

## Organic Labeling (Cathy Greene, ERS)

In the United States, both the private and public (non-Federal) sector provide third-party certification of organic food. Certification standards vary among certifying organizations, and farmers' ability to choose among certifiers varies regionally. The U.S. Department of Agriculture is currently developing regulations that would set national standards for foods marketed as organic and make certification to these standards mandatory for all but the smallest producers. National standards may reduce transaction costs between farmers and food manufacturers, and may reduce costs of meeting EU organic standards. National standards may help to abate any environmental problems caused by conventional agriculture only to the extent that they increase use of organic farming systems.

### Background

Organically grown food has been produced and marketed for over half a century in the United States. The most influential early advocate of organic farming systems in the United States was J.I. Rodale, who began popularizing these systems in the 1940's with the publication of *Organic Farming and Gardening* magazine (Kelly, 1992). A few farmers began experimenting with these systems, marketing directly to consumers, and, by the late 1950's, organic foods were being featured in small health food stores. By the late 1960's, "a new generation of environmentally conscious consumers—Baby Boomers—were coming of age and demanding foods produced without chemicals" (Mergentime, 1994). Large natural foods supermarkets began developing in the 1980's, and industry analysts estimate that retail sales of organic food totaled about \$4 billion annually in the mid-1990's, approximately 1 percent of consumer expenditures for food consumed at home (Scott, 1996). The amount of certified organic cropland in the United States more than doubled between 1992 and 1997 (Greene, 2000). Analysts expect retail sales growth to continue at 20-30 percent annually in most industrial countries for at least a decade (International Trade Centre, United Nations Conference on Trade and Development/World Trade Organization, 1999).

### Firms Have an Incentive To Label Organic Food

From J.I. Rodale to the Baby Boomers, many U.S. consumers have preferred and sought foods grown without chemicals. Surveys indicate that consumers purchase

organic products for a variety of reasons: personal safety, which might be compromised by dietary intake of pesticides; environmental concerns, such as the impacts of pesticide use on the environment, groundwater, and wildlife; and farmworker safety (Hartman & New Hope, 1997; Bruhn et al., 1992; Weaver, Evans and Luloff, 1992; Cuperus et al., 1996; Goldman and Clancy, 1991; Davies, Titterington, and Cochrane, 1995; and Morgan, Barbour, and Greene, 1990). Whatever the reasons, demand for organic foods has translated into a price premium for organic goods.

The existence of organic price premiums was documented by USDA for several crop sectors in the 1970's (USDA, 1980). By the late 1980's, USDA had determined that organically grown produce formed a distinct market and was tracking premiums for representative commodities in its vegetable market reports (USDA, 1989). Thompson and Kidwell (1998, p. 280), measuring fresh fruit and vegetable prices, stated "...the average premiums found in the stores ranged from over 40% to as high as 175%." Organic grains and soybeans command price premiums, and the price gap between organic and conventional widened during the late 1990's for some of these crops (Dobbs, 1998). Of course, the cost of producing organic foods is also higher than the cost for conventional food. For organic producers to stay in business, organic premiums must cover differences in farm production practices as well as differences in processing and transportation costs, including segregation costs. The premium also must cover any certification costs.

Farmers, food processors, and other businesses that produce and handle organically grown food certainly have a financial incentive to advertise that information. Organic food is a credence good. Consumers cannot visually distinguish organic food from conventional food. Thus, consumers must rely on labels and other advertising tools for product information. Firms would have no way of acquiring a price premium without labels.

### Third-Party Services Bolster Organic Label Claims

As the demand for organic food has grown from a handful of consumers bargaining directly with farmers to millions of consumers acquiring goods from supermarket shelves as well as market stalls, varying State

and private institutions providing third-party verification of label claims evolved. Private organizations, mostly nonprofits, began developing certification standards in the early 1970's as a way to support organic farming and thwart fraud. The first organization to offer third-party certification, California Certified Organic Farmers, was formed in 1973, and the first regulations and laws on organic labeling were also passed in the 1970's. The States' approaches to regulation vary. About half the States currently have some form of legislation pertaining to the labeling of organics.<sup>8</sup> At least 49 organic certification organizations, including more than a dozen States, are currently conducting third-party certification of organic production in the United States.

Third-party certification has been developing as a means to set organic production and handling standards and verify that producers meet these standards, thereby strengthening claims of organic product quality. Most large food processors and grain traders now require certification and many growers have turned to certification as a marketing tool.

Certification offers producers additional benefits such as greater marketplace recognition, because of the promotion and consumer education activities of certification organizations, and may facilitate greater information exchange among participating farmers (Tourte and Klonsky, 1998). However, small producers may currently receive fewer benefits from certification relative to the costs of becoming certified. In California, for example, certification is much more common among large producers than among smaller ones.

Most private certifiers charge fees on a sliding scale based on the farmer's gross sales of organic products, number of acres operated, or other measure of size (Fetter, 1999; and Graf and Lohr, 1999), while State certifying programs often charge only nominal, unremunerative fees to producers of all sizes. Some certifiers also charge an hourly rate for inspection and audit services. The University of California Cooperative Extension service estimates certification fees generally

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<sup>8</sup> Most States still do not mandate third party-certification, and many small organic producers still market goods without certification. Of the States with legislation, some allow voluntary certification; others require all products marketed as organic to be certified. Some States require registration of all organic growers. Some States provide organic certification services. Others have State-specific private certification agencies.

represent less than 1 percent of the total operating costs for large organic growers in that State.

## **Industry Groups Sought Federal Assistance in Establishing Consistent Standards**

Even with voluntary certification increasingly available from State and private certifiers, organic food producers and processors experienced a number of marketing problems as the industry expanded in the 1980's, and led the industry request for national organic standards. One problem was that, even though industry standards were largely overlapping, small differences caused disagreements among certifying agents over whose standards would apply to multi-ingredient organic processed products. That is, the certifier as well as certification came under negotiation between buyers and sellers (*Federal Register*, 2000). Also, the variable State standards have required the organic industry to take on the costs of private accreditation or shipment-by-shipment certification, to gain access to some foreign markets such as the European Union (EU).

Congress passed the Organic Foods Production Act (OFPA) of 1990 largely to address these marketing problems. The OFPA requires the Secretary of Agriculture to establish an organic certification program for farmers, wild-crop harvesters, and handlers of agricultural products that have been produced using organic methods. The stated objectives of this legislation are: (1) to establish national standards governing the marketing of certain agricultural products as organically produced products; (2) to assure consumers that organically produced products meet a consistent standard; and (3) to facilitate interstate commerce in fresh and processed food that is organically produced. This legislation will require that all except the smallest organic growers (those with annual sales under \$5,000) must be certified by a State or private agency accredited under national standards currently being developed by USDA. State and private groups that currently certify growers and processors are expected to seek accreditation by USDA when the national organic standards are implemented.

USDA has released two proposed rules to implement this legislation. The first was released on December 16, 1997, and drew over 275,000 comments (the largest public response to a proposed rule in recent USDA history), largely objecting that the proposed standards were weaker than those the industry was currently

using. The second proposal was released on March 13, 2000, and reflects the recommendations made in response to the first proposal. The most controversial aspects of the first proposal—the potential to allow the use of genetic engineering, irradiation, and sewage sludge in organic production—were dropped from the second proposal. Also, USDA program fees were lowered in the second proposal. The second proposal drew only 40,000 comments, many expressing support for the revisions.

USDA lacked the data to make a quantitative estimate of the benefits of the proposed rule, or to calculate net benefits, but expects many different groups to benefit. The primary benefits from implementation of the proposed rule are expected to be improved consumer protection from false and misleading claims, and potentially improved access to international markets from elevating reciprocity negotiations to the national level. The costs of the proposed regulation are the direct costs for accreditation and the costs of complying with the specific standards in the proposal, including the reporting and recordkeeping requirements. Certifiers will be charged fees based on the actual costs of the accreditation work done by USDA staff. Smaller certifiers, with less complex programs, are expected to pay lower fees. Organic farmers, ranchers, and wild-crop harvesters will have to pay fees for organic certification from a State or private certifier, but will not be charged any additional fees by USDA.

One general issue with standards set by government is that they may be less flexible than industry standards, and may reduce innovation. Organic production methods are still developing. If national standards are fixed, certifiers will have less flexibility to promote innovation by setting new standards. In this case, sellers would be unable to communicate their willingness and ability to innovate, and consumers would be unable to signal their preferences, selecting foods with innovative characteristics. On the other hand, food processors and distributors might benefit from holding all certifiers to exactly the same standard. For example, if most organic food consumers dislike the idea of biotech foods, an organic standard that prohibits biotech means processors and distributors only have to observe the organic label to know that the food they purchase is free of biotech attributes. They would not have to be concerned with the possibility that some certifiers might allow biotech. Thus, any choice for a standard will embody some tradeoffs. Under the current proposal, State and private certifiers are required to have programs that meet the national standard. State certifica-

tion programs would be allowed to have organic standards that are more strict than the national standard, but would not be allowed to block interstate trade of products that meet the national standard. Private certification programs would not be allowed to set stricter standards, although they could meet contractual arrangements for stricter standards, label additional requirements, and propose changes to the national standard.

While the Organic Foods Production Act of 1990 does not target improvements in environmental and human health as an explicit objective of the regulation, these concerns are addressed in Section 2119 of the Act, which establishes the criteria for approving and prohibiting substances for use in organic production and handling operations: (1) the potential of such substances for detrimental chemical interactions with other materials used in organic farming systems; (2) the toxicity and mode of action of the substance and of its breakdown products or any contaminants, and their persistence and areas of concentration in the environment; (3) the probability of environmental contamination during manufacture, use, misuse, or disposal of such substance; (4) the effect of the substance on human health; (5) the effects of the substance on biological and chemical interactions in the agroecosystem, including the physiological effects of the substance on soil organisms (including the salt index and solubility of the soil), crops, and livestock; (6) the alternatives to using the substance in terms of practices or other available materials; and (7) the compatibility of such substances with a system of sustainable agriculture.

Most countries in Europe and several States offer some financial support for conversion to organic farming systems as a way to capture the environmental benefits of these systems. Organic crop production is eligible for cost-share support with Federal conservation funds in Iowa, for example, and in Minnesota, the State will reimburse two-thirds of the cost of organic certification. Some States that run certifying programs subsidize program costs with general revenues.

The Organic Foods Protection Act may also have implications for the structure of the organic farming industry. All certifiers will need to pay for accreditation, and all organic farmers with sales over \$5,000 will need to pay for certification to label their products as organic. According to USDA's regulatory impact analysis, even with the small business exemptions, some small organic farms and some small certifiers may exit the industry and small operations may be discouraged from entering the industry. However, the analysis indicates that other

features of the national organic program, such as the livestock standards, which restrict confinement operations, may be easier for small operations to comply with than for large.

The national standard is likely to have only a modest impact on environmental externalities caused by conventional production methods. Organic food is still a niche market in the United States—a small portion of agricultural production requiring only a small portion

of agricultural resources. Thus, the impact of the national standard will be measured by the extent to which it causes the organic market to grow. The national standard could influence the structure of the certifying industry, especially if State agencies continue to subsidize organic agriculture and have flexibility in setting standards. However, if the national standard increases the demand for organic food, the demand for certification will rise as well.