in their local Jewish communities, many as congregational rabbis or respected teachers. They interact closely with community members, who are also kosher consumers. Agency personnel form personal bonds with their food-industry clients, many of whom they have been working with for decades. Personal ties also exist among religiously observant kosher consumers, ranging from close connections between congregants to more extended Internet exchanges carried on through postings on kosher food websites. These various relationships constitute a complex network that enhances the regulatory performance of the kosher certification system by increasing social pressure to conform to industry standards and facilitating the diffusion of reputational information and consumer alerts.

Advantages of Private Certification

Kosher certification highlights a number of advantages of private certification over government regulation.

Private certification can offer greater technical expertise. Government regulators have less expertise than private certifiers in determining how the traditional laws of kosher observance apply to modern industrial food production. Kosher certification agencies are advised by leading rabbinic experts in Jewish law and are

run by managers with extensive training in Jewish law coupled with practical experience in food chemistry, food technology, marketing, information technology, and commercial law. By contrast, most state officials charged with enforcing kosher fraud laws have little or no training in Jewish law.

Private certification frequently provides better inspection and monitoring coverage of regulated entities. For government regulators, inspection and monitoring strain agency budgets. For private certifiers, inspection and monitoring generate fees. Kosher certification agencies have strong financial incentives to expand their inspection and monitoring activities, while government kosher inspection in the only two states that provide it—New York and New Jersey—has been drastically curtailed in the past few years because of budget cuts. Aside from incentives, private certifiers also face fewer obstacles to monitoring and enforcement. They are not limited by local, state, or national jurisdictional boundaries, which makes it possible for them to more easily provide onsite inspection nationally and around the world.

Theoretically, government agencies could charge fees for inspection and monitoring. Indeed, government routinely charges fees for services such as permitting and licensing, but proposals to charge inspection and monitoring fees typically face stiff political resistance. Moreover, government fees are designed merely to cover costs, not increase profits, so they do not offer the same level of incentive as private fees to expand inspection and monitoring.

Private certification is typically more proactive and prospective than government regulation. Private kosher certifiers actively seek out problems before they affect consumers and set new policies to avoid trouble later. They are more likely to act as soon as a problem arises and to be involved on an ongoing basis to correct it. By contrast, state officials are merely reactive to complaints about kosher fraud and they typically wait to intervene until a major scandal attracts widespread public attention.

Private certification can be more responsive to both regulated industries and consumers. State legislators and state agency officials—for whom adulteration and mislabeling of kosher food is a relatively low priority—are not likely to pursue consumer complaints vigorously, especially in states where religiously observant Jews are a small minority with little electoral influence. Moreover, legislative and administrative rulemaking processes are very slow, frequently taking years to produce results. By contrast, kosher certification agencies owe the brand value of their services to their reputation among consumers and they are motivated by a sense of religious mission. They solicit consumer feedback and respond to concerns through their public presentations, telephone hotlines, websites, newsletters, and magazines. Furthermore, kosher certification agencies can respond to consumer concerns more quickly by instituting kosher policy changes without the procedural hurdles faced by government regulators.

Regulation by private certification facilitates cooperation by regulated entities. Within ongoing private agency-client relationships, manufacturers are eager to satisfy the demands of certifiers upon whom they rely for access to the kosher market.

Private certification is often more efficient than government regulation. Competition among certifiers provides incentives for them to cut costs in order to keep their fees as low as possible while at the same time maintaining high standards in order to protect their brand value. By relying primarily on informal sanctions such as the refusal to certify, private certifiers do not incur the costs associated with passing legislation, making administrative rules, filing enforcement actions, establishing guilt in legal proceedings, and defending appeals. Moreover, as already mentioned, private certifiers generally have a more cooperative relationship with the companies they regulate. In addition, since private certifiers are motivated to regulate in part by industry demand, they are less likely than government regulators to develop standards whose costs outweigh their benefits. There is, of course, no demand for such standards among regulated industries.

Kosher certification is hardly unique. The use of private certification as a means of quality assurance has a long history and is widespread in many industries. A *Directory of U.S. Private Sector Product Certification Programs* published in 2001 by the U.S. Department of Commerce lists 180 nongovernmental organizations based in the United States that certify more than 850 types of products—ranging from adhesives, bananas, and cabinets, to valves, weatherproofing, and yachts. Private certification is common in professional services, such as dentistry and financial management, as well as institutions, such as hospitals and universities.

Unfortunately, private certification is not always reliable. Market competition among certifiers sometimes leads them to lower their standards in order to reduce the cost of their services and ease the demands that they place on their clients. The result is a race to the bottom. For example, in the wake of the 2007–2008 financial crisis, a congressional panel accused credit rating agencies of issuing favorable assessments of mortgage-backed securities that proved to be worthless, calling the agencies an “essential cog in the wheel of financial destruction.” In another notorious example, a private food safety auditing firm awarded the Peanut Corporation of America a “superior” rating shortly before the company’s products caused a nationwide salmonella outbreak that killed nine people and sickened over 22,000 in 2008–2009. Following the outbreak, federal inspectors found dead rodents, open holes in the roof, and pools of stagnant water at two of the company’s production facilities. “‘Superior’ clearly doesn’t mean much,” quipped one congressman, “How many dead mice do you have to find in your food before you get an ‘Excellent’ rating?”

Reliable private certification harnesses market demand for certification without succumbing to competitive pressures to cut corners. The history of kosher food certification in America—a story of triumph over widespread fraud and corruption and the successful evolution of a network of private kosher certification agencies that effectively protects consumers—highlights essential market and social conditions that support reliable private certification, as well as its advantages over unregulated markets on the one hand and government regulation on the other. While kosher certification may not be the only example of successful private certification, it is surely one of the most remarkable. **R**