A Brief Retrospective on the U.S. Organic Sector: 1997 and 2003

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Introduction

Organic products have shifted from being a lifestyle choice for a small share of consumers to being consumed at least occasionally by two-thirds of American consumers (5), consequently increasing opportunities for producers, handlers, and retailers of organic products. Along with the increased market opportunities, the production and distribution sides of the sector have taken on a new character. Formerly, organic foods were judged not only by taste, price, and appearance, but also by their social and environmental benefits. As the market has grown, consumers and businesses have developed broader reasons for purchasing and producing organic food.

Today’s organic industry consists of new entrants — including most notably conventional supermarkets, manufacturers, and distributors — as well as long-time, established organic firms — including producers, natural foods stores, and distributors. Each group has a comparative advantage in the industry. Conventional firms have established, low cost ways of moving product along the supply chain. In many cases, they are building up knowledge of the organic sector by purchasing organic firms and their expertise. Long-time organic firms have extensive knowledge of organic products and how to access the natural products markets, and are learning to compete with and coexist with conventional firms new to the industry.

In this paper, we trace some of the changes in the organic sector by comparing the industry in 1997 and 2003, starting with consumers and moving back through the supply chain to the farm level. We conclude with a brief discussion of opportunities and obstacles to market growth in the organic sector.

The Organic Consumer

The portrait of the typical organic food consumer has changed over time, reflecting the dynamic nature of the organic industry. Just a few years ago, most studies characterized organic consumers as Caucasian, affluent, well-educated, and concerned about health and product quality (6,11,12). While this type of consumer still purchases organic food, consumers today are far more diverse and not as easily characterized. Income and ethnicity are no longer significant predictors: half of those who frequently buy organic food have incomes below $50,000, and African Americans, Asian Americans, and Hispanics purchase more organic products than Caucasians (4). In addition, the average age of organic consumers is clustered in two age groups: 18 to 29 years and 40 to 49 years (7,12). One element has remained constant as the industry grows: many consumers of organic food are parents of young children or infants.
Consumers have many reasons for buying organic food. While health motivations have remained constant over time, purchasing organic food because of environmental concerns has become less important to today’s organic food consumer than to those from a decade ago. Analysis of responses to the 1997 Hartman survey and a 1994 study commissioned by the Food Alliance of Portland indicated that health and environmental issues were the most important factors organic-interested consumers considered when making decisions about purchasing organic food (1). More recently, consumers indicated that health and nutrition (66%), taste (38%), and food safety (30%) were the top three motivating factors behind organic food purchases, with the environment fourth (26%) (4).

Consumer interest in organic products rose rapidly between 1997 and 2003, resulting in total US retail sales increasing from $3.6 billion to $10.4 billion (9). The eight-year increase of 190% translates to an average annual growth rate of 24%. The top-selling category in both 1997 and 2003 was fruits and vegetables, which grew 166% from $1.6 billion to $4.3 billion, or an average annual increase of 21% (Tables 1a and 1b). Produce retail sales made up 46% of the value of all organic sales in 1997, declining slightly to 42% in 2003. While the same five categories dominate sales in 1997 and 2003, with the exception of produce, the ranking of categories changed as the value of retail sales of beverages grew 236% and of dairy increased 282%.

Table 1a. Top five organic product categories in 2003 (9).

<table>
<thead>
<tr>
<th>Category</th>
<th>Sales ($ millions)</th>
<th>Percentage of total sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fruit and vegetables</td>
<td>4,336</td>
<td>42</td>
</tr>
<tr>
<td>Beverages</td>
<td>1,581</td>
<td>15</td>
</tr>
<tr>
<td>Dairy</td>
<td>1,385</td>
<td>13</td>
</tr>
<tr>
<td>Packaged/prepared</td>
<td>1,326</td>
<td>13</td>
</tr>
<tr>
<td>Breads and grains</td>
<td>966</td>
<td>9</td>
</tr>
<tr>
<td>Total organic sales</td>
<td>10,400</td>
<td>—</td>
</tr>
</tbody>
</table>

Table 1b. Top five organic product categories in 1997 (9).

<table>
<thead>
<tr>
<th>Category</th>
<th>Sales ($ millions)</th>
<th>Percentage of total sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fruit and vegetables</td>
<td>1,642</td>
<td>46</td>
</tr>
<tr>
<td>Packaged/prepared</td>
<td>511</td>
<td>14</td>
</tr>
<tr>
<td>Beverages</td>
<td>471</td>
<td>13</td>
</tr>
<tr>
<td>Breads and grains</td>
<td>389</td>
<td>11</td>
</tr>
<tr>
<td>Dairy</td>
<td>362</td>
<td>10</td>
</tr>
<tr>
<td>Total organic sales</td>
<td>3,600</td>
<td>—</td>
</tr>
</tbody>
</table>

**Organic Food Retailing and Distribution**

Before the late 1990s, organic food was sold almost exclusively in natural product stores. This has been changing over the greater part of the last decade. In 2003, 47% of organic food sales took place in natural food stores, a decrease from 63% in 1998. The share of sales in conventional supermarkets has risen from 31 to 44% over the same time period. Direct sales and exports have also increased, from 6 to 9% (9,10). As organic products have become
more available in a wider range of venues, organic food has become accessible to more consumers. As a result, sales of organic products as a share of total food sales have grown from 0.8% in 1997 to 1.9% in 2003 (10), and annual new organic product introductions have nearly doubled from 290 to 536 new product introductions (14).

Some products are sold mostly in conventional stores, while others are marketed primarily in natural products stores. For example, in 2003, conventional stores dominated the following categories: nondairy beverages (86% of all organic sales); packaged fresh produce (75% of all organic sales); baby food (74% of all organic sales); and milk, half and half, and cream (74% of all organic sales). Many of these products are manufactured and distributed by conventional firms that have acquired a successful independent organic company; these firms possess extensive distribution networks, allowing easy access to conventional supermarkets. The natural food stores sold more organic meats (96%), candy and individual snacks (81%), organic baked goods (65% of all organic sales), organic soup (60% of all organic sales), and yogurt and kefir (59% of all organic sales) (8). Many of these products are produced and distributed by independent organic firms.

Interestingly, products dominant in the conventional market are those referred to as "gateway" products, or the first organic products purchased by consumers. Organic gateway products, which include produce, dairy, nondairy (soy), and baby food products, are considered important frontline commodities for the industry that steer consumers toward other organic products, such as cereals, snacks, and meat and poultry, many of which are dominate in natural food stores. The focus on gateway products in conventional markets indicates that firms are concentrating on new organic consumers at these retail outlets, while natural product stores seem to be catering to long-time organic consumers.

Certified Organic Acreage

Rapid growth at the farm level is also observable between 1997 and 2003, although the growth is slower than on the demand side. Overall, certified US organic cropland increased from 850,000 acres in 1997 to 1.45 million acres in 2003, while certified organic pastureland increased from 496,000 acres to approximately 745,000 million acres over the same period. The total acreage increase from 1.36 million acres in 1997 to 2.2 million acres in 2003 represents a 10% annual growth rate over the six years. Growth is also evident in the livestock sector. The number of certified organic dairy cows increased from almost 13,000 in 1997 to almost 75,000 in 2003 and beef cows from 4,000 to 27,000. Broilers also experienced a considerable increase during this period, from 38,000 in 1997 to over 6.3 million birds in 2003 while layer hens rose from almost 540,000 to almost 1.6 million hens (15).

In addition to the domestic supply increases, imports of organic products in 2002 were an estimated $1 to 1.5 billion. At the same time, exports of US grown organic products were an estimated $125 to 250 million (16). A key imported category is fresh produce in the winter, paralleling an established trend in the conventional sector. However, imports also consist of raw ingredients used for manufacturing. The high level of imports relative to the total size of the market may suggest that increases in certified organic farmland may not be keeping pace with growth in domestic demand.

Growing Pains: Market Opportunities and Obstacles

Over the past decade, as the sector has evolved, a natural tension has emerged between established organic industry members and new entrants, most notably conventional firms. At the core of this friction is a concern whether the essence of "organic" can be maintained as the industry expands,
firms grow larger, and conventional agricultural companies enter the sector. Primary research has shed some light on industry concerns about the changing nature of the organic sector at the farm and intermediary levels.

Long-time organic farmers, speaking in focus groups, indicated that the industry is experiencing growing pains as a result of rapid market expansion (3). Competition from new market entrants was an issue highlighted by all organic farmers in the focus groups. Small organic farmers feel increasing competition from larger operations able to provide retailers with large volumes of production, thus reducing small farmer access to retail markets. Some farmers feel threatened by the approach taken by new entrants to organic production and marketing. Others indicated that price premiums have become less stable and are decreasing in some cases, and that long-time markets can disappear quickly. Supermarket chains, according to some farmers, appear disinterested in selling locally-grown organic food.

Intermediaries (or organic handlers) in the organic chain have also expressed similar concerns. Approximately 25 organic industry stakeholders, representing certifiers, producers, and processors, attending a 2004 workshop at the Economic Research Service of the US Department of Agriculture, voiced concern about the direction of organic industry growth, echoing the sentiments expressed by farmers in the focus groups. Many of their comments focused on whether organic handlers and retailers work with large or small suppliers, promotion of organic foods, local versus national procurement and distribution, and company philosophies.

Differences are also apparent in the recent dialogue around the 2005 ruling in the case Harvey v. Johanns (formerly Harvey v. Veneman) [Docket No. 04-1379 (1st Cir. 2005), amended at 396 F.3d 28 (1st Cir. 2005)], which found that multiple provisions of the National Organic Program Final Rule, 7 C.F.R. Pt. 205, are inconsistent with the Organic Foods Production Act of 1990. A portion of the ruling refers to USDA’s allowing the use of 38 synthetic substances in manufactured food products labeled as organic. Following the court ruling, the National Organic Program (NOP) could no longer allow most of these substances. Harvey had asked that there be a two-year phase-in of the ruling so that manufacturing of organic products not be disrupted. However, amendments were made to the NOP legislation in the FY2006 Appropriations Act that allow the use of synthetic ingredients in products labeled organic if they are listed on the National List (2). Many long-time organic firms and farmers, as well as consumers, see this as a weakening of the organic standards (13). Debate is likely to continue on these and other related issues.

Although there is a tension between new and old organic industry members, each has a comparative advantage in the industry. Conventional firms have established, low-cost ways of moving product along the supply chain. In many cases, they are building up knowledge of the organic sector by purchasing organic firms and their expertise. However, these businesses also face challenges. Many of the leading organic brands have now been acquired and relatively few independent brands of size remain. Conventional firms will most likely need to focus on internal development of their organic businesses to expand (9). In addition, the lack of expertise in organic products on the part of these conventional firms, and the high transaction costs for larger firms to distribute niche organic products will, for now, probably slow their involvement in organic food (9). Long time organic firms, on the other hand, have extensive knowledge of organic products and how to access the natural products markets, and are learning to compete with and coexist with conventional firms new to the industry. However, access to conventional markets is a significant challenge.

Many of the concerns outlined are the opinions of those firmly entrenched in the organic industry, who may feel the most threatened by the market’s changing character. Their uncertainty about the future of the
industry as a whole, and the future of their business, is understandable: it would appear that the industry is at a crossroads, and like anything in a state of flux, accurately predicting the sector’s future form is not possible. One possible outcome, however, is that organic and natural products retail markets will coexist with conventional outlets but serve different customers. They may rely on different distribution networks or rely on the same distribution networks. Regardless of how the two streams mix, the supply and distribution of organic products is crucial to the success of the organic sector. A better understanding of the organic industry supply chain, paying careful attention to opportunities and obstacles for different size organic businesses, including farms, intermediaries, and retailers, and both new entrants and long-time participants, could help ease the industry’s growing pains. The views expressed in this article are the those of the authors and not of the Economic Research Service.

Literature Cited
