Inorganic Growth in the Organic Food Industry: Examining Barriers to Entry and Economic Rents

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Introduction

General Background
The current literature on organic food focuses solely on the growth it has seen from the consumer side of the market. Less research focus is directed at the production side of the organic food market. It is essential to examine what is meant by the term organic. The Organic Foods Production Act of 1990 established the official definition of organic when they wrote in the law that any agricultural product sold as organic must “have been produced and handled without the use of synthetic chemicals...to be produced on land to which any prohibited substances, including synthetic chemicals...not to be produced on land to which any prohibited substances have been applied during the 3 years immediately preceding the harvest of the agricultural products; and be produced and handled in compliance with an organic plan agreed to by the producer and handler of such product and the certifying agent” (1990).

Theoretical Insights
Barriers to entry remains vital in examining the efficiency in all sorts of markets. When a market is perfectly competitive, it will attract entry into that market as more and more firms hope to capture the profit. This continues until the point where enough firms enter the market so that there is no longer any profit that is able to be captured. Incumbent firms in a market thus have an incentive to construct barriers to entry so that fewer firms are able to enter the market and capture the incumbent firm’s profits. The cost of a barrier to entry, such as licensing of labeling, is relatively small for the firm compared to the profits they can maintain once licensed or certified.

Gunthorpe (2004) describes how the steps to becoming certified organic are barriers to entry that create rents for organic producers precisely because the certification process imposes an artificial scarcity of certified organic food based on USDA regulations. Since not all farmers can afford to have their land and production methods certified organic, this leads to a shortage of food items bearing the official USDA Certified Organic seal while demand for these items only grows. This artificial scarcity has allowed the profit margins of organic producers to remain so high for so long. A closer examination of economic rents illustrates how applicable this theory is in the realm of organic food. In his seminal work George Stigler elucidated many of these ideas most clearly when he wrote that industries with the ability to influence regulation strive to have “regulatory policy...so fashioned as to retard the rate of growth of new firms” (Stigler 1971).}

Figure 1: USDA Organic Label
There is a reimbursement program in place called the National Organic Certification Cost Share Program, which can reimburse up to 75 percent of certification costs and which has been in place in its most current form since 2009 (AMS). Benefits of this Cost Share program are not directed at a farm in the initial stages of transitioning to organic and facing the three-year transition period where they must incur costs without being able to sell their products under the organic label and earn no price premium during this time.

Figure 2: New Kashi Certified Transitional Label

Data

Preliminary Findings
In this study I am utilizing two data sets and combining them in my analysis. The first set comes from the USDA National Agricultural Statistics Service’s Quick Stats database. The second set of data comes from the USDA’s public Report to Congress on the National Organic Certification Cost Share Program, which is produced yearly. The national level data indicates that despite the length of time the program has now been in place, both the number of operations utilizing the cost share program and the total funds utilized are just starting to be back around and slightly exceed levels from when the program started.

National level data on the number of organic operations and organic acres over the last decade offer an unclear picture about the effectiveness of the National Organic Certification Cost Share Program in inducing more farmers to transition to organic since it subsidizes those farmers who are already certified. This data leads to the question of whether or not the NOCCSP is functioning as a barrier to entry.

Organic Acres and Number of Organic Operations over Time

Funds utilized and number of farms assisted through NOCCSP: National Level

Next Steps
Proceeding with the next steps
After analyzing state level data on the number of farms certified organic, transitioning to organic, and the amount of NOCCSP funds disbursed and utilized by the states, I will formalize my economic model and proceed to perform ordinary least squares regression. In my analysis I will test the relationship between not only the number of organic farms and the funds from the NOCCSP, but also the relationship between certified organic acreage and funds from the NOCCSP.

In my econometric analysis, I will be sure to test for heteroskedasticity in my model to ensure estimates from the regression are not biased.

My goal is that the results from this study will help to inform better public policy surrounding farming and in particular organic farming. One area I am most interested in a policy impact is policy development that has the potential to influence a traditional farmer whether or not to take the first step in the process to convert to organic.