

Is My Fair Trade Coffee Really Fair?

Trends and Challenges in Fair Trade Certification

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Abstract

Fair trade sales grew rapidly over the past decade but it is still a small and decidedly niche market and rifts over further growth are deepening. There is currently a fierce debate between advocates arguing that mainstreaming undermines core fair trade principles and the US fair trade initiative, which split from the international organization because its leaders believe that mainstreaming needs to go much further. Expanding the range of fair trade certified products beyond the simple food and beverage commodities that currently dominate the market is also a challenge. Perhaps most important, is the value of certification high enough that farmers will continue to pay its costs in an era of booming commodity prices?

This paper surveys the current landscape of fair trade markets and examines recent trends. It then provides a brief description of how these markets operate, how they differ from traditional commodity trade, and what the key challenges facing fair trade are. This paper is as an introduction to these issues, while future papers will address in more detail the implications of the Fair Trade USA defection and what we know about the impact on producers.

NB: In this paper, fair trade refers to any form of fair trade labeling while Fairtrade is reserved for products certified by or activities of the Fairtrade Labelling Organization International (FLO) (also Fairtrade International for short).

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Introduction

Initiatives trying to get consumers to pay attention to the treatment of farmers and workers producing what they buy are at least several decades old. One story traces the idea as far back as Quaker abolitionists promoting markets for slavery-free cotton and fruit in the late 18th century.¹ Certification and labeling of fair trade products, which allowed them to be sold by mainstream retailers, began in 1988 in the Netherlands with the Max Havelaar Foundation label for coffee. Activists in several other countries followed that example and several national labeling initiatives joined together a decade later to create the Fairtrade Labelling Organization (FLO).

The creation of a Fairtrade label resulted in remarkable growth in the demand for certified coffee and, later, bananas and other products, though the market shares are still small in most countries. Global sales of Fairtrade certified goods were more than six times larger in 2011 than just seven years earlier, and Fairtrade coffee in particular is going mainstream. Starbucks sold a fifth of all Fairtrade coffee in the United States in 2010 and Dunkin Donuts uses Fairtrade coffee in all their espresso drinks. Certified coffee is even available in Wal-Mart's Sam's Clubs.² Still, the total value of all Fairtrade certified products sold globally in 2011 was just \$7 billion, a drop in the bucket of global commodity trade.

Despite the small overall size of the market, rapid growth is raising concerns among some advocates that fair trade is losing its meaning. They wonder whether mainstreaming is compatible with basic principles of fair trade that emphasize the role of smallholder producers and the empowerment of those producers through the creation of a fundamentally changed relationship between producers and buyers. These critics point out that for most mainstream retailers offering fair trade goods, those sales are only a small share of the total and they suspect that the commitment to fair trade is just window dressing. Paul Rice, the head of Fair Trade USA, wants to keep expanding the market to help more producers and workers and believes the scope for that is limited if mainstream retailers are not more involved.³ But further expansion in mainstream markets also raises the dilemma for retailers of how to respond to consumer demand for fair trade goods without implying that the conventional goods they offer are *unfair*. This concern could be why it is often easier to find information about fair trade on some retailers' websites than in their stores.

While the debate over fair trade as a market or a movement continues, the sharp rise in commodity prices raises more fundamental questions. In 2010, when coffee prices spiked to

¹ See <http://www.just-works.com/img/FairTradeTheLongJourney.pdf>, and <http://www.thenation.com/article/169515/brawl-over-fair-trade-coffee>, accessed October 17, 2012.

² <http://www.dunkindonuts.com/content/dunkindonuts/en/coffee/espressostory.html>;
<http://www3.samsclub.com/NewsRoom/Press/593>, accessed December 14, 2011.

³ <http://www.thenation.com/article/169515/brawl-over-fair-trade-coffee>, accessed October 17, 2012.

a 13-year high, there were numerous reports of Fairtrade coffee buyers being left high and dry because producers reneged on their coop commitments and sold their coffee at higher spot market prices to independent buyers. Because prices rose rapidly in the summer of that year, and because Fairtrade encourages sustainable and predictable contracting, most cooperatives had signed contracts with buyers months before the price spiked. Unexpected spikes aside, if commodity prices stay relatively high, will producers still see value in fair trade certification?

This paper provides an introduction to the fair trade approach, how it has evolved, where it is going, and the challenges it faces. Future papers will dig more deeply into what we know about the benefits, and costs, for producers and whether the new approaches to expanding the market that Fair Trade USA is testing will work. I begin with the premise of the fair trade model—that consumers care about the conditions under which the products they buy are made and that they are willing to pay for better conditions.

Markets, Consumers, and Social Certification

The premise behind fair trade is that consumers care about the welfare of the people producing what they buy and are willing to pay a bit more to ensure they are treated decently. The problem is that information about working conditions in other countries is generally unavailable or difficult and costly for ordinary consumers to obtain. The fair trade response to this problem shifted over the years, from a model where trusted charitable organizations provided a direct link between consumers and poor people in developing countries, to one where product labels certifying compliance with fair trade conditions provided consumers with the necessary information. Before turning to the details of that transition, it is helpful to review the evidence that consumers will pay more for products if it improves the welfare of others.

Respondents regularly tell pollsters that they would pay more for goods made under good labor conditions, but the messages are often mixed. A poll of college students found that 79 percent would purchase fair trade items if available on campus, but the share dropped to just one in two if they had to pay more for the item (Suchomel 2005). In various surveys, around 80 percent of those asked consistently said they would be willing to pay more for an item made under good working conditions. In surveys that explored how much they would be willing to pay, 84 percent would pay for the higher standards product when the alternative was either the same price or cost only \$1 more for a \$20 item. But the share willing to pay more dropped to roughly 75 percent when the price went up \$5 on a \$20 item.⁴ Support for altruism in economic decision-making can also be found in laboratory experiments, but what about real-world evidence?

Studies of stock prices in the wake of sweatshop scandals find negative effects and perhaps the most compelling evidence that there is something to the demand for standards to protect

⁴ These surveys and other evidence are reviewed in more detail in Elliott and Freeman (2003, chapter 3).

workers is that many brand-name companies responded to the anti-sweatshop movement of the 1990s by adopting codes of conduct and engaging in various monitoring schemes. Elliott and Freeman (2003, chapter 3) concluded that fear of negative reputational effects and erosion of brand value was the major motive in these corporate responses. The authors commissioned a survey designed to explore the nature of the consumer demand for “sweat-free” products and it helps to explain the response of the major brands targeted by the anti-sweatshop movement. The survey suggests that at least some consumers are willing to pay more if they know goods are produced under decent conditions, but most are not willing to pay very much more. At the same time, most consumers say they would *avoid* buying something if they knew it was produced under poor conditions or they would want a large discount. Adopting codes of conduct and monitoring their suppliers provides a form of insurance to protect the brand against scandal.

There is also evidence from real-world experiments designed by researchers to test the willingness to pay to improve working conditions for others. In one experiment conducted by a team at the University of Michigan and involving socks sold in a department store, researchers found that only 26 percent of shoppers (far lower than indicated by the surveys) would buy the product labeled as made under good conditions when it cost more than an identical conventional item (Prasad et al. 2004). In perhaps the best-designed experiment to date, Hiscox and colleagues (2011) sold seemingly identical polo shirts on eBay, except one was produced in a factory certified by a social auditing initiative and the other was not. The authors found that about a third of participants bid only on the certified shirt, about a third only on the uncertified shirt, and the other third went back and forth between the two auctions. Overall, the average premium paid for the certified shirt across all the auctions was \$1, just under 10 percent of the average \$11 price (Hiscox et al. 2011, pp. 20, 38).⁵

Thus, there is evidence that a substantial number of people are willing to pay a modest premium to ensure the products they buy are produced under decent conditions. But the potential power of this “market for labor standards” cannot be fully harnessed if consumers do not have positive alternatives to choose and the options remain relatively limited. The complex supply chains involved in apparel and footwear, where the anti-sweatshop movement focuses, make monitoring difficult and recurring scandals likely, which could damage the reputation and “brand” of any NGO providing an endorsement. The lack of easily identifiable, “sweat-free” alternatives continues to be a problem for consumers of clothing, footwear, and other items. But the fair trade movement is increasingly identifying positive alternatives in some sectors, mainly minimally-processed food or beverage items where the supply chains are short and more easily monitored.

⁵ The premium was higher in paired auctions, but the figures vary widely and are difficult to interpret.

The Evolution of Fair Trade: From Direct Trade to the Fairtrade Labelling Organization

International charitable organizations developed “direct trade” as a tool to help the poor in countries where they were working by serving as intermediaries to help them sell their goods to consumers back home. But this approach could only go so far. Demand for these early fair trade products depended on consumer trust in the sponsoring organizations, which had to be involved at every step in the supply chain to maintain the credibility of the system. In the 1990s, organizations interested in the fair trade model created a certification and labeling system that expanded the potential market enormously by allowing mainstream retailers, perhaps your supermarket down the street, to begin selling fair trade products.

Expanding the Market

SERVV International started in 1946 as the Sales Exchange for Refugee Rehabilitation and Vocation, an organization devoted to helping refugees in Europe after World War II by buying their handicrafts and selling them back home in New Windsor, Maryland.⁶ Oxfam in the United Kingdom and the Mennonite Central Committee in the United States launched similar initiatives in developing countries in the middle of the last century, buying goods directly from poor producers in countries where they ran development programs and selling them in shops they operated back home. Today, Oxfam has gotten out of direct trade, but there are still nearly 3,000 “world shops” across Europe that sell “alternative trade products” (Krier 2005). In the United States, the efforts of those early Mennonite volunteers grew into more than one hundred “10,000 Villages” stores and a website selling fair trade handicrafts in 36 states.⁷ SERVV uses similar methods today and also focuses on the poor in developing countries.

A key element in this direct, or alternative, trade model is to link consumers more directly to poor producers and to ensure that producers are paid a “fair price.” A key issue at the center of many debates today is whether fair trade is still about relationships, or is it about supply chain management. Advocates of fair trade as a movement tend to emphasize the relationship aspect of fair trade and the desire to engage the empathy of the consumer, by giving a face to the producer on the other side of the transaction. But the potential market for direct trade, especially in those early days, was sharply limited because consumers had to be near a store or stumble across a mail-order catalogue. The internet broadened the potential reach of the market, but consumers would still have to discover and seek out fair trade websites.

⁶ The history is summarized at <http://www.serrv.org/category/our-story>, accessed December 7, 2012.

⁷ The history of United States is available on the Fair trade Federation website at <http://www.fairtradefederation.org/ht/d/sp/i/2733/pid/2733>, accessed October 15, 2012.

Certification and labeling significantly expands the potential market by allowing the sale of fair trade goods at your neighborhood coffee shop or supermarket. The Max Havelaar Foundation in the Netherlands launched the first fair trade label in 1988 for coffee. Today, the FLO encompasses 19 national labeling initiatives that license the Fairtrade label in 24 countries. The FLO also licenses use of the label in the Czech Republic, Hong Kong, and South Korea. The range of products available is now well beyond coffee, though most are still agricultural or food-related. Ironically, given the origins, the FLO does not certify handicrafts.

The FLO Model

A key objective of the Fairtrade approach is to remove some of the volatility that plagues commodity markets and to provide some protection to smaller, poorer producers that have few resources to cushion the impact when prices fall. The core of the FLO model is that certified traders must buy directly from a certified producer organization and pay a minimum price that is set by the FLO with the intent of covering sustainable production costs. Even when the market price is above that minimum, as it has been for most products the past few years, traders must also pay a social premium that is to be used for social, economic, or environmental development of the community.⁸

The standards encourage “sustainable trade partnerships” and ask buyers to provide a sourcing plan to each producer organization to facilitate planning. They also require buyers to provide up to 60 percent of the value of the contract in advance, though they may charge interest. FLO standards do not dictate the interest rate and guidance suggests that producers check whether locally-available credit might be cheaper.

The FLO emphasis is on small, family-based producers and it views the creation and strengthening of democratically-run producer organizations (POs) as part of its mission to empower marginalized producers. But these organizations are also needed to make the FLO model work: to provide a representative that can interact with the certification organization, and to determine allocation of the social premium. Smallholders also have to comply with international standards relating to forced and child labor and, consistent with those standards, family labor is allowed as long as it is not hazardous and does not interfere with education. Other international labor standards, relating to freedom of association, nondiscrimination, and other working conditions, are applicable only for hired labor situations. There are also standards relating to natural resource conservation, the safe use of chemicals, and other health and environmental issues.

For sectors where smallholders dominate, certification for plantations is generally not even offered. But in some sectors, such as bananas, large operations using hired labor are the norm

⁸ For some products—sugar, flowers and plants, some herbs and teas, and some fruits and vegetables—there is no minimum price, but the traders must still pay the social premium.

and, in seeking to expand the potential beneficiaries, the FLO adapted its rules to accommodate them. Table 1 shows the products eligible for certification, including whether they are eligible when using hired labor, and the number of farmers or workers covered. The largest number of certifications are for coffee, with 365, followed by cocoa and tea, with 96 and 89, respectively (Fair Trade USA 2011, p. 8).

Table 1. FLO Certification by Type and Product (2010)

Certification allowed for small producers only		Certification possible for hired labor situations	
Product	Number of farmers covered	Product	Number of farmers, workers covered
Cane sugar	17,600	Bananas	9,900/5,500
Cocoa	125,900	Flowers and plants	0/34,000
Coffee	532,000	Fresh fruit/vegetables	3,400/21,500
Cotton	58,500	Sports balls	0/16,400
Dried Fruit	6,700	Tea	142,200/81,500
Fruit juices	10,000	Wine grapes	400/3,800
Gold	*		
Herbs, spices	3,600		
Honey	16,900		
Nuts, oilseeds	2,900		
Quinoa	5,400		
Rice			

* According to the FLO-CERT website, there are five producer organizations certified, but no other data is available on these operations; <http://www.flo-cert.net/flo-cert/index.php?id=29>.

Source: Fairtrade International (2011).

Creating standards for hired labor raises new challenges in ensuring that the minimum price and social premia benefit workers. Hired labor situations also increase the importance of monitoring and verifying that working conditions meet standards. The FLO standards for hired labor address this by requiring that workers be organized in a union or other representative body and that management and workers create a “Joint Body” to determine the allocation of the social premium. Management must comply with International Labor Organization conventions relating to health, safety, and other working conditions, as well as the core standards on freedom of association, forced and child labor, and nondiscrimination. Management is also subject to more extensive standards on protecting the environment than are smallholders.

To do certify that these standards are being met, the FLO created FLO-CERT, which has a network of more than 100 auditors in 50 countries to cover roughly 900 certified producer

organizations and plantations.⁹ Traders are subject to an audit designed to ensure that they are buying only from certified producer organizations and are paying the minimum price and social premium. For producer organizations, as of the end of 2011, just to apply for certification cost €525. The initial inspection fee for legally-organized cooperatives of small producers ranges from €1,430 to €3,470, depending on size, and there are additional fees for more than one product and for processing plants run by the organization. Slightly different fee schedules apply to other types of producer organizations. Fees for single plantation operations are also based on the number of workers and fall in a similar range, while there is a separate schedule for multi-estate operations. Certifications are good for three years, with interim surveillance to ensure compliance, and annual fees range from €1,170 to €2,770. FLO provides support to smallholder organizations that cannot afford all of the certification fees, with the possibility of co-financing of up to 75 percent for certain types of organizations, if funding is available.¹⁰

For many years, the FLO was directed by a board that was composed primarily of traders and the national labeling initiatives that together created the umbrella group. But in recent years, this approach has been challenged by producers increasingly frustrated by the costs of meeting the standards and getting certified, and decreasingly inclined to deal with them, given rising prices. The FLO leadership decided in 2007 to include representatives of producer organizations on the board and in subsequent years it expanded their role, increasing the number of board seats for certified producer organizations to four, one from each region, along with 5 representatives of labeling initiatives, 2 trader representatives, and 3 independent external experts. In 2011, the FLO expanded the general assembly, which approves standards and appoints the board, so that representation is evenly divided between producer and labeling initiative representatives.¹¹ The organization also adopted a New Standards Framework that gives more power to producer organizations to prioritize noncore “developmental standards” that they most value, while being *required* to meet only a more limited set of core standards in order to be certified.

In Fall 2011, the US labeling initiative, previously Transfair USA and now Fair Trade USA, announced that it was leaving the FLO and setting up its own labeling program with the aim of spreading the benefits more broadly.¹² The FTUSA follows the FLO model in many areas—it still uses the FLO standard for small producer organizations and it will accept FLO-CERT certifications. But the new US initiative wants to reach out to producers and workers not currently covered by the FLO model and begin offering certification to coffee

⁹ <http://www.flo-cert.net/flo-cert/156.html>, accessed September 26, 2012.

¹⁰ <http://www.flo-cert.net/flo-cert/23.html?&L=0>, accessed December 14, 2011.

¹¹ See the leadership section of the FLO website, www.fairtrade.net/how_we_are_run.html, and the October 14, 2011 press release on the general assembly decision, www.fairtrade.net/single_view1+M5ea9a970524.html, accessed September 6, 2012.

¹² See the joint press release here: http://www.fairtrade.net/single_view1.0.html?&L=0&cHash=eb14b25774&tx_ttnews%5btt_news%5d=235, and, for an example of the media coverage: <http://www.nytimes.com/2011/11/24/business/as-fair-trade-movement-grows-a-dispute-over-its-direction.html?pagewanted=all>, both accessed October 3, 2012.

plantations using hired labor and smallholder producers not organized in coops. The former is a particular source of controversy because it turns away from the focus on smallholder producers in sectors such as coffee. The effort to reach out to unorganized smallholder producers seems more in keeping with traditional Fairtrade principles, but the question is whether it can be done while maintaining the commitments to producer empowerment and community development. Since the Fair Trade USA experiments are still relatively new and some standards are still being developed at the time of writing, these issues will be explored in more depth in a future paper.

How Extensive is the Fair Trade Market?

Fair trade sales are still tiny overall, but they are growing rapidly and have significant market shares in a few cases—for bananas in Switzerland (roughly half) and for coffee in the United Kingdom (about a fifth) (Krier 2005, p. 81). The range of products available is also much broader now and includes tea, cocoa, a variety of fruits and vegetables, wine, and cotton, though mostly in far smaller quantities than coffee and bananas. This section first presents a look at the current status of fair trade markets and then looks at trends.

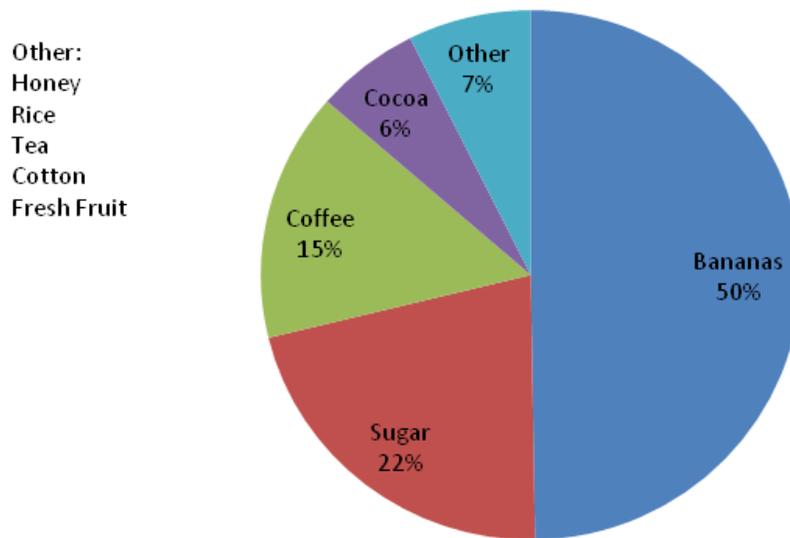
A Snapshot of Fair Trade Markets around the World

In 2011, the estimated retail value of Fairtrade goods sold was nearly \$7 billion (Annex Table 1). In 2009-10, the latest year for which data is available, producer organizations reported selling 600,000 metric tons of certified products worth more than \$700 million dollars, mostly coffee and bananas.¹³ About half of the sales were in the United States and United Kingdom, with the UK market being the largest by far. While these figures are up sharply from the early 2000s, producer revenues are still less than 1 percent of the 2011 value of global exports of bananas, cocoa beans, coffee, and cane sugar.

In 2011, bananas accounted for about half the volume of Fairtrade goods sold, while nearly half the value was accounted for by coffee (figure 1, next page). Sugar has grown rapidly and the *volume* of Fairtrade certified sugar sold surpassed that for coffee in 2009, but it is a bulky product and accounts for a small share of the value of sales. Cocoa accounts for about 6 percent of the market by volume and 11 percent by value, while fresh fruit (other than bananas), tea, cotton, honey, spices, cotton, and other minor products account for the remainder. Some items are not shown in figure 1, either because data is not available, sales are tiny, or sales are measured in different units, making it difficult to compare volumes.

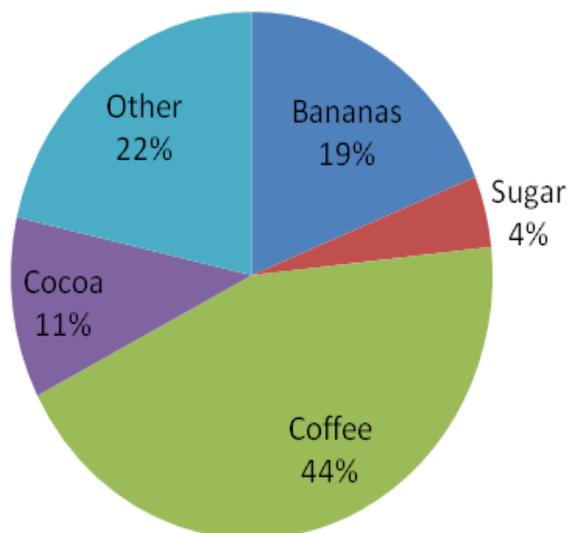
¹³ The producer-level value of certified sales is from the FLO monitoring report and is based on auditor reports covering 96 percent of certified producer organizations; see Fairtrade International (2011, p. 13).

Figure 1a. Fairtrade products by volume, 2011



Source: Fairtrade International, Annual Report 2012.

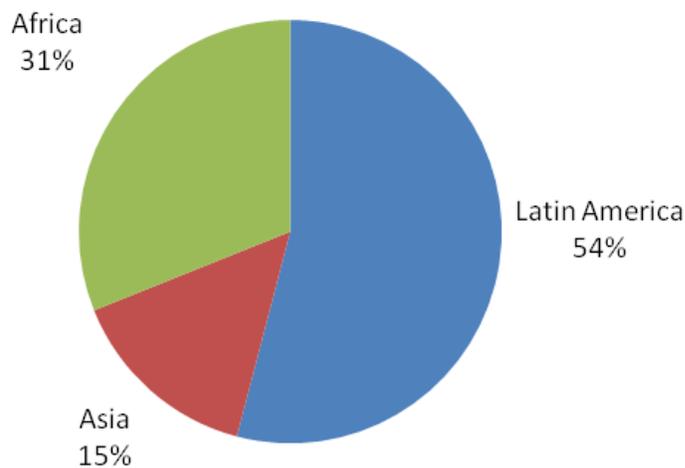
Figure 1b. Producer revenues from Fairtrade by product, 2009–10



Source: Fairtrade International Monitoring report 2011.

Given that the product distribution is concentrated so heavily in coffee and bananas, it is no surprise that Latin America is the location of just over half of the certified producer organizations (figure 2). By 2011, however, Africa was home to almost a third of the producer organization certified for Fairtrade, while fewer than one in five were in Asia. Mexico, until recently, was home to more certified producer organizations than any other country, mostly for coffee, but it has been surpassed by Peru, Colombia, India, and Kenya, with South Africa now just behind Mexico (Fairtrade International, 2011, p. 29). All the other countries with as many as 20 certified producer organizations were in Latin America. African certified producer organizations contain just over half all individual members globally (mostly hired workers on plantations), but reap only about a quarter of sales. Latin America has only a quarter of farmers and workers in the Fairtrade system but, with its dominance in fair-trade coffee, it earns nearly 70 percent of global sales revenues (Fairtrade International 2011, pp. 71, 78).

Figure 2. Geographic Distribution of Certified Producer Organizations, 2011

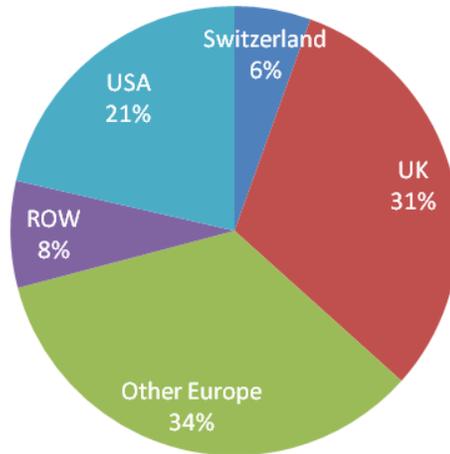


Source: Fair Trade USA (2011).

On the consumption side, Europe and the United States were home to more than 80 percent of the traders and retailers licensed to use the Fairtrade mark in 2006, the last year for which data is consistently available, and these destinations account for virtually all sales (figure 3 and annex table 1). Despite its much smaller size, the United Kingdom surpassed the United States as the largest Fairtrade market in 2008, reaching a level of \$2 billion in 2011, some \$34 per person. Per capita consumption is highest in Ireland and Switzerland, where citizens bought an average of \$50 worth of Fairtrade goods in 2011. Despite being relatively early

adopters, Japan's and Italy's limited enthusiasm for Fairtrade stands out, with average per capita sales well below those in other countries.¹⁴

Figure 3. Value of Fair Trade Sales by Region, 2011



Source: Fairtrade International (2012).

In the United States, the vast majority of Fairtrade-certified sales are coffee, which accounted for 4 percent of US imports of unroasted coffee in 2010. In Europe, for those markets where data is available, coffee reached a roughly 2 percent share in 2004 in Austria, Belgium, Denmark, and Ireland, 6 percent in Switzerland, and an astonishing 20 percent in the UK. Fairtrade tea also captured 5 percent of the market in Switzerland and bananas nearly half. Tea also captured a 2 percent market share in Austria and Germany, while bananas reached roughly 2 percent in Austria and Norway, and 4 to 5 percent in Belgium and Finland.¹⁵ One source estimated that Fairtrade chocolate is around 1 percent of global supply (Parenti 2008).

Trends in Fair Trade Markets

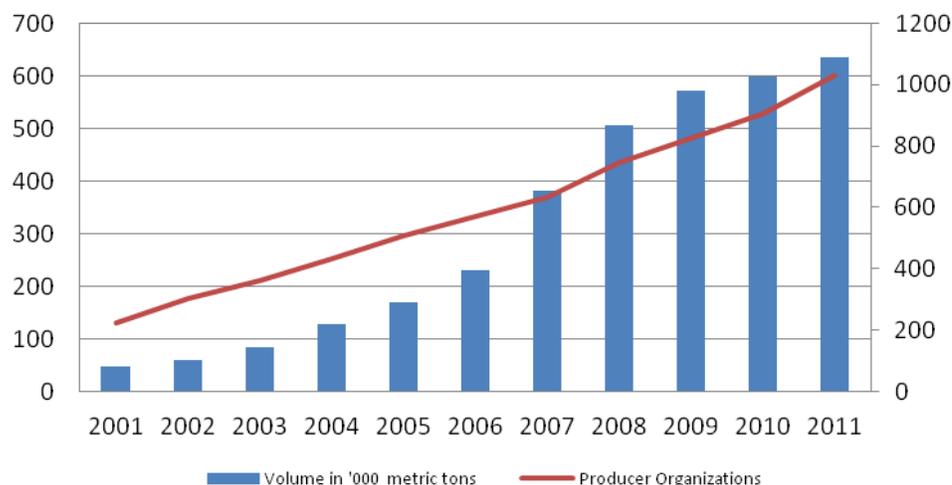
While the overall volume remains quite small, Fairtrade demand grew rapidly in many parts of the rich world until the Great Recession hit in 2008-09. Sales growth dropped sharply in most markets in 2010-11, but it remained in a range of 15 percent to 30 percent in 12 of the 19 markets shown in annex table 1. And in the countries with the newest initiatives, such as Australia, New Zealand, and Spain, growth remained quite strong. Overall, the Fairtrade market seems to have held up reasonably well.

¹⁴ Spain's per capita level is also quite low, but it launched its initiative much later and demand is growing rapidly.

¹⁵ All figures on Europe are from Krier (2005) and for the United States, TransfairUSA (2007).

Figure 4 provides other indicators of increasing supply and demand for Fairtrade products from 2001-11. The number of producer organizations certified as eligible to sell Fairtrade goods grew five-fold, while the volume sold grew sharply in the mid-2000s and then slowed in the recession. Over that period, bananas and coffee, grew 10-fold and 7-fold, respectively, and other products grew collectively by 500 percent over just five years from a much lower base (Fairtrade International, various annual reports).

Figure 4. Growth in Fair Trade Supply, Producers



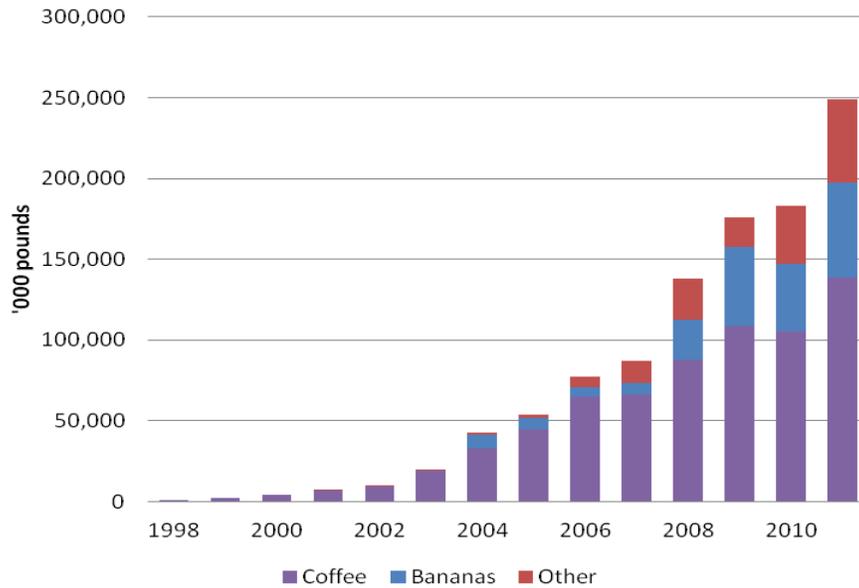
Source: Fairtrade International (2011, 2012).

To put this growth in context, the FLO says that certified producer organizations represented a bit over 1million producers and workers in 2011 and that benefits reached as many 6 million people.¹⁶ But, like sales, this is a drop in the bucket relative to the estimated 25 million coffee producers (70 percent of them with less than 10 hectares), and 14 million plantation workers and 2.5 million smallholders producing cocoa (Green 2005).

Figure 5 focuses on the US market for Fairtrade products and shows the familiar pattern of rapid growth from a low base, as well as the dominance of coffee in the American market. Coffee was the only product licensed to use the Fairtrade mark in the United States for the first three years after Transfair USA was launched in 1998. Tea and cocoa were introduced in 2001 and 2002, respectively, bananas in 2004, rice and sugar in 2005, and vanilla in 2006. But even with the introduction of several new products and the weight differential in favor of bananas, coffee continues to account for more than half of the US Fairtrade market even in volume terms.

¹⁶ See the question on “how big is the Fairtrade market globally” at <http://www.fairtrade.net/faqs.html>, accessed December 6, 2012.

Figure 5. Fair Trade Sales in the United States



Source: Fair Trade USA (2011).

A key element in the growth of the US market was the success activists had in pressuring Starbucks to offer Fairtrade coffee. Following numerous public protests, the company announced in 2000 that it would begin offering Fairtrade certified coffee in all its US stores and its purchases grew to an average of just under 20 million pounds a year from 2006-08. After additional activist pressure in the mid-2000s, Starbucks pledged to double the amount of Fairtrade coffee purchased and also around that time announced that all of its espresso drinks in Europe would use Fairtrade certified beans by early 2010.¹⁷ Starbucks' purchases fell back to around 20 million pounds in 2010, when the company reported that it had been unable to sell all that it had purchased the previous year, but then surged again in 2011, to 34 million pounds. That accounted for 8 percent of Starbucks' coffee purchases and 16 percent of global Fairtrade coffee sold, making Starbucks one of the, largest purchasers in the world.¹⁸ Dunkin Donuts also announced in the mid-2000s that it would move to 100 percent Fairtrade coffee in its espresso drinks in both the United States and Europe (FLO, annual report, 2007).

How Does Fair Trade Work for Producers?

A key goal of fair trade advocates is to empower marginalized producers and to reduce their vulnerability by guaranteeing payment of a minimum price. To achieve this, and to ensure that buyers pay the Fairtrade price and social premium, licensees using the Fairtrade label

¹⁷ http://starbucks.tekgroup.com/article_display.cfm?article_id=265, accessed October 4, 2012.

¹⁸ Starbucks annual corporate responsibility reports for various years, posted at www.starbucks.com, accessed October 4, 2012.

must buy the product from a certified trader who, in turn, must have purchased it from a certified producer organization. To further the empowerment goal, and to make the model workable, the FLO also requires that producers organize themselves in democratic cooperatives or other associations. This section looks, first, at how certification affects supply chains and, second, at whether and how producers benefit, especially when prices are high.

Fair Trade Supply Chains

Annex figure 1 illustrates a typical supply chain for coffee in conventional and fair trade markets, which should be similar to that for many other minimally processed products eligible for certification. In conventional coffee markets, farmers often sell to intermediaries who pay them immediately and transport their minimally processed product to plants that finish the processing into green coffee beans ready for roasting. To maintain freshness, coffee beans are typically roasted close to where they will be consumed, so the processor typically sells the green beans to a local exporter who sells them to an international trader or roaster.¹⁹

The FLO certification process requires compression of the traditional supply chain, since both the producer organization and the initial buyer must be certified to ensure that the minimum guaranteed price and social premium go to the producer organization. Requiring that producer organizations are democratically-organized is intended to ensure that any price premium remaining after costs are covered is delivered to individual producers, and that the social premium is allocated according to community preferences.

Many advocates believe that eliminating intermediaries in the supply chain is part of empowering producers, but the net gains to producers are uncertain a priori. The links in the chain that are eliminated were providing services that the producers or cooperatives must now provide themselves. There can only be a gain from eliminating these middle men if markets were uncompetitive, producers did not have accurate information about the prices or quality of the goods they were selling, or coops are more efficient at providing the intermediary services.

Markets may well be imperfectly competitive or incomplete in many remote rural areas where coffee or other primary commodities are grown, and fair trade may play a role in ensuring that more of the value from coffee exports goes to producers. But the information disparity is likely to be less today than even a few years ago because of the spread of cell phones. And, the costs of transporting, processing and trading must still be covered so that any savings from eliminating middle men may not be as great as sometimes asserted, if they exist at all. Even though the Fairtrade minimum price provides a floor for producers, the added costs for transportation and processing may not be fully compensated if the market

¹⁹ The figure and discussion are based on Milford (2004).

price is close to the minimum. There are also additional costs associated with certification that must be covered.

In sum, moving down the supply chain may be empowering, but it also entails costs and requires knowledge and equipment that marginalized producers might not have or be able to afford. Several case studies point to the important role that non-governmental organizations or buyers have played in organizing cooperatives and helping them build the capacity to engage in export markets, especially for higher quality specialty coffee where one most often finds fair trade labels.²⁰ But the net benefit for producers of compressing the supply chain is not obvious.

Producer Impact

When prices are well below the Fairtrade floor, as they were for coffee when labeling began in the late 1990s, the costs of certification seem like a good investment. But what is the incentive to bear them when prices are well above the guaranteed minimum? There is the social premium, which is paid regardless of market prices, but it is relatively modest and does not seem sufficient on its own to make certification attractive.²¹ Yet figure 4 shows little slowdown in the growth of producer certifications in recent years and that suggests that producers perceive benefits. While more rigorous impact studies are needed, the evidence from the case studies and evaluations that have been done suggests that the benefits are more indirect and derive from mitigating the market imperfections discussed above.²²

Studies done even when prices were well below the Fairtrade floor generally found that the minimum price was not the key source of benefits because many certified producer organizations sold only a portion of their crop on Fairtrade terms. Jaffee (2007, p. 90) cites a global average figure of 20 percent for the share of certified coop coffee production that was sold on fair trade terms, but studies of individual coops show wide variation. Other early studies of fair trade, mainly looking at coffee, almost all report that fair trade sales were only a fraction of the total for most POs and that the resulting average price premium was usually too small for the cooperative to bother distributing it to individual producers. For other products, and in more recent years, the numbers look better. Data collected as part of the

²⁰ See, for example, the analysis of 7 coffee cooperatives in Reynolds et al. (2004, pp. 1115-16).

²¹ It is difficult to calculate the average social premium because the minimum prices for some products vary widely (based on quality or source), but they appear to generally fall in a range of 10-15 percent. The premium for Arabica coffee was doubled in 2011 to \$0.20 per pound, on top of a minimum price of \$1.40 per pound for washed beans, up from \$1.25 per pound;
http://www.fairtrade.net/fileadmin/user_upload/content/2009/news/releases_statements/2011-03-09_FLO_coffee_Factsheet_final-EN.pdf, accessed December 7, 2012.

²² The impact studies that have been done to date are relatively few in number and use different methods, so the results are difficult to compare across studies. The studies also rarely compare fair trade producers and their communities systematically to other producers selling in conventional markets. Most of them are for coffee, so they look at smallholder producer and not at hired labor situations, and most were done in the late 1990s and early 2000s, during the so-called “coffee crisis.”

FLO's monitoring and evaluation process show that roughly 80 percent of bananas, cane sugar, and rice produced by certified POs was sold on Fairtrade terms (Fairtrade International 2011, p. 40-41). Overall, 32 percent of producer organizations were able to sell almost all their production as Fairtrade and another 26 percent sell more than half on those terms; about a third sell less than 25 percent on Fairtrade terms (*ibid.*).

Studies of the effects of fair trade from the late 1990s and early-to-mid 2000s, a period when both prices and demand were lower, generally found that the proceeds from fair trade certification were invested in improving the producer organization—by buying or upgrading processing equipment, by investing in other quality control equipment, or by providing training to producers on quality improvement or better environmental practices. Often, this included the social premium, as well as any price differential, even though the standard for smallholder organizations required that the social premium be used for community development. Originally, using the premium to cover business costs was specifically prohibited. But the standard also left it to producer organization members to decide how the premium should be spent and they often chose to invest it, along with any price premia, in improving their ability to sell a quality product. Interestingly, when the FLO revised the coffee standard in 2011 and raised the social premium—after producers had acquired a greater voice in management—a portion was specifically earmarked for productivity and quality improvements. Overall, then, producers may gain by improving their ability to sell their products more readily in export markets and they might also sell it at higher margins over the minimum if quality improves. But the gains are not necessarily because individual producers *directly* increase their incomes as a result of the higher price guaranteed by Fairtrade certification.²³

Case studies also find that producer organizations often do a poor job of communicating with members about Fairtrade certification and what it means for them, perhaps because it is difficult to do when the benefits are indirect. A recent study of certified coffee coops in Ethiopia found that under half of the members knew they were certified and even fewer knew what certification meant. In that case, 75 percent of producer sales were to private traders rather than the coop (Jena et al. 2012, pp. 435, 438). Thus, when prices go above the floor, producers that are not aware of the benefits of fair trade will be more likely to sell to whomever is offering the highest price, which creates problems for coops, traders and the sustainability of the system.

Still, the fact that producer organizations are willing to pay the costs of certification suggests that they still see benefits. For example, while some producers independently form cooperatives to strengthen their hand in bargaining with buyers, these cooperatives often have little access to credit and have problems paying producers until their product is sold, which is a serious problem in lean times. FLO certification requires buyers to advance up to

²³ A recent literature review investigating the impact of private standards, with roughly half of the studies analyzed including fair trade, came to similar conclusions; see International Trade Centre (2011).

60 percent of the contract value, if requested, so that cooperatives can pay at least a portion of individual producer costs to tide them over until the product is sold and give them an alternative to traditional intermediaries.

Ronchi (2002) is one of the few studies that compares the situation of farmers in certified coops to conventional farmers in the same geographic area. In this case, about half the sales by the certified coop are on fair trade terms and she still finds that individual producers' incomes are higher than other producers in the area selling only conventional coffee. But this and other studies also emphasize the capacity-building benefits from engaging in fair trade markets in terms of information about export markets, best practices in growing and processing, and the access to pre-financing. These studies also find that nearby conventional growers benefit as well because fair trade buyers provide information and a degree of competition that can allow other producers to bargain more effectively with buyers. Balat et al. (2007) provide a formal model and empirical evidence from Uganda that shows how an increase in the number of intermediaries providing access to export markets (not involving Fairtrade in this case) lowers export costs, increases the volume of exports, and reduces poverty.

As noted, however, these impact studies were generally done at a time when market prices were well below \$1 per pound. Since 2007, prices for Arabica coffee have been above the Fairtrade minimum, except for several months after the financial crisis hit in late 2008 and early 2009. In 2010, prices rose to nearly \$2 per pound, well above the then Fairtrade price of \$1.25. It then spiked to over \$2.70 a pound, before dropping back to a bit under \$2 per pound, still well above the new Fairtrade price of \$1.40 per pound (plus the \$0.20 social premium). Average export unit values in 2011 for bananas and cocoa beans were also well above the Fairtrade price floors.²⁴

Nevertheless, the fact that certifications continued to rise in 2011 suggests that producer organizations perceive a benefit even in a time of high prices (figure 4). Continued interest in certification would seem to support the finding of Raynalds et al. (2004), Ronchi (2002), and others that the principal benefits are in the areas of capacity-building, quality improvement, and market connections. Still, some coops reportedly had problems fulfilling contracts when prices spiked because members chose to sell elsewhere. That could be because of the problems with information about certification and its meaning for producers, as found in the Ethiopian study cited above, or simply because some members chose to free ride, as found in a study of Kenyan coffee coops (Vorlauffer et al. 2012). If prices stay high, it will be interesting to see what happens to the demand for fair trade certification.

Is Fair Trade Fair for Consumers?

While some advocates claim that consumers do not pay more because fair trade eliminates the middle man, the supply chain analysis above undermines that claim. But it is also unclear

²⁴ Calculated from UN Comtrade trade data.

how much more they are, or should be, paying. Consumers attracted to fair trade products are presumably willing to pay more to cover the costs associated with fair trade production and certification, but they could be turned off if they think retailers are charging more than necessary and ripping them off. The problem is that it is often difficult to tell where the truth lies.

When a certified producer organization sells to a certified trader, the price of the certified product should be higher than comparable conventional products by at least the amount of the social premium, plus any margin above current world prices that the guaranteed minimum requires. To the extent that the producer organization is more efficient than intermediaries in the conventional market, it may be able to increase the returns going to its members, but it will not affect the price at which it sells to the international buyer.

Transaction costs are increased further by the auditing costs that the Fairtrade-certified trader must pay, plus the licensing fee that the firm using the label on its packaging pays. Even if there is compression of the supply chain, such as when Starbucks imports beans directly from certified suppliers and roasts and sells them in its own stores, there are still processing and distribution costs at each stage, as well as the FLO certification and licensing fees, and someone must pay them.

So Fairtrade products should be more costly, even when conventional market prices are at or above the guaranteed minimum. But price differences will be more or less noticeable depending on the product. The bananas that are consumed in rich countries, for example, are mostly of the same variety and minimally processed so the products in store are relatively similar and price differences are relatively obvious. The same is likely true for many other Fairtrade products that are relatively homogeneous, unprocessed, and not heavily branded and advertised, such as other fruits and vegetables and sugar.

Coffee, tea, and cocoa are different, however. These products exhibit wide quality and taste differences, depending on where and how they are grown and, in the case of cocoa, what kind of chocolate it is used in. Fairtrade-certified coffee, tea, and chocolate also tend to be sold as specialty or gourmet products, rather than as mass market items. The gourmet items are also often branded and heavily marketed as providing additional quality or other features that consumers will pay more to get, whether the products are Fairtrade-certified or not. This means that there is no standard price and it can be difficult to ferret out exactly why one chocolate bar costs more than the other.

There are a number of ways that retailers might respond in their pricing strategies. Given that other costs at the retail level often swamp the cost of the primary commodity, the retailer could choose to forgo a small amount of profit by not raising the price of fair trade products, if that helps in marketing its overall brand and product line. Tim Harford (2012, p. 37) estimates that the costs of fair trade certification for a cup of coffee at your local coffee shop would be less than a penny. Rather than either absorbing or just covering the costs associated with certification, retailers could use the fair trade label to target consumers willing to pay more and raise the price above what is necessary. And, indeed, Harford points

to one London shop that tried exactly that. In the early 2000s, Costa Coffee tried charging an extra 10 pence for a cup of fair trade coffee, but backed off when Harford inquired about it because the chain feared a backlash if consumers felt they were being ripped off (ibid.).

What about buying fair trade coffee by the pound for home consumption, can consumers tell when they are being ripped off? Even in this case, certification costs should not be too much more than the \$0.20 per pound social premium, depending on the scale over which the retailer can spread other certification costs. So what is a consumer to make of Starbucks' pricing for fair trade coffee? The online coffee store offers two fair trade certified blends, both dark-roasted. The Italian roast, at \$11.95, is the same price as the conventional French roast. The other fair trade coffee, the Café Estima blend, is priced at \$13.95, not the highest-priced coffee they offer, but higher than the House and Breakfast blends and several other varieties. It is virtually impossible to know whether the higher price for the Café Estima is due to higher quality, higher costs, or price-gouging. Given the difficulties in controlling for quality differences, it is simply impossible to know whether consumers are paying more than they should.

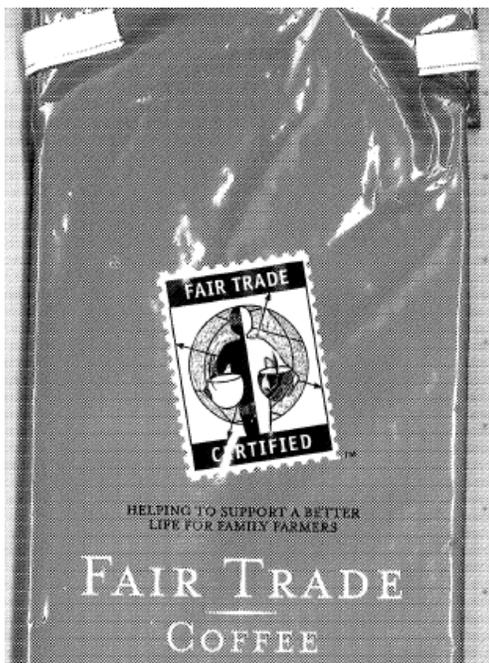
What are the Limits of the Market?

There are obstacles to expanding fair trade markets on both the supply and demand sides. The emphasis on goods with short supply chains derives from the need for credible, and affordable, certification and is likely to continue limiting the variety of goods available. The FLO and Fair Trade USA are both examining how to certify clothing and other manufactured products, but the costs and complexity of certifying chains with many links are going to be difficult to overcome. On the demand side, growth slowed dramatically in recent years. In some markets, the slowdown seemed to be primarily a reaction to the recession and growth seems to be recovering. In others, there are signs demand in more mature markets could be leveling off.

In terms of expanding the scope of fair trade markets, cotton provides an illuminating example of the challenges involved. Unlike many of the food items that are minimally processed, the cotton that the final consumer sees goes through many more steps. It must be cleaned and ginned, and woven or spun into fabric that is died, cut, and assembled into final products—and that is the simplified version! Each step will often be done in different plants with different owners and, perhaps, in several different countries. Even though the full FLO certification requirements apply only to the cotton grower and initial buyer, the product-specific standard for cotton (summarized in Box 1) requires that each link in the chain demonstrate efforts to comply with International Labor Organization conventions related to a broad range of working conditions. *Credibly* certifying compliance with the Fairtrade standard along this much more complicated supply chain is a significant challenge. Moreover, it is still only the cotton, and not the final product, that is certified as meeting fair trade standards, which could confuse consumers. So far, Fairtrade cotton is estimated to account for less than 1 percent of cotton grown worldwide though, like other new products, sales are growing at phenomenal rates (various FLO annual reports).

On the demand side, as noted, the Great Recession and sluggish economic growth in high-income markets took a toll on the expansion of fair trade and the response over time will no doubt be carefully monitored. Over the medium run, however, more than half the countries in annex table 1 have average annual sales per capita that are well above the overall average of \$8 per person. That suggests the potential for further substantial growth in these markets.

That growth could hit limits, however, if mainstream retailers become nervous. Most mainstream sellers, in contrast to those selling exclusively or primarily labeled products, are reluctant to aggressively promote Fairtrade-certified products because of the implication that their other products are inferior or unsavory. Thus, while the mainstream outlets typically have greater access to consumers, they are often disinclined to use it to try to increase demand for Fairtrade products. For example, when Starbucks first introduced certified coffee in response to demonstrations from Global Exchange, it was called Fair Trade Coffee and the label prominently featured the US initiative's certification mark right on the front (image on the left). Today, Starbucks is more interested in promoting its own social responsibility code and we can see the shift away from emphasizing fair trade in the changing packaging. Several years ago, the name on the original fair trade certified coffee was changed to something more generic—Café Estima—with a package featuring a colorful picture and a smaller Fairtrade certification mark. The Fairtrade label shrank further over the years and eventually moved from the front of the package to the side of the bag (image on the right). That product is now sold only online and the only fair trade certified coffee available in Starbucks stores is the Italian Roast, which says fair trade certified next to the name but with the Fair Trade USA label on the back.



Others retailers using fair trade certification for only selected products, for example Dunkin Donuts espresso drinks, put out press releases announcing the decision but do little to advertise it in their stores. Overall, recent history suggests the job of educating consumers about fair trade and advocacy to increase demand will remain with movement actors. But Fairtrade advocates also fear that mainstreaming will result primarily in “greenwashing,” with corporations using fair trade to improve their image while continuing to traffic overwhelming in conventional products. But is this really a problem? As long as all the FLO requirements are met, and if the easier availability of labeled products in mainstream retail outlets increases demand for fair trade products, then it seems like a development to be welcomed by those wanting to help as many poor producers as possible.

Conclusions

In sum, there are consumers willing to pay for fair trade goods and producers willing to bear the costs of certification, which suggests they gain from it, though not necessarily in the ways usually thought. Smallholders are not held to rigorous labor standards, except for forced and child labor, and many may see relatively limited *direct* benefits because not all their output is sold on fair trade terms. But producers can still gain from increased information and competition provided by fair trade buyers, and from assistance in improving quality and linking to international markets.

And the number of producers that can be helped is far larger if certified products are readily available in mainstream outlets, such as supermarkets, Starbucks, and Dunkin Donuts stores. If the national initiatives and FLO-CERT have the resources to maintain an effective inspection and certification process, then the credibility of the label should not be threatened by mainstreaming. As of now, we do not know whether the US experiment in extending the reach of fair trade to more producers and the efforts of both the US and international initiatives to expand the range of certified products will succeed.

Another challenge is the sustainability of the subsidies that NGOs and governments often provide to producer organizations and the FLO. The impact studies emphasize that a key benefit from selling fair trade-certified goods is the initial assistance in creating and developing a producer organization capable of exporting a quality product. The capacity-building assistance that is often cited as one of the most important benefits of Fairtrade is typically subsidized by the NGOs that provide it (often with funding from aid agencies). Whether there are enough of them to continue expanding the market and whether they have the resources to maintain those efforts is a key question for the future of fair trade. Whether aid agencies should supporting fair trade markets, rather than funding agricultural development projects through other means, is an area deserving of careful evaluation and further research.

Finally, producer representatives have only recently been added to the board of the Fairtrade umbrella group, FLO. Since many elements of the standards appear to have been driven more by Northern and movement concerns than Southern producer concerns—for

example, the flat ban on the use of genetically-modified products—it will be interesting to see whether increased producer involvement in setting the standards has any impact. That could be a test of whether the movement is really about helping Southern producers, or about helping salve the consciences of Northern consumers.

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Annex Box 1. Requirements for traders in the Fairtrade cotton chain

(adapted from the product-specific FLO standard for seed cotton)

Every company in the supply chain that takes ownership of Fairtrade cotton must demonstrate efforts to comply with the following ILO Conventions before it can be approved to process of manufacture FT cotton (and must re-submit a similar demonstration every two years):

- 001 Hours of work [1919]
- 029 Forced Labour [1930]
- 087 Freedom of Association and Protection of the Right to Organize [1948]
- 098 Right to Organize and Collective Bargaining [1949]
- 100 Equal remuneration [1951]
- 105 Abolition of Forced Labour [1957]
- 111 Discrimination (Employment and Occupation) [1958]
- 131 Minimum wage fixing [1970]
- 138 Minimum Age Convention [1973]
- 155 Occupational Safety and Health [1981]
- 182 Elimination of the Worst Forms of Child Labour [1999]

Firms taking ownership of Fairtrade cotton has sub-contracted the CMT (cut, make, trim), the trader must provide the same demonstration of efforts to comply with the above ILO conventions for any sub-contractor(s) involved in ginning, spinning, weaving, knitting and/or dyeing of the cotton, or in cutting, making, or trimming the item incorporating the cotton.

The following will be accepted as indicators of compliance with the above requirements:

1. The trader has provided an WFTO membership certificate.
2. The trader has provided an SA 8000 certificate.
3. The trader has provided documentary proof that the production unit involved participates in one of the following initiatives: Ethical Trading Initiative, Fair Wear Foundation, Fair Labour Association, Workers' Rights Consortium.
4. The trader has provided a letter of endorsement of a union accredited by ICFTU.
5. The statutes of the applicant company prove that the applicant company is owned by the workers

Annex Table 1. Estimated Retail Value of Fairtrade-Certified Sales (US dollars)

Country	2004	2011	Average Annual Growth, 2005-08	Average Annual Growth, 2010-11	Per capita in 2011	Year label launched
Netherlands	43,536,500	205,203,630	15%	31%	12.44	1988
Belgium	16,923,260	107,268,700	38%	17%	10.30	1991
Germany	71,524,250	557,998,887	39%	22%	6.82	1992
Luxembourg	2,487,800	10,436,980	21%	19%	21.22	1992
Switzerland	169,170,400	368,829,476	6%	10%	48.50	1992
United Kingdom	255,691,881	2,087,152,996	50%	28%	33.67	1992
Austria	19,630,325	139,310,000	44%	18%	16.97	1993
Japan	3,109,750	27,006,918	45%	21%	0.21	1993
Italy	31,097,500	80,162,529	14%	15%	1.33	1994
Denmark	16,170,700	104,355,222	43%	17%	18.97	1995
Ireland	6,283,723	221,313,925	128%	16%	48.32	1996
Sweden	6,834,615	187,143,066	95%	28%	20.66	1996
Norway	5,953,181	74,694,601	62%	17%	16.03	1997
Finland	9,395,177	143,033,912	64%	9%	27.24	1998
France	86,662,961	439,407,017	39%	5%	6.82	1998
USA	266,944,999	1,435,827,345	45%	10%	4.68	1998
Canada	21,813,746	278,298,188	62%	-7%	8.31	1998
Australia,						
New Zealand*	3,110,250	209,349,802	98%	172%	8.22	2003
Spain*	373,230	27,898,285	227%	59%	0.60	2005
Total	1,033,230,766	6,704,691,480				

* First year of data is 2005.

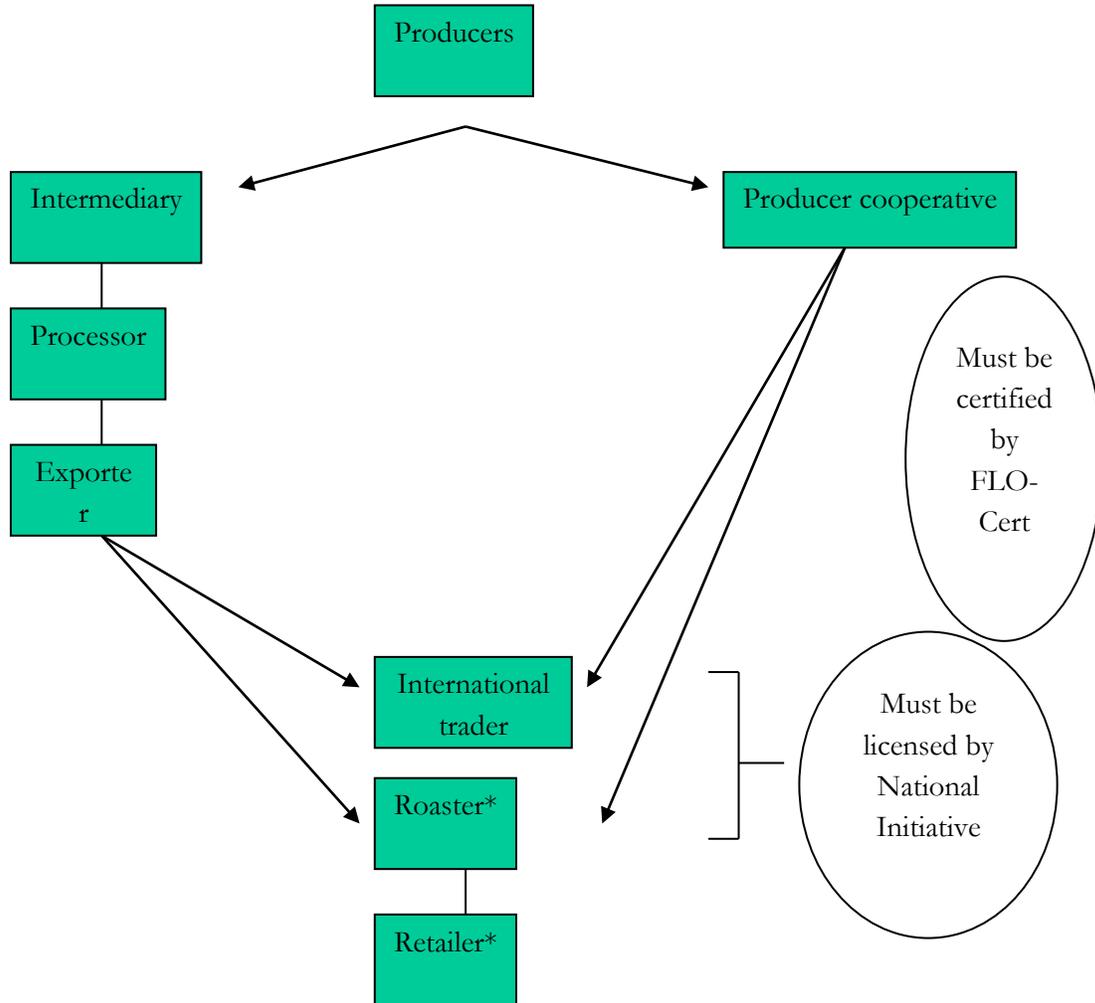
NB: New national initiatives not included in table are Czech Republic, Estonia, Latvia, Lithuania, South Africa.

Source: Boonman et al. 2011; Fairtrade International, Annual Report, various years.

Annex Figure 1. The Coffee Supply Chain

Conventional Markets

Fair trade Markets



*May be the same.

Source: Adapted from Milford (2004).