Is Fair Trade Worth Its Cost?

Victor V. Claar
Henderson State University

Colleen E. Haight
San Jose State University

Abstract: This paper extends the existing literature on fair trade by incorporating the latest empirical analyses as well as responding to recent claims that even if fair trade is deemed to be an inefficient or ineffective tool toward poverty alleviation, there may nevertheless be other compelling reasons to retain either the fair trade model or the fair trade label. The analysis contrasts the alternative trade organization (ATO) model of fair trade with the commodity-based Fairtrade International (FLO) model, and also discusses the recent departure of Fair Trade USA from the FLO. We conclude that commodity-based fair trade initiatives are simply not worth their opportunity cost. JEL: F13, I38, O15, O19. Keywords: fair trade, economic development, poverty, trade, exports

For nearly a decade we have argued that, based upon both economic theory and the unfolding empirical evidence, commodity-based fair trade initiatives—even though well-intended—may not be of particular service to the poor producers they presume to help. See, for example, Haight (2007), Claar (2010), Haight and Henderson (2010), Haight (2011), Claar (2013a), Claar (2013b), and Claar and Haight (2015).

The aim of this paper is to update and extend our past work along several dimensions. First, we contrast the Alternative Trade Organization (ATO) model of fair trade with commodity-based initiatives that are carried out almost exclusively by Fairtrade International (FLO). Second, we discuss the recent departure of Fair Trade USA from the FLO model practiced elsewhere. Third, we review carefully the recent empirical evidence regarding fair trade since the publication of Claar (2010).

Finally, and probably most significantly, we respond to recent claims that even if the FLO model of fair trade proves ineffective or inefficient

Authors: Victor V. Claar is Professor of Economics at Henderson State University (vclaar@gmail.com); Colleen E. Haight is Associate Professor of Economics at San Jose State University (colleen.haight@sjsu.edu)
in reducing poverty, it should be retained for the time being because it is superior to some alternative approaches to poverty reduction, or because its greatest value lies not in its effectiveness in reducing poverty but in its ability to promote poverty awareness. In response to the first claim we will argue simply that there are more effective and more efficient ways to tackle extreme poverty than via the fair trade network. In response to the second claim—that fair trade should be retained because of its ability to raise poverty awareness—we maintain that the opportunity cost of doing so is simply too great.

1 A Brief Overview of the Fair Trade Movement

In a new book, Sylla (2014) lays out nicely the origins of both strands of fair trade. In what Raynolds and Murray (2008) refer to as the alternative-trade-organization (ATO) approach, intermediary organizations connect poor producers of unique goods with eventual buyers with whom they would not otherwise connect. Ten Thousand Villages (TTV) is probably the best-known example of the ATO model. TTV began in 1946 during a trip to Puerto Rico by businesswoman Edna Ruth Byler. Disturbed by the plight of the poor craftswomen she encountered during her visit, Byler began importing textile products and selling them in the United States via a network of Mennonite churches and women’s organizations (Sylla 2014, p. 35). According to their annual report for the year ending on March 31, 2014, today TTV’s total annual sales volume is nearly $28 million, with the majority of revenues generated through their network of retail outlets (Brighter Futures 2014, p. 11).

In contrast to the ATO model of fair trade that connects producers of unique goods with their eventual buyers, the Fairtrade International (FLO) model of fair trade deals in commodities rather than in the distinctive crafts, garments, and rugs sold by TTV. Though coffee was the first—and remains the primary—commodity channeled through the FLO network, today the list of goods distributed through FLO includes bananas, cocoa, cotton, flowers, sugar, tea, fruit, gold, honey, rice, and even sports balls.

The FLO story is much newer than TTV’s. The FLO model began during the late 1980s, with two defining events transpiring on both sides of the Atlantic. Since 1962 the global price of coffee had been kept artificially high due to a production quota system known as the International Coffee Agreement (ICA). Brokered during a conference sponsored by the United Nations, the ICA restricted the quantities of coffee that could be produced by each nation. At the onset of the ICA, nations like the United States were
willing to agree to its terms due to perceived Marxist threats at the time—especially in Latin America. However, as the Soviet era drew to a close, strong support for the ICA began to erode. The consequent drop in global prices due to the reduction in monopoly power created by the collapse of the ICA set the stage for the fair trade coffee movement.

Equal Exchange was the first fair trade importer in North America. Exploiting a loophole in the U.S. trade embargo against Nicaragua in the 1980s, the Boston-based importers and roasters created the first fair trade coffee brand. At about the same time, the Unión de Comunidades Indígenas de la Región del Istmo—an entrepreneurial group of coffee growers from the Mexican state of Oaxaca—were working together with the Christian international aid organization Solidaridad to find new markets for their coffees. Eventually they were able to sell their coffee to importers in the Netherlands, and the first official fair trade seal—the Max Havelaar label—was born. Today all FLO-certified coffees sold in the Netherlands bear the Max Havelaar seal as well as the FLO logo. In other nations FLO products are labeled with that particular nation’s variation on the FLO mark; for example, FLO coffees sold in Canada bear the FLO logo but are sold under the label Fairtrade Canada. The international umbrella organization Fairtrade International (FLO) controls the global use of the label, and had an annual budget in 2013 of roughly €15 million (Fairtrade International 2014, p. 23).

Today Fairtrade International is made up of two distinct entities: FLO e.V. and FLO-CERT. FLO e.V. sets the production standards for products that may be labeled with the fair trade seal, while FLO-CERT is the monitoring and compliance arm that tracks the realities of production. For example, in the case of fair trade coffee these arms of Fairtrade International aim to assure caring customers that FLO-certified products have been grown by democratically organized cooperatives of small-scale growers, that producers observe International Labour Organization (ILO) standards for their paid employees—including paying any local minimum wage and not using child labor—and that the production methods used are environmentally sustainable.

2 Fair Trade Coffee

Though the FLO model now certifies and distributes a vast array of commodities, it remains helpful to focus upon coffee as the primary illustrative case of the model. Given that fair trade coffee is the oldest and largest FLO market, any positive impact upon the plight of the poor should
be greatest there.

Since 2011 the FLO has guaranteed its certified producers a minimum price per pound of $1.40. Of course, coffee prices have been relatively high since 2007, so the minimum price has rarely been binding in recent years. When the global price of coffee rises above the fair trade minimum, certified growers receive the market price. Regardless of the market price of coffee, for each pound that growers are able to sell as fair trade coffee the cooperative receives a “social premium” that can be used for projects in local communities or invested in the cooperative’s productive activities. The social premium was recently raised from 10 to 20 cents per pound.

Since its inception, the FLO has restricted participation in the fair trade network to cooperatives of small coffee growers. Beginning in 2012, Fair Trade USA left the FLO so that Fair Trade USA could certify coffees produced on both large and small scales, and also so that it could certify products as “fair trade” with as little as 10 percent fair trade content (compared with the 20 percent minimum required elsewhere).

3 What the Fair Trade Label Cannot Conveniently Convey

A guaranteed price for a pound of coffee (currently $1.60 if one includes the social premium), democratic organization, abhorrence of child labor, decent working conditions, and sustainable methods: these are the primary assurances offered by the fair trade label to caring consumers. Digging slightly deeper into the realities behind the label reveals some lesser-known facts that should give caring consumers reason to pause before plucking a fair trade commodity from a supermarket shelf to place in their carts.

To begin, champions of the fair trade movement rarely spell out the details of the fees demanded by FLO from cooperatives of coffee growers who aspire to join the fair trade network. Even in their recent survey of “The Economics of Fair Trade,” Dragusanu, Giovannucci, and Nunn (2014) mention the fees only in passing and do not bother to articulate the fee structure. And in our opinion, by not spelling out the fees Dragusanu, et al. (2014) may give readers the incorrect impression that the fees are trivial. Elliott (2012) summarizes the current fees imposed upon poor coffee growers by the FLO. For aspiring cooperatives of poor growers the initial application fee is €525, and fees for the first inspection conducted by FLO-CERT range from €1430 to €3470 depending upon the size of the cooperative. Though certification is good for three years, annual fees range from €1170 to €2770 and include interim monitoring of growers’
practices. In short, the poor are asked to pay thousands of dollars in order to gain access to the FLO network and the price stability and the 20-cent social premium that participation offers. This fact is especially intriguing inasmuch as the fair trade network is presumably intended to offer relief from local coyotes: merciless local monopsonists who prey upon poor growers.

Another little-known fact about fair trade is that merely joining the network does not guarantee a willing buyer on the other side of the market. Further, and as Fridell (2007) notes, newcomers to the fair trade network are the least likely to benefit due to the challenges they face in attempting to compete with other established growers in a market that is already saturated. Fridell cites Martinez (2002), who describes the challenges faced by one certified cooperative that searched for eight years to find a willing buyer. Though Martinez’s case study is especially distressing, the trouble faced by certified growers to locate willing buyers is the norm rather than the exception. In a sample of fair trade certified growers from four Latin American nations, Méndez, et al. (2010) found that 60 percent of the growers’ coffee was sold as fair trade. And among four fair trade producer organizations interviewed by Dragusanu and Nunn (2014), the fraction of each cooperative’s crops sold as fair trade in the prior year were 10, 40, 53, and 80 percent. The findings of Méndez, et al. (2010) and Dragusanu and Nunn (2014) are not inconsistent with the FLO’s own report: that in 2011-12, just 35 percent of coffee grown by certified producers was sold on fair trade terms (Fairtrade International 2013, p. 46). Remaining coffees are sold in the conventional coffee market.

Fair trade also has some little-known distributional consequences that actually widen income disparities rather than narrow them. As we note above, since 2007 coffee prices have been relatively high so the guaranteed minimum price has rarely been binding. In this case all coffee growers—whether fair trade or not—receive the market price for their coffees. Under these circumstances the primary benefit to selling a portion of one’s crop as fair trade coffee is the social premium, which is currently 20 cents per pound. Valkila (2014) notes that if coffee prices plummet again as they did during the 1990s, the coffee growers who would benefit most are those who are already positioned to sell large volumes of high-quality coffee to the fair trade network. Valkila observes that such growers are most likely male owners of large tracts of land, and who live in nations where the standard of living is already relatively high. For example, according to Fairtrade Foundation (2012) data, in 2009-10 Peru supplied 25 percent of all fair trade coffee: a nation with annual per-capita GDP in the same
period of roughly $4500 (current dollars). In the same period Tanzania was the tenth-largest fair trade coffee supplier—supplying merely four percent of the total—with per-capita GDP of just over $500 (GDP data are from the World Bank).

Valkila’s findings are undergirded by Sylla’s (2014) argument that fair trade actually marginalizes the poorest nations. According to Sylla, 54 percent of certified producer organizations are located in nations considered by the World Bank to already be “upper middle-income,” while 21 percent are located in “low-income” countries, and a mere 13.5 percent of certified producers are in LDCs (p. 131). Sylla contends that the fair trade network is not going out of its way to engage in trading with the producers that need its benefits most; instead, fair trade “selects the most capable producer organizations locally” (pp. 131-32). Sylla cites the cases of Ethiopia and Burundi relative to Mexico and Peru. Coffee accounts for 34 percent of Ethiopia’s export revenue and 26 percent of the export revenue for Burundi, yet during 2009 just three coffee certifications were issued to both nations. In contrast, even though coffee accounts for just two percent of export revenue for Mexico and Peru, in 2009 Mexico and Peru were granted 99 certifications (pp. 132-33). And, according to Sylla, other FLO-certified commodities follow a similar pattern: the nations that are most heavily dependent on certifiable commodities for their incomes tend to be the least diversified yet also the most underrepresented in the fair trade network.

The distributional consequences of fair trade are not confined to growers. Authors such as Mochrie (2012), who cling to the notion that fair trade is a form of market-based justice, should know that a growing body of research indicates that the primary gains from fair trade initiatives accrue mainly to those further down the supply chain who are already rich by global standards. For example, Valkila, Haaparanta, and Niemi (2010) examine the distribution of the benefits from fair trade between producing and consuming nations. Tracing certified coffees grown in Nicaragua and consumed in Finland, Valkila et al. (2010) discover that a larger fraction of the retail price of certified coffee remains in the consuming nation than in the conventional coffee market.

Or consider the case of Fair Trade USA. Though organized as a not-for-profit entity, its revenues from coffee alone are stunning. The primary source of funds for Fair Trade USA is the fees that are paid by retailers who affix the fair trade seal to their products. Retailers pay Fair Trade USA 10 cents per pound of coffee for the use of the seal. In 2009 the nonprofit had a budget of $10 million, 70 percent of which came from the fees (Haight
Sylla (2014), a former fair trade insider, provides a book-length treatment of such distributional consequences. Finally, though hard empirical evidence has been scant regarding whether fair trade initiatives do, in fact, deliver on their primary promise to improve the lives of the poor, a growing body of scholarship suggests that commodity-based fair trade efforts simply do not improve the lot of the global poor in enduring ways. For example, Beuchelt and Zeller (2011) find that after 10 years of participation in fair trade networks, Nicaraguan fair trade coffee producers had actually grown poorer relative to their conventional counterparts. In Mexico, Barham, Callenes, Gitter, Lewis, and Weber (2011) discover that investment in education and labor opportunities outside coffee dominate those in certified coffees. Dragusanu, Giovannucci, and Nunn (2014) summarize the rather mixed evidence regarding fair trade outcomes.

4 Our Response to Recent Arguments on Behalf of Fair Trade

Despite theoretical evidence that fair trade cannot improve the lives of the poor in significant enduring ways, and against mounting empirical evidence that supports such theories, some continue to cling to fair trade for reasons other than its overall effectiveness (or lack thereof). Consider the recent critique of Claar (2010) by Meredith (2014). While Meredith writes that, “Claar is correct that the current incarnation of FT is not economically sound,” she also contends that “Claar tears down a popular institution without fully considering….one of the key strengths of the FT movement, which is placing the issue of poverty on supermarket shelves” (p. 53). Meredith’s proposed third way—keeping the fair trade concept around as a means of promoting poverty awareness while discarding altogether its existing operational incarnation and replacing it with an entirely different structure that works better for the poor—is likely a fantasy. While it may be true that the fair trade label helps raise awareness, today’s fair trade network diverts consumers’ money away from the intended recipients and instead enriches mainly coffee importers, roasters, wholesalers, retailers, and fair trade bureaucrats. Sylla (2014) estimates that “for each dollar paid by American ‘consum’actors’ to purchase an FT product, 3 cents of ‘additional income’ are transferred to the South” (p. 125). If Sylla is correct that fair trade profits are “hogged by economic actors based in the North (including labelling initiatives),” then the difference is being captured by the entrenched intermediaries along the way who are unlikely to accommodate an externally imposed overhaul of the fair trade system.
Dragusanu et al. (2014) tepidly defend fair trade by suggesting that even if fair trade is not very effective, it nevertheless constitutes an improvement over direct aid efforts because direct aid is subject to misuse by corrupt dictators and bureaucrats. We wholeheartedly agree that governmental aid efforts with little accountability spawn corruption; Leeson and Sobel (2008) demonstrate that this truth holds even when aid is transferred between governments located within the national boundaries of an already rich nation. Yet this conclusion—that fair trade trumps direct aid because direct aid is subject to corruption—discounts the abiding truths of economic growth and development. When poor people grow rich in an enduring way, it happens primarily because they acquire better human capital, better physical capital, superior technology, and greater access to trading partners. Caring consumers should stop wasting money on “caring” coffees that make life better mainly for everyone along the supply chain but the poor we intend to help. Instead we should purchase the products that we like most and that fit our budgets best, and generously invest our charitable giving with the NGOs best positioned to knowledgeably and effectively invest directly in those we long most to help.

Lastly, we who live in the developed world need to work harder to ensure that the global poor have an equal shot at competing for our trade. Sylla (2014), citing data from the Progressive Policy Institute, notes that the United States collects more tariff revenue on imports from Bangladesh and Cambodia than from England and France (p. 31). Instead of restricting our markets in order to protect already-rich producers in the North, nations like the United States should instead lower trade restrictions so that those best positioned to serve us well have an opportunity to do so.

References


