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Emerging Issues in the U.S. Organic Industry

Catherine Greene, Carolyn Dimitri, Biing-Hwan Lin,
William McBride, Lydia Oberholtzer, and Travis Smith



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Abstract

Consumer demand for organic products has widened over the last decade. While new producers have emerged to help meet demand, market participants report that a supply squeeze is constraining growth for both individual firms and the organic sector overall. Partly in response to shortages in organic supply, Congress in 2008 included provisions in the Food, Conservation, and Energy Act (2008 Farm Act) that, for the first time, provide financial support to farmers to convert to organic production. This report examines recent economic research on the adoption of organic farming systems, organic production costs and returns, and market conditions to gain a better understanding of the organic supply squeeze and other emerging issues in this rapidly changing industry.

Keywords: organic agriculture, farmers, handlers, consumers, organic production costs, organic supply, marketing organic products, organic label, organic price premiums, local food, organic food imports.

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Summary

Consumer demand for organic food has risen quickly over the past decade, triggered in part by the development and success of USDA's organic regulatory program and label. This rapid growth highlights challenges still to be overcome in the organic sector. As consumer demand for organic products has widened, organic retail sales have spread far beyond the "natural products" market niche in urban areas and college towns and into big-box stores across the country. The 2008 Farm Act includes many new provisions to help domestic producers meet the challenges of organic agriculture and facilitate consumer access to organic food.

What Is the Issue?

Since the late 1990s, U.S. organic production has more than doubled, but the consumer market has grown even faster. Organic food sales have more than quintupled, increasing from \$3.6 billion in 1997 to \$21.1 billion in 2008. More than two-thirds of U.S. consumers buy organic products at least occasionally, and 28 percent buy organic products weekly, according to the Organic Trade Association. This fast-paced growth has led to input and product shortages in organic supply chains, and several new issues—concern about premium-priced product sales in a tight U.S. economy, as well as competition from new environmental labels—are emerging in the organic industry.

What Did the Study Find?

Significant price premiums, fast-paced growth in demand, and fluctuating market conditions have characterized the U.S. organic sector since the beginning of the decade. Early in the decade, demand for organic products outpaced supply, and market participants reported that a supply squeeze was limiting growth in the overall sector. For example, 44 percent of organic handlers reported short supplies of needed ingredients or products in 2004, according to an ERS nationwide survey, and 13 percent were unable to meet market demand for at least one of their organic products that year.

More recently, U.S. organic producers and manufacturers have had to contend with the impact of a weaker U.S. economy on organic food sales. Surveys suggest that many organic consumers may not be particularly sensitive to the price premium paid for organic products. While frequent buyers of organic products may not change their organic purchasing habits even with the current economic slowdown, infrequent buyers may limit their purchases of organic products, and the rate of gain for new organic consumers may decline.

The low organic adoption rate for grain crops continues to be a bottleneck for expansion of the U.S. organic livestock sector, as organic livestock producers struggle to find reliable sources of affordable feed grains. Only 0.2 percent of U.S. corn and soybean crops were grown under certified organic farming systems in 2005, according to ERS estimates.

Organic imports have increased as U.S. demand for organic products has exceeded domestic supply. USDA-accredited groups certified 27,000 producers and handlers worldwide to the U.S. organic standard in 2007, with approximately 16,000 in the United States and 11,000 in over 100 foreign

countries. Organic handlers reported relying primarily on domestic suppliers in 2004, although 38 percent imported some or all of their organic products.

At the retail level, organic produce and milk, the two top organic food sales categories, receive significant price premiums over conventionally grown products. ERS analyzed organic prices for 18 fruits and 19 vegetables using 2005 data on produce purchases, and found that the organic premium as a share of the corresponding conventional price was less than 30 percent for over two-thirds of the items. The premium for only one item—blueberries—exceeded 100 percent. In contrast, organic price premiums for a half-gallon container of milk ranged from 60 percent for private-label organic milk above branded conventional milk in 2006 to 109 percent for branded organic milk above private-label conventional milk.

Organic food costs more to produce and also commands significant price premiums at the farm level. According to recent ERS analysis of national dairy and soybean survey data, total economic costs were significantly higher for organic dairy and soybean operations than for conventional operations. With an average price premium of \$6.69 per hundredweight for organic milk, organic milk producers covered most of the additional costs of organic production in 2005. In 2006, organic soybeans were more profitable than conventional soybeans, mainly because the price premiums paid for organic soybeans compensated for their higher cost of production.

Organic producers also face competition from new labels like the “locally grown” label. USDA organic regulations define organic production as an ecological production system that fosters cycling of resources, promotes ecological balance, and conserves biodiversity, but the regulations do not address where organic farmers and handlers market their products. According to an ERS survey of organic handlers, 24 percent of organic sales in 2004 were made locally (within an hour’s drive of the handlers’ facilities) and another 30 percent were made regionally. Partly in response to organic supply shortages, Congress in 2008 boosted funding for organic research and for a certification cost-share program in the Food, Conservation, and Energy Act. Congress also made conservation practices related to organic production and transition eligible for payments of up to a \$20,000 annual limit, with an \$80,000 cap over a 6-year period, under the Environmental Quality Incentives Program.

How Was the Study Conducted?

The study drew on a range of ERS studies and surveys on organic production and handling, and conducted an extensive literature review to better characterize the U.S. organic sector. One set of studies has analyzed data from certification groups for over a decade to track adoption patterns within the U.S. organic sector. In recent years, ERS has surveyed organic soybean producers and organic dairy producers in USDA’s annual Agricultural Resource Management Survey. ERS has also tracked the characteristics and purchasing patterns of U.S. organic consumers for two major organic food sectors—produce and dairy—using retail food purchase data, which are scanned at home by a nationally representative panel of consumers. Findings are also presented from ERS’s first nationwide survey of practices in the U.S. organic handling sector (organic manufacturers, processors, distributors, and other organic intermediaries), conducted in 2004.