THE DEVELOPMENT OF FAIR TRADE LABELS —
A MARKET SOLUTION TO A SOCIETAL CONCERN?

Dr. Helena Johansson

Consumers are increasingly taking an interest in how their foods are produced. Concerns are being voiced that practices that are environmentally harmful, involve maltreatment of animals, or exploit poor and vulnerable farmers, should be avoided. The term “societal concerns” has been coined for concerns that are derived from broadly shared values within a society, often entailing an ethical dimension. Many societal concerns are shared across countries, but depending on differences in, for example, development level, history, religion or risk perception, policy responses may differ or the weight assigned to a specific concern may differ. The Fairtrade labelling system addresses a societal concern among consumers in developing countries; the improvement of working and living conditions for export-oriented small-scale farmers and hired labour in developing countries. The idea is that consumers in rich parts of the world can contribute to better conditions for them by paying at least a minimum price for their produce, in addition to demanding good working conditions and sustainable production methods on farms and plantations.

Four main questions are addressed in this chapter: i) Is the labelling system beneficial for the farmers? ii) If so, can the benefits of Fairtrade be extended to the vast majority of poor farmers? iii) Are Fairtrade standards efficient in handling the problems that poor farmers are faced with? and finally, iv) How efficient is the Fairtrade scheme in transferring resources from consumers to producers?

The aim in this chapter is to discuss what can be learned from the Fairtrade labelling system when it comes to handling societal concerns through market mechanisms and consumer choice. The perspective is from both the producer and consumer points of view. In the examples given, the focus is generally on coffee. Along with bananas, coffee is the most important Fairtrade commodity in terms of value and volume (Ponte 2002a). Coffee is also one of the few agricultural commodities dominated by small-scale farmers. The principal line of reasoning, though, is valid for the broader range of agricultural products covered by the system. The chapter does not cover all potential impacts of the Fairtrade system but focuses on central aspects in the attempt to give a comprehensive picture of benefits and drawbacks in an efficiency perspective. Finally, the focus is primarily on farmers but it can be noted that goods produced by organised hired workers on plantations are also covered by the scheme.

1. AgriFood Economics Centre, Lund University, Sweden.
Fair trade background

The fair trade movement started in the 1940-50s. Various religious and political groups aimed at initiating trade co-operation with producers in developing countries, to provide market access to developed countries on non-exploitive terms. Initially, mostly handicrafts were sold by charity organisations, at church bazaars and later in so-called Worldshops. However, relying on a few, small and scattered outlets for the products meant reaching few consumers. If the goods could be on display in conventional stores, the sales potential would be much greater, but an attribute like “good working conditions” or “a fair price to the producer” is a credence attribute, i.e. it is related to the production process and cannot be discerned by the consumer by observing the final good. An item of goods traded according to Fair Trade principles simply does not look any different from a traditionally traded item. A way to handle this asymmetric information problem, in which the producer but not the consumer, knows of the underlying production process, is to label the goods as a signal to the consumers that it contains special attributes that are otherwise difficult to detect. The first fair trade label, Stichting Max Havelvaar, was introduced in the Netherlands in 1988. Several different national labels followed and sales took off.

<table>
<thead>
<tr>
<th>Issue/market failure</th>
<th>Fair Trade solution</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small-scale farmers lack information about prices.</td>
<td>Farmers must be organised in co-operatives; can pool resources to access information.</td>
</tr>
<tr>
<td>Smallholder farmers lack information about market requirements.</td>
<td>Farmers must be organised in co-operatives; can pool resources to send co-operative leaders to visit trade shows and clients to learn about quality requirements. Direct long-term relations are required; clients more likely to share information.</td>
</tr>
<tr>
<td>Smallholder farms lack access to financial markets.</td>
<td>Importers must pre-finance up to 60% of seasonal crops.</td>
</tr>
<tr>
<td>Smallholder farms are risk-averse and do not diversify.</td>
<td>No direct solution – raising income through Fair Trade may decrease risk aversion.</td>
</tr>
<tr>
<td>Weak enforcement of labour law in producing countries.</td>
<td>Standards require that producers adhere to ILO standards regarding minimum wages, child labour, working conditions, freedom to join unions.</td>
</tr>
<tr>
<td>World prices not covering cost of production.</td>
<td>Fair Trade floor price guaranteed no matter how low the world price falls.</td>
</tr>
<tr>
<td>In effort to lower costs, less sustainable production methods are used in the developing world, harming workers and the environment.</td>
<td>Fair Trade floor price covers costs of sustainable production. Environmental standards prohibit certain chemicals and land over-use; premium required for certified organic product.</td>
</tr>
<tr>
<td>Farmers and farm workers in the developing countries are poor.</td>
<td>Fair Trade guarantees minimum or regional wages for workers and price floors for smallholders. Social premium guaranteed, which must be spent on development projects to improve wellbeing of farm workers and smallholder farmers.</td>
</tr>
</tbody>
</table>

Source: Nic.
In 2002, the international label Fairtrade was launched by the Fairtrade Labelling Organisations International (FLO) in order to replace the multitude of national labels with one single label and one set of certification rules, the goal being increased consumer awareness and streamlined producer standards, irrespective of export market. Today, almost all national Fair Trade labelling initiatives are members of FLO. The Fairtrade system is based on a number of perceived market failures that are claimed to lower the return to farmers and expose them to a high degree of price volatility (Ronchi, 2006). Table 1 presents the Fair Trade movements’ conceptualisation of these failures and the corresponding Fair Trade solutions, as interpreted by Nicholls and Opal (2006). The main problems are viewed to be low world market prices in addition to low and imperfectly competitive prices paid to farmers by middlemen (e.g. EFTA, 2001).

Based on the Fair Trade principles, the Fairtrade standards are designed to address the imbalance of power in trading relationships, unstable markets and the injustices of conventional trade, according to FLO. The key objectives are stated to be (FLOa, 2010):

- to ensure that producers receive prices that cover their average costs of sustainable production;
- to provide an additional Fairtrade Premium which can be invested in projects that enhance social, economic and environmental development;
- to enable pre-financing for producers who require it;
- to facilitate long-term trading partnerships and enable greater producer control over the trading process;
- to set clear minimum and progressive criteria to ensure that the conditions of production and trade of all Fairtrade certified products are socially, economically fair and environmentally responsible.

The Fairtrade labelling system has three main components (FLOa 2010, FINE 2001): Firstly, a form of price support, which consists of a i) guaranteed minimum price and a ii) social premium. The minimum price comes into effect when world market prices are low. This means that the farmer is guaranteed a certain lowest price, irrespective of how low the world market price may be. In addition, a social premium is paid to the producer organisation to be used e.g., for building schools or providing credit at a low interest rate: Secondly, different standards that regulate production conditions and the relation between the buyer and producer organisation, and thirdly, a requirement that farmers have to be organised into a democratic form as a co-operative, association or similar organisation which is democratically controlled by its members, while workers have the right to join an independent union to collectively negotiate their working conditions. Only small-scale farmers can be covered by the system.

Mainly food products are covered by the system, e.g. coffee, tea and bananas, but there are also standards for products like flowers, cotton and footballs. Globally, consumers spent approximately EUR 2.9 billion on products certified in accordance with FLO’s criteria in 2008 (FLO 2010). In recent years, growth rates have been impressive. The sales of Fairtrade products have increased by an average of 40% per year for the last five years (FLOB, 2010). In 2008, the rate of growth was 22% (FLO, 2010). However, despite rapid growth, the share of Fairtrade goods in total production remains small. For instance, only 1% of the total yearly banana harvest is Fairtrade certified (Fairtrade/Rättvisemärkt, 2010).
Producer income perspective

In this part we discuss how farmers are affected by belonging to a certified co-operative. The first question is whether farmers gain from belonging to a Fairtrade certified organisation. If they do, the next question is whether this is a model that can be beneficial to farmers on a larger scale.

The minimum price as income insurance

An important part of the Fairtrade system is the minimum price, the purpose of which is to safeguard farmers’ incomes when international market prices fall. In the last two decades, international coffee markets for green coffee have displayed considerable real price volatility and a drastic general decline in prices reaching the lowest price level in over 100 years in 2002 (Ponten, 2002a).

Several studies have found that farmers belonging to Fairtrade certified co-operatives receive higher prices than traditional farmers in times of low world market prices, and studies have also found a positive impact on incomes for Fairtrade certified co-operatives compared to traditional farmers (Bacon, 2005; Calo and Wise, 2005, Murray, Raynolds and Taylor, 2003; and Nicholas and Opaln, 2005). There are few studies comparing farmers when world market prices are above the minimum price, one exception being Mendoza and Bastiaensen (2003). They found no notable differences between prices received by Fairtrade certified co-operatives and traditional farmers during years when world market prices are higher than the minimum price, thus supporting the notion that the minimum price acts as an income buffer (Mendoza and Bastiaensen, 2003). However, producers rarely sell their whole produce as Fairtrade, because of the lack of consumer demand, which means that the average price received is lower than the minimum price. In fact, only 30% of the total amount of the certified production gets paid the minimum price and receives the social premium (Fairtrade/Rättvisemärkt, 2010b). This means that the income buffer effect is smaller than the level of the minimum price indicates.

Thus, the Fairtrade system functions, to some extent, as insurance for farmers belonging to certified co-operatives. FLO states that “Fairtrade is an alternative approach to conventional trade” (FLO, 2009a). To truly be an alternative, it needs to include a large share of the world’s poor farmers in the system. For instance, most of the world’s coffee is grown by small-scale farmers having access to only a few hectares of land. Could most of those, potentially, be covered by the scheme?

Minimum prices for all?

The answer to this question requires an understanding of why prices are low in the first place, and whether a minimum price tackles the underlying mechanisms causing prices to be low. It is also necessary to have a perspective on the full extent of poverty.

Starting with the low world market prices for coffee, the main explanation is structural changes in supply leading to oversupply. In the early 1990s, the international markets for green coffee collapsed. Prices recovered in the mid-1990s due to alternating droughts and frost in Brazil, but plummeted again in the early 2000s. At the depth of the crisis, Oxfam (2002) estimated that farmers received 25% of the coffee price paid in 1960, taking inflation into account. Farmers were severely hit. Oxfam (2002) reports that the incidence of poverty and hunger increased sharply among affected farmers, children were taken out of school and healthcare deteriorated.
What had happened was that several events had coincided, leading to a paradigm shift in the nature of supply (Lewin et al., 2003 and Ponte, 2002a). The International Coffee Agreement (ICA) system, which had rather successfully controlled production and prices since 1962, was undermined by free-riding and disagreements about quota-sizes (Ponte 2002a). An increasing volume of coffee was traded by non-members at the same time as large coffee producers like Brazil and Indonesia turned to a more export-oriented development strategy. In addition, technical change, most notably in Brazil, led to increased productivity. As a consequence, a considerable increase in the supply of coffee followed from, most importantly, Brazil and Vietnam. A large increase in supply, combined with modest increases in demand, led to a sharp decline in price.

In this situation, a minimum price that, for example, equals the world market price before the slump, cannot cover all producers and all their output, simply because there is so much more coffee available than the consumers want, at that price. That lack of demand is a problem is illustrated by FLO estimates showing that the certified coffee export capacity in Latin America, Africa and Asia was roughly seven times greater than the actual Fairtrade exports during the depth of the coffee crisis (Murray, Raynolds and Taylor, 2003). In addition, Murray, Raynolds and Taylor (2003) noted that many producer groups, which could meet the Fairtrade standards, were not included in the system because of the lack of demand. Today, slightly more than a million farmers and workers are estimated by FLO to be covered by the Fairtrade system (FLOa 2010). To put this figure into perspective, it can be noted that there are currently 25 million producers of coffee, most of them small-scale farmers, and 880 million poor in the rural areas of developing countries, a majority of whom are directly or indirectly dependent on farming for their living (World Bank, 2007).

The minimum price and structural change

That prices should cover production costs is a chief Fairtrade concern. During the coffee crisis, Oxfam (2002), among others, found that many producers faced prices below costs (Oxfam, 2002). In the prevailing situation, this was not due to an inherent unfairness of the conventional trading system, but to the increase in supply in an inherently price-volatile market. The market price is simply a clearing mechanism, falling when supply is larger than demand. A low market price forces some high-cost producers to exit, reducing the amount of oversupply, and in the longer run the market price will cover the costs of (at least) the low-cost producers. That high-cost producers are replaced by low-cost producers is not a problem per se. On the contrary, it results in more efficient production and lower prices for consumers. Such structural change is constantly taking place to the benefit of society. Instead, the problem is the high adjustment costs faced by deprived high-cost farmers living in countries with poor safety nets. Structural change is often very hard on the poor.

For some farmers, it could be a good idea to continue to grow a crop, despite low prices. That is the case for farmers having a potential to be successful. Berndt (2007), however, indicates that several of the Fairtrade certified co-operatives in Costa Rica are situated in Zona Norte, an area with inferior conditions for coffee production, while only one Fairtrade co-operative is located in Los Santos, which is the best area for coffee production in the country. Instead, it is better to support those having the best prospects for success to remain in business, and instead help farmers with less good prospects to find new income sources. For them, to remain in a sector with low returns may not be a good long-term strategy. Lewin et al. (2004) note that, between 1998 and 2001, poverty rates increased by more than 2% among those farmers who remained in the coffee sector. At the same time, rural poverty rates as a whole fell by more than 6%.
This is not to say that it is easy for farmers to find new income sources, on the contrary. Difficulties to obtain loans, low levels of education and lack of safety-nets, for instance, are important obstacles (McCulloch, Winters and Cirera, 2001). In general, however, to achieve long-term income growth for farmers in developing countries, a transformation towards fewer, larger and more efficient farms is needed. It is important to facilitate structural transformation so that less productive farmers may find new income sources, while more productive farmers may expand. From this perspective, a minimum price has its drawbacks. Most importantly, the income support is linked to production, i.e., the farmers must grow specific crops, like coffee or bananas, to be eligible for the Fairtrade certification. This may create lock-in effects as the farmers cannot change crops if they want to keep the premium.

If the objective of Fairtrade is to include many farmers, the principle with a minimum price linked to production is particularly problematic as it hinders overall structural change. Conserving a situation with many small-scale farmers means that their income growth will continue to be slow. As discussed above, however, it is not even possible to provide a minimum price to a major share of the poor farmers in developing countries. A main problem is how to reconcile the future gains of structural change with the current costs that poor farmers face. The Fairtrade system can be said to try to reduce the consequences of structural change and low prices, by providing the minimum price. The objective as such is good, but the remedy is problematic.

If, instead of having the intention of being an alternative system to conventional trade, the objective of Fairtrade is to create a niche-market for a limited number of farmers, the situation will be different. Then, it will be possible to give some farmers the opportunity to benefit from the minimum price and the social premium, without having to worry about how incomes are to be enhanced for the majority of poor small-scale farmers. It is possible to have a price higher than the world market price for a limited number of farmers and for a variety of a product.

To conclude, rather than being an alternative to conventional international trade, the Fairtrade labelling scheme may be seen as a differentiated good with certain attributes that some consumers are interested in, i.e., a niche-market. In effect, as the Fairtrade label is constructed and actually works, it is a niche-market. As such, it is not a means to combat poverty to any significant extent, neither is it an example of an alternative and fairer trading system. This is not to say that the farmers included do not benefit from the scheme, but simply that it is not a large-scale alternative. If Fairtrade would like to make a difference for a large number of farmers and workers, a different strategy is needed.

**Agriculture and development in a wider perspective**

When discussing and assessing the potential contributions of Fairtrade to development and poverty reduction, it is essential to understand the mechanisms that contribute to income growth in rural areas.

Agriculture has a crucial role in promoting economic development in developing countries. This was highlighted when the World Bank devoted its World Development Report 2008 fully to the role of agriculture in development, and emphasised that agriculture is central for meeting the United Nation Millennium Goal of halving poverty and hunger by 2015. One reason is that so many poor people depend on agriculture. Of the 5.5 billion people living in developing countries, 3 billion, nearly half of humanity, live in rural areas (World Bank, 2007). Another reason is that farm households generally are poorer than urban households in developing countries (Aksoy and Beghin, 2005).
The early development in Europe, the United States and Japan shows that increased productivity in agriculture was a catalyst to industrialisation and economic development. The surplus from agriculture was invested in other sectors and over time the share of agriculture in the economy decreased as other sectors developed. The World Bank shows that GDP growth originating in the agricultural sector is at least twice as effective in reducing poverty as growth originating in any other sector. In China and India, for example, rapid growth in agriculture due to technological innovation and market liberalisation lead to considerable decline in rural poverty (World Bank, 2007). The World Bank concludes that a combination of underinvestment in productivity enhancing measures combined with policies that excessively tax agriculture, is the main explanation for slow per capita growth and little structural transformation.

**Producer socio-economic perspective**

In addition to the direct income effects, Fairtrade aims to achieve supplementary socioeconomic goals. Incomes are expected to be influenced, e.g. by strengthened bargaining power, but also additional effects are expected. The problems that have been highlighted by the Fair Trade movement are, for example, that farmers have difficulties obtaining credit, that there are too few public goods such as schools, that farmers have a weak negotiating position vis-à-vis domestic middlemen and that weak legislation leads to low environmental responsibility and poor working conditions for hired labour. The Fairtrade means are standards, the social premium and the requirement of democratic organisation of farmers or workers. The question is whether Fairtrade has a positive impact on those problems and whether the suggested solutions are efficient? To begin with, we start by looking at the transfer efficiency of the Fairtrade system; how large a share of the price premium paid by the consumer does the intended recipient benefit from?

**Transfer efficiency**

When a sum of money is to be transferred from consumers via a shop, wholesaler, buyer, roastery, and co-operative to finally reach a coffee farmer, costs are incurred for maintaining the system. The costs of certification raise the production costs of Fairtrade products; costs that burden the farmers and reduce the income effect of the minimum price. Small volumes also mean that the production cost per unit can be higher than conventional production, because of the lack of economies of scale. There is also a risk that others, not the intended recipients, are enriched along the way. If farmers are tenants, some of their additional income may for instance go to the landholder in the form of increased rent. In the market place, retailers or cafés can charge consumers a higher price than justified to cover the costs for the system. This is a form of price discrimination, i.e. that retailers sell varieties of a product to consumers at different prices (Harford, 2006). For example, Zehner (2002) estimates that Transfair producers receive 45% of the increment in price paid for a Transfair good compared with a conventional alternative, while Harford (2006) shows that only 10% of the price increment for a cup of a Fairtrade coffee in a café goes to the farmer. In the case of bananas sold in the UK, Oppenheimer (2005) finds that only 6% of the price increment for Fairtrade bananas goes to the farmers. There are also examples where there is no price premium for the Fairtrade alternative compared with a conventional alternative. For instance, when Nordic Sugar introduced the Fairtrade mark on cane sugar cubes in Sweden, they left the consumer price unchanged. In such a case price discrimination is not a problem. In comparison, Swedish authorities demand that 75% of the amount collected for charity is to reach the intended recipient, if an organisation is to be allowed the use of a charity bank account number for their transactions. Low transfer efficiency means that a small share of
the donation made by the consumer reaches the farmer. Hence, buying a Fairtrade product can be an inefficient way to support the incomes of poor farmers and the construction of schools in developing countries.

It is sometimes argued that the issue of transfer efficiency is irrelevant as the Fairtrade system guarantees a minimum price, not that a particular share of the price premium is to reach the farmer. It is also argued that Fairtrade cannot be compared with charity, since Fairtrade is a trading arrangement. However, for the social premium the comparison is directly relevant, as it is aimed for investments akin to those intended by aid or charity. Also, if consumers decide to spend less money on charity when buying Fairtrade goods, the poor lose in total if the Fairtrade system is less efficient than the charity system. Finally, it can simply be argued that a system with the objective to transfer resources from rich to poor should be as efficient as possible. Hence, the issue of efficiency cannot be irrelevant.

Socioeconomic effects

A key Fair Trade movement assumption is that producers have a weak negotiation position vis-à-vis middlemen and, therefore, face a low share of returns. This assumption forms the ideological support of co-operative organisations (Ronchi, 2006). The market power assumption is tested by Ronchi (2006) in an informative study using data from coffee cultivation in Costa Rica. There are three types of ownership of mills to which the producers in Costa Rica can deliver; co-operative, private domestic or private multinational processing mills. She found evidence of market power, i.e. that a group of mills pay lower producer prices than explained by cost recovery and scale inefficiency. Co-operative mills were found to exercise lower market power than private domestic mills and she also found evidence of an additional and reinforcing “Fairtrade effect”. It was further found that multinational mill/exporters also exercise less market power than private domestic mills, and that the sum of the coefficient quantifying the impact of co-operative organisations and the separate “Fairtrade effect” on markdowns was not statistically distinct from the estimated coefficient on the effect of multinational firm. Ronchi suggest that “[o]ne interpretation is that Fairtrade does for co-operatives what vertical integration into multinational firms does for the non-co-operative, domestically owned firm”. That is, to strengthen their position towards domestic middlemen, it is important for local producers to link to the world market; one way is to belong to a Fairtrade certified organisation, and another way is through direct interaction with multinational firms.

A second key Fair Trade movement assumption is that farmers face credit constraints. Therefore, Fairtrade standards require buyers to give a financial advance on contracts, called pre-financing, if producers ask for it (FLO, 2010). Similarly, the income generated by the minimum price can be used to develop or diversify production. The underlying main problem, though, is a malfunctioning local credit market. Instead of providing conditioned credits tied to the growing of a specific crop; a much more viable solution in the longer run would be to provide micro-credits without formal collateral for the poor to spur entrepreneurship. The rise of microfinance has given millions of poor people access to loans, but the World Bank (2007) notes that it has not yet reached small-scale farmers to any significant extent. As pointed out above, the best business opportunity for a farmer in the longer run may not be to continue with the current crops, but to diversify or to find non-agricultural incomes.

A third Fair Trade movement key assumption is that low prices may harm workers and the environment if less sustainable production methods are used in an effort to lower costs of production. The Fairtrade requirements for hired workers follow the ILO-standards. The
Fairtrade standards also include basic environmental requirements; minimised and safe use of agrochemicals, a proper and safe management of waste, maintenance of soil fertility and water resources (FLO, 2010). The standards also include requirements regarding how the price support shall be used. In countries with a weak environmental and labour legislation, or a weak control of compliance with existing legislation, the Fairtrade standards can improve conditions. There is, however, an inherent risk of corruption due to the combination of money to be earned and costs of compliance. Hence, an independent agency, in this case FLO-CERT, is needed to control that Fairtrade marked goods are in fact produced and traded in accordance with the requirements. If the goals of Fairtrade are to be reached, a necessary condition is that the control system actually works and that the standards are followed.

In an article in the Financial Times, which received much attention, the certification and control process was questioned as labour hired by farmers to pick coffee were found to be paid below the minimum wage (Weitzman, 2006). Also, in a Danish documentary “The Bitter Taste of Tea”, the journalists visit tea plantations in Sri Lanka, Kenya, India and Bangladesh with the purpose of exposing unsafe work environment and labour exploitation. They claim to find little meaningful difference between conventional plantations and Fairtrade certified plantations in this respect. It is beyond the scope of this chapter to determine whether the control process works or not. What is worth noting is that effective control and enforcement can be difficult to obtain.

The Fair Trade movement focuses on poverty alleviation and improved living condition. A key component is the social premium that the farmer organisations receive in addition to the minimum price. The idea is that the premium is to be used for building schools, healthcare, infrastructure such as irrigation systems, to provide loans at a low interest rate to farmers and suchlike. There are several examples of successful projects, for example Transfair reports that the AGOGA co-operative in Papua New Guinea has invested in a medical team, and that the CECOVASA co-operative in Peru is assisting members from indigenous groups in raising coffee quality and transitioning to certified organic production. The drawback of the system is inefficiency, as pointed out above. It is simply an inefficient way of transferring money to these types of projects. A direct financial contribution or aid would be more efficient, as a larger part of the consumers’ donations may reach the recipient. Also, the costs of maintaining the Fairtrade system would be avoided.

High quality is an important attribute for many consumers. An interesting question is therefore whether Fairtrade supports attempts to enhance the level of quality. Both the minimum price and the social premium provide earnings that potentially could be invested in quality enhancing measures, implying a positive impact. For instance Calo and Wise (2005) found that Fairtrade certification has facilitated organic certification in Mexico. However, it has been noted that Fairtrade inadvertently can encourage low quality. Berndt (2007) points out a potential free-rider problem as farmers sell their produce both as Fairtrade marked and at the conventional market. He notes that when a farmer delivers his beans to the co-operative for milling they are mixed with everyone else’s beans. Berndt points out that any advantage in quality the farmer might have is diminished by the quality of the rest of the coffee; it therefore pays to keep the better beans for the conventional market and deliver the lesser beans to the Fairtrade mill. Whether a positive or a negative effect on quality dominates is, however, not possible to determine.

Non-certified producer perspective

An important question is how non-certified farmers are affected by the certification scheme. According to Consumer International (2005), most commentators support the notion
that oversupply is a main factor behind poverty among coffee farmers. Hence, if being Fairtrade certified stimulates production among the certified farmers, Fairtrade can aggravate the situation for other poor farmers, as the level of output increases (see for example the discussion in The Economist 2006a, 2006b).

There are two general arguments against a link between certification and production: First, that the output level is unaffected since only the volume that consumers buy receives the Fairtrade price. Hence, there will be no contribution to coffee oversupply from Fairtrade production (Steinrücker and Jaenichen, 2007): Second, that conventional coffee and Fairtrade coffee are goods with different attributes, thus belonging to separate market segments with different and uncorrelated prices (Hayes and Moore, 2005).

The arguments, however, fail to take into account the fact that a minimum price can subsidise production sold at the world market price. It is common that Fairtrade certified farmers sell part of their output in the conventional market. If some fixed costs for coffee production are covered by the minimum price or the social premium, the conventional part will be cross-subsidised. Lower costs mean higher profitability, which in turn encourages production. Moreover, in this case conventional farmers are at a cost disadvantage, making them less competitive, which means that some producers selling conventional coffee are favoured at the expense of others, with a sub-optimal mix of producers as a result.

Further, Fairtrade goods are sometimes more expensive than conventional alternatives. Consumers have a restricted budget; if they spend money on a more expensive Fairtrade variety of a good, they will have less money for savings or consumption of other goods. An alternative is to buy a lesser quantity of the more expensive Fairtrade good, but it is also possible that the consumer buys less of something else, for example other goods that are exported from a developing country.

Altogether, poor farmers not covered by the Fairtrade system may be negatively affected by reduced demand for conventional alternatives. They may also suffer from a downward pressure on prices of conventional alternatives, if the minimum price has a production-stimulating effect. Whether or not this is the case, has to be empirically verified, but few such studies are made. There are some case studies showing that certification has led to increased production. For example, Imhof and Lee (2008) find that coffee producers in Bolivia have increased the number of hectares with coffee after certification. Pérezgrovas and Cervantes (2002) also find increased production in the co-operatives they have studied. However, an important argument against any significant impact on prices, or demand for conventional varieties, is that the Fairtrade market shares are so small that the world market prices of conventional varieties are probably not affected.

There are also arguments that the minimum price has a certain positive effect on local prices. In a study on coffee producers in Mexico, Milford (2004) found that non-certified farmers receive a higher price from buyers in areas where there are Fairtrade-certified co-operatives present. She interprets this as a positive competition promoting effect of the co-operatives’ presence. In general, though, she concludes that there are few studies showing any direct positive effects on non-certified farmers.

A more wide-ranging positive effect of all certification systems with socioeconomic and/or environmental protective objectives, however, can be increased awareness among consumers, creating a demand for social responsibility among multinational firms that are active in developing countries (Becchetti, Frederico and Solferino, 2006). Hence, a potentially much larger number of farmers and workers may indirectly be affected by the movements. However, the downside is that consumption of goods originating from
developing countries may be stigmatised, leading to an overall reduction in demand. An alternative of this argument is that consumers may start to regard varieties produced in developed countries as a viable alternative to expensive Fairtrade products or socially unacceptable non-certified alternatives (Lindsay, 2004).

**Consumer perspective**

The evolution of fair traded goods is part of a larger trend incorporating organic food, high quality alternatives or differentiation according to origin (Boström and Klintman, 2008). The Fairtrade label gives the concerned consumer an opportunity to support certain production processes by providing information about credence attributes. This opportunity can be compared with demands sometimes raised e.g. by trade unions that the World Trade Organisation (WTO) should include minimum standards for labour, allowing for trade boycotts of non-abiding countries. The Fairtrade system enables positive action; to buy good alternatives instead of boycotting bad ones, which has several advantages (The Economist, 2006). Those consumers who cannot afford to pay a higher price (if a Fairtrade good is more expensive than a traditionally traded alternative), or do not share the underlying concern, have the alternative of buying a conventional alternative of the good instead. Furthermore, the producers do have a choice as the standards are voluntary; those who cannot abide by the rules are not forced to exit the market, which could be the case if the standards were mandatory.

How then are consumers affected by the possibility of buying goods incorporating ethical values and attributes? There are several possible effects. One is the so-called warm glow effect, the feeling of moral satisfaction obtained when contributing to a better world (Nunes and Onofri, 2004). The concept of a “fair price for work done” rather than charity may be appealing to both consumers and producers. There is also an increased consumer demand for goods with a “story” attached to them (Berlan, 2008). It may finally be seen as easier by the consumer to contribute when shopping rather than going to the trouble of making a monetary donation to a charity organisation (Steinrücke and Jaenichen, 2007). However, the fact that only a very small share of poor small scale farmers is embraced by the Fairtrade system has generated concerns pointing out that consumers may be led to believe that they are making much more of a difference than they are. See for example Sidwell (2008) who points out that the focus in the Fairtrade marketing material is on anecdotal evidence and growth rates, information which says very little about the total impact of the system.

**Conclusions**

Fairtrade has positive effects. For the consumer, the system provides an opportunity to actively contribute to a better world. For producers, the price fall during times of low world market prices is limited. Fairtrade may also have positive socioeconomic effects, for example in financing schools and contributing to a strong negotiating position vis-à-vis domestic middlemen for the farmers. It is also psychologically more attractive to achieve a higher price for something one has produced than to receive charity assistance. There are several weaknesses, though. Above all, the Fairtrade minimum price can never be extended to a larger number of poor farmers. There are simply too few rich consumers compared with poor farmers, to make an income transfer really matter. Fairtrade is, and will remain, a niche market for relatively few producers. Hence, the Fairtrade system as currently constructed cannot have a significant role in combating world poverty. In addition, Fairtrade is generally inefficient in transferring resources between consumer and producer, or dealing with other problems like lack of micro-credits or too few schools.
Insufficient policies and underinvestment in agriculture is a main problem in many developing countries with a large agricultural sector and slow economic growth. Higher agricultural productivity and, in the longer run, fewer, larger and more efficient farms are needed to raise rural incomes. In this perspective, the way forward for the agricultural sector as a whole in developing countries is not a minimum price and a social premium conditioned on the continued production of a specific crop, as structural change would be substantially slowed down if many farmers were to be covered by such a scheme.

It is, finally, important that the Fairtrade initiative does not mislead people into thinking that conventional international trade is exploitative and unfair in its nature. Instead, conventional trade has a large potential to promote prosperity among poor people. If consumers cut down on their purchases of labour-intensive goods from developing countries, it will have a negative impact on the income levels of farmers and employees living in those countries.

**Notes**

1. Note that the term Fairtrade as one word is used to describe the certification and labelling system governed by FLO, while the term Fair Trade as two words is used to refer to the Fair Trade movement as a whole and can be used to describe both labelled and unlabelled goods and the work of Alternative Trade Organisations (ATOs), Fair Trade federations and networks such as NEWS, EFTA, etc. (FLOa)

2. Green coffee consists of dried but unroasted beans.

3. In addition, the international coffee market is also subject to high price volatility, as the market is characterised by low price elasticity of both supply and demand, which aggravates the problem. It takes several years for a tree to reach its full productive capacity, which means that the productive area cannot increase in the short run. Because of the investment, farmers are reluctant to replace the trees with other crops in the short run. Coffee demand increases as incomes rise, levelling off at higher income levels, which results in low price elasticity. Overall demand drops only significantly when large price increases occur. Large price falls induce only small increases in demand.

4. Green coffee consists of dried but unroasted coffee beans.

5. The impact on prices of weak farmer bargaining-power vis-à-vis middlemen is discussed below.

6. At the national level, structural transformation implies that the share of agriculture in GDP decreases while the share of industry and services increases as GDP per capita rises.

7. A US-based system that is a member of FLO.

8. When large price differentials between Fairtrade and conventional alternatives are presented in a study, the Fairtrade price is often lowered as a consequence. This happened in the studies mentioned above.

9. The International Labour Organisation (ILO) is a UN agency promoting decent working condition throughout the world. They demand, in essence, that workers shall have the right to join an independent union, salaries must be equal or higher than the regional average or than the minimum wage, absence of child labour and equitable working conditions for all workers.

10. A film by Tom Heinemann and Erling Borgen, Denmark, 2008; Heinemann (2008) comments on this film.

11. Responses to these criticisms can be found in Fairtrade Foundation (2006) and Fairtrade/Rättvisemärkt (2010a).
References

Aksoy, M. A. and J.C. Beghin (eds.) (2005), Global Agricultural Trade and Developing Countries, World Bank, Washington DC.


