

**The Fairness of Fair Trade:  
An Analysis of the Economics of Fair Trade**



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## **Abstract**

In 2015, a study done by Cone Communications found that millennials are "universally more engaged in corporate social responsibility."<sup>1</sup> In fact, 87% of millennials are willing to purchase a product with social or environmental benefits.<sup>2</sup> Enter, the fair trade label. The fair trade label, which is attached to products which meet the previously mentioned consumer demands, has emerged over the last three decades. Products like organic produce, textiles, and natural commodities have entered into global retailers and supermarkets through these non-traditional distribution channels, supported by increased consumption as well as changing consumer preferences. In order to uncover the underlying economic and social benefits and potential disadvantages, an analysis of the fair trade model has been conducted. Additionally, this paper will examine the future outlook of fair trade labels and how companies are creating niche business strategies within the model to develop sustained competitive advantages.

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<sup>1</sup> Cone Communications, "Research Confirms Millennials as America's Most Ardent CSR Supporters." September 23, 2015, <http://www.conecomm.com/news-blog/new-cone-communications-research-confirms-millennials-as-americas-most-ardent-csr-supporters>, accessed September 2018.

<sup>2</sup> Cone Communications, "Research Confirms Millennials as America's Most Ardent CSR Supporters." September 23, 2015, <http://www.conecomm.com/news-blog/new-cone-communications-research-confirms-millennials-as-americas-most-ardent-csr-supporters>, accessed September 2018.

## I. Introduction

The idea of Fair Trade labels first emerged in 1988 on an international level when an NGO in the Netherlands began an initiative that focused on providing agricultural laborers with "sufficient wages."<sup>3</sup> The NGO, which produced and sold products, developed a fair-trade label known as "Max Havelaar," which refers to a fictional character from a classic Dutch tale who was an active opposer to the exploitation of slaves and laborers in the early Dutch colonies.<sup>4</sup> The "Max Havelaar" initiative became a way for disadvantaged producers to earn increased income as well as see an increased role in society by utilizing sustainable production processes. As a result, these impoverished communities saw positive economic as well as social change.

Fast forward to modern day and roughly 2 billion people around the world derives their livelihoods, or income, from the agricultural industry.<sup>5</sup> Agricultural practices have become the grass roots of economies in

rural and developing parts of the world and historically, farmers have relied on the exportation of their product to survive. From a trade perspective, the amount of product exported is largely dependent of markets which sell derivative contracts of the underlying commodity that is produced. These commodity contracts, traded by individuals and institutions in developed nations around the world, have become popular investments, resulting in increased exports from the largest agricultural producing countries. However, these commodities are often subject to high price volatility, all of which is incurred by the producers. In order to address this negative impact and improve the lives of those responsible for making the product, there has been a dramatic increase in the application of the fair-trade model, specifically towards agricultural producers around the world.

As of 2012, there were a total of 1,149 fair trade producers around the world.<sup>6</sup> Over 50% of these producers are located in South

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<sup>3</sup> Raluca Drausano, Daniele Giovannucci, and Nathan Nunn, "The Economics of Fair Trade." July 2014, [https://scholar.harvard.edu/files/nunn/files/drausanu\\_giovannucci\\_nunn\\_jep\\_2014.pdf](https://scholar.harvard.edu/files/nunn/files/drausanu_giovannucci_nunn_jep_2014.pdf), accessed December 2018.

<sup>4</sup> Raluca Drausano, Daniele Giovannucci, and Nathan Nunn, "The Economics of Fair Trade." July 2014, [https://scholar.harvard.edu/files/nunn/files/drausanu\\_giovannucci\\_nunn\\_jep\\_2014.pdf](https://scholar.harvard.edu/files/nunn/files/drausanu_giovannucci_nunn_jep_2014.pdf), accessed December 2018.

<sup>5</sup> Food and Agriculture Organization of the United Nations, "World Food and Agriculture 2018." 2018, <https://www.globalagriculture.org/fileadmin/files/weltagrbericht/Weltagrbericht/10B%C3%A4uerlicheIndustrielleLW/Pocketbook2018.pdf>, accessed January 2019.

<sup>6</sup> Robin Michelle Odegard, "Fair Trade in Transition: Evolution, Popular Discourse, and the Case of the CADO Cooperative in Cotopaxi, Ecuador." January 2014, <https://scholarcommons.usf.edu/etd/5287/>, accessed January 2019.

America as they produce some of the highest demanded fair-trade products including bananas, coffee, and other natural products grown in tropical environments. Food, produce, and grains make up some 60% of all fair-trade goods produced and the remaining 40% is a mix of textiles, crafts, and consumable goods.<sup>7</sup> By studying and understanding the process of fair trade with regards to the highest demanded products, processes for other fair-trade goods can be understood, critiqued, and ultimately improved.

Fair Trade has evolved significantly since "Max Havelaar" and modern fair trade now functions to ultimately provide producers in developing countries with better trading opportunities as well as promotes a sustainable production process and mindset. This evolution of fair trade has led some individuals to characterize fair trade as a market strategy and others to characterize it as a social movement.<sup>8</sup> In terms of a social movement, it has been argued that fair trade is a vehicle which promotes a fairer production process and lasting socio-

economic improvements for the people involved in the fair-trade process. On the other hand, when studied from a market strategy perspective, it has been argued that fair trade is essentially a disguise. This suggests that at its very foundation, fair trade operates in the same way a free trade market would with an elevated level of protectionism.<sup>9</sup>

The remainder of this paper will address the relationship between these two perspectives, taking into the consideration the economic mechanisms, social implications, and supply chain structures associated with the fair-trade model.

## II. Economic Mechanisms

One defining feature of fair trade is that it seeks to improve the personal economic situations of disadvantaged producers resulting in increased stimulation of the economy of developing regions around the world. In order to do this, the fair-trade model features a price floor, a social premium, and direct relationships between producers and fair-trade distributors, or

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<sup>7</sup> Robin Michelle Odegard, "Fair Trade in Transition: Evolution, Popular Discourse, and the Case of the CADO Cooperative in Cotopaxi, Ecuador." January 2014, <https://scholarcommons.usf.edu/etd/5287/>, accessed January 2019.

<sup>8</sup> Robin Michelle Odegard, "Fair Trade in Transition: Evolution, Popular Discourse, and the Case of the CADO Cooperative in Cotopaxi, Ecuador." January

2014, <https://scholarcommons.usf.edu/etd/5287/>, accessed January 2019.

<sup>9</sup> Alan Reynolds, "The Unfairness of Fair Trade," CATO Institute." November 13, 2003, <https://www.cato.org/publications/commentary/unfairness-fair-trade>, accessed March 2019.

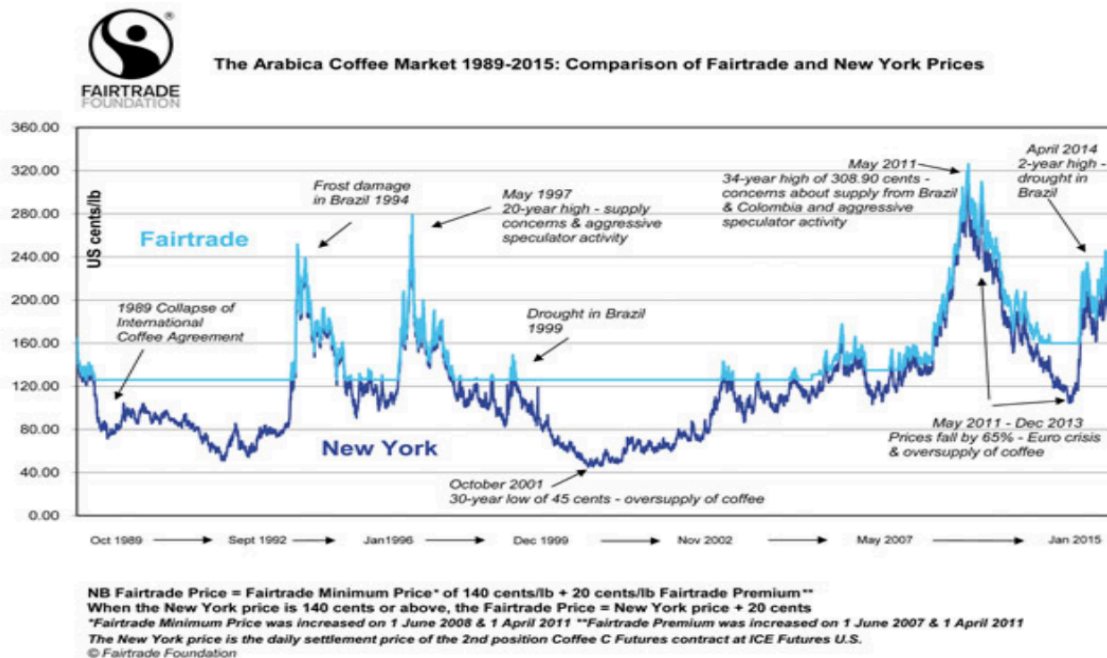
buyers. When combined, the fair trade model claims that these economic mechanisms function to deliver increased income and economic stability to producers and their communities compared to the traditional free trade model. The extent of this impact will be reviewed further in the following sections.

### Price Floor

The first defining economic factor of the fair-trade model is the use of a price floor. The concept of price floors was introduced by governments to specify the lowest price at which a commodity (or good) can be sold. The presence of a price floor ultimately keeps

prices from being too low. Price floors are most often seen in agriculture and when it comes to fair trade, they are used to protect the farmers and individuals responsible for producing the underlying product.<sup>10</sup>

The minimum cost, or price floor, of fair trade products is determined by identifying the sustainable production cost of the good as well as the living wage in the sector, most commonly agriculture. Price floors provide incentives for producers to be fair trade certified by reducing the risk of fluctuating market prices for the commodities they produce.<sup>11</sup> When market prices fall below the fair trade price floor, fair trade



Source: Fairtrade Foundation, 2016

<sup>10</sup> Raluca Drausano, Daniele Giovannucci, and Nathan Nunn, “The Economics of Fair Trade.” July 2014, [https://scholar.harvard.edu/files/nunn/files/drausanu\\_giovannucci\\_nunn\\_jep\\_2014.pdf](https://scholar.harvard.edu/files/nunn/files/drausanu_giovannucci_nunn_jep_2014.pdf), accessed December 2018.

<sup>11</sup> Raluca Drausano, Daniele Giovannucci, and Nathan Nunn, “The Economics of Fair Trade.” July 2014, [https://scholar.harvard.edu/files/nunn/files/drausanu\\_giovannucci\\_nunn\\_jep\\_2014.pdf](https://scholar.harvard.edu/files/nunn/files/drausanu_giovannucci_nunn_jep_2014.pdf), accessed December 2018.

buyers or distributors are still required to pay fair trade producers the guaranteed minimum price for their products, resulting in increased producer surplus for fair trade producers compared to traditional producers. Because these products are sold for a premium price compared to standardized products, they are considered to be specialty goods. Although the consumer is the one that is responsible for paying the premium, this pricing structure can create a quality problem for fair trade products. For example, certain traditional products are considered to be “specialty,” meaning that they are of higher quality, resulting in higher prices. Fair trade products are considered to be specialty products because of the special production requirements attached to them. Opposite of traditional products, the quality of the fair trade product is not associated with the premium that is being paid. Tying this idea back to the price floor, a fair trade producer, provided there is demand, will sell the lower quality product in order to maximize his/her income and operate as economically efficient as possible. This price floor mechanism is also applied to the wages earned by fair trade producers. Producers are to be paid "at least

equal to the legal minimum or regional averages."<sup>12</sup>

The graph above represents the price floor of Arabica Coffee, one of the most popular fair trade products, from 1989 to 2015. The light blue line represents the fair-trade price floor, or the price paid per unit of coffee, compared to the dark blue line which represents the free trade market prices of derivative contracts on the free market, in this case in New York. One main point that this graph illustrates is the downside risk protection that producers have with a price floor. For many fair-trade products, typically commodities, markets can be volatile due to external factors. For example, in October of 1989, the International Coffee Agreement collapsed, sending the market price down by nearly 30%. However, because of the fair-trade price floor, fair trade producers were able to sell their product at a price much higher than the lower free trade market price. Additionally, a price floor allows fair trade producers to more accurately predict the price at which their goods will be sold. With an idea of the “guaranteed income” that they will receive, producers can more efficiently use the resources available to them in the production process.

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<sup>12</sup> Raluca Drausano, Daniele Giovannucci, and Nathan Nunn, “The Economics of Fair Trade.” July 2014, <https://scholar.harvard.edu/files/nunn/files/drag>

usanu\_giovannucci\_nunn\_jep\_2014.pdf, accessed December 2018.

### *Social Premium*

In addition to a fair-trade price floor, the fair-trade model also includes a fair-trade premium, often referred to as a social premium. Recognized as specialty goods, fair trade products are often priced well outside of the purchasing power of those who actually produce them. As a result, fair trade producers do not have significant opportunities within the local economy for trade and increased welfare opportunities. With the majority of producers located in developing countries, fair trade organizations have promoted the development of co-operatives, or groups of producers in the same geographical area or production segment. Not only does this promote community, but it allows them to share production methods and efficiencies to ultimately improve their product. To address and improve these co-operative groups, the social premium was created. The social premium is an additional cost that is paid above the price floor to fair trade producers. This premium is designed to flow directly to fair trade co-operatives to fund community based educational, social, and political programs and improvements. Despite the design of this mechanism within the greater

fair trade model, it was found that only about 10% of the social premium that is paid by consumers actually goes to small scale fair trade producers.<sup>13</sup> The inefficiencies of these economic flows between consumers and producers will be examined through the lens of the fair trade supply chain in the following sections but further study must be done to assess the long term economic impact provided by these premiums.

### *Defining Living Wages*

As previously mentioned, the fair trade model provides producers in developing countries with opportunities to earn, what fair trade regulators consider to be, a living wage. Increased review of the fair trade model has led organizations to study and further refine the definition of living wage and the methodology utilized to measure it. Together, Fairtrade International, the Forest Stewardship Council, GoodWeave, Sustainable Agriculture Network/Rainforest Alliance, Social Accountability International, and UTZ Certified have established the following definition of living wage:

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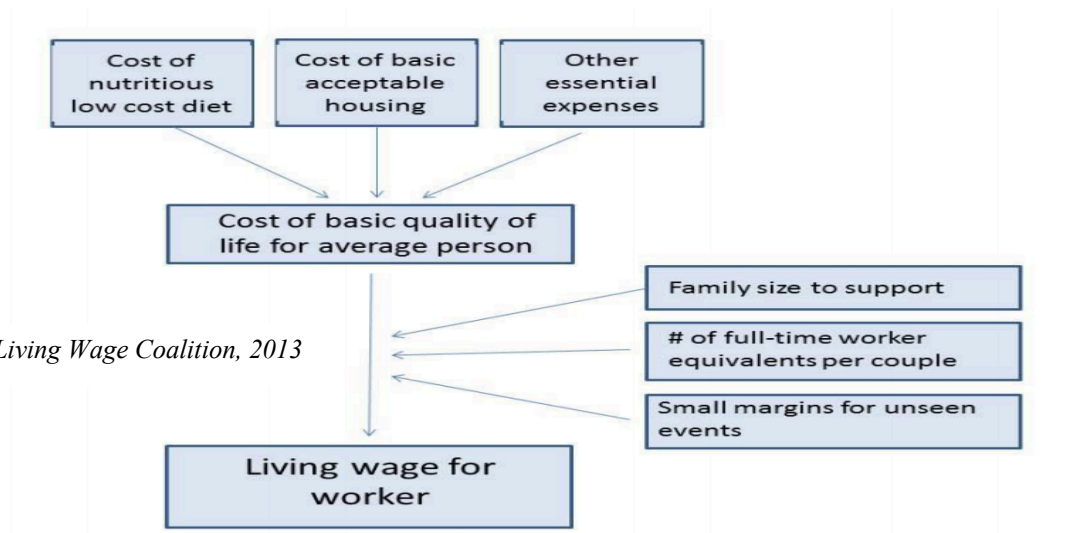
<sup>13</sup> Uwe Kaufmann, "Fairtrade and its unexpected consequences for the Pacific Island Countries." East Asia Forum, August 6, 2011,

<https://www.eastasiaforum.org/2011/08/06/fairtrade-and-its-unexpected-consequences-for-the-pacific-island-countries/>, accessed March 2019.

“Remuneration received for a standard work week by a worker in a particular place sufficient to afford a decent standard of living for the worker and her or his family. Elements of a decent standard of living include food, water, housing, education, health care, transport, clothing, and other essential needs, including provision for unexpected events.”<sup>14</sup>

model uses normative standards, resulting in a practical compromise between separately estimating the costs of each and every expense fair trade producing families have. The following flow chart depicts the elements considered in estimating living wage for fair trade producers.

From an economic perspective, it is important to be critical of this definition as it does not account for important economic factors. While it does examine cost of living



Source: Global Living Wage Coalition, 2013

In addition to defining what a living wage is, these organizations have also developed a methodology for estimating living wage in a fair trade producing country. While typical methodologies rely on available expenditure data to estimate housing and other “nonfood” costs, this

in the local context, the definition is lacking economic elements including, but not limited to: the amount of time and skill required for production, the minimum wage where products are made, and the purchasing power of the respective production area.

<sup>14</sup> Richard Anker & Martha Anker, “A Shared Approach to Estimating Living Wages,” Global Living Wage Coalition, November 2013,

[https://www.fairtrade.net/fileadmin/user\\_upload/content/2009/standards/documents/GLWC\\_Anker\\_Methodology.pdf](https://www.fairtrade.net/fileadmin/user_upload/content/2009/standards/documents/GLWC_Anker_Methodology.pdf), accessed March 2019.



### *Economic Mechanisms in Action*

There is significant evidence that the economic mechanisms of the fair trade model deliver additional monetary benefits to fair trade producers compared to traditional farmers. In a study done by Jeremy Weber in 2011, it was found that fair trade growers received 12.8 cents more per pound of coffee compared to farmers who were not fair trade certified.<sup>15</sup> Additionally, in the same study, 100% of the farmers that were interviewed stated that their ability to access higher prices was significantly impacted by the power of their respective fair trade co-operative. On the other hand, only 50% of traditional farmers stated that their conventional co-operatives played a role in achieving higher sales prices.

At first glance, the positive economic impact of fair trade price floors, social premiums, and cooperatives is very visible. However, in order to better understand the long-term impact of these mechanisms, further analysis of variables including farm size, production specialization, geographic location, country-risk, and length of

certification should be conducted. While these variables will offer more consistent comparison with traditional producers, it is still incredibly difficult to quantify and measure the “entrepreneurial zeal” of a fair trade producer, a factor which can generate significant bias.<sup>16</sup>

### **III. Free Trade and Fair Trade**

Although it can be expensive for fair trade producers to achieve fair trade certification, they are able to benefit from increased market accessibility. Although the majority of their product will be produced according to fair trade standards, in the event the market price is greater than the price floor offered, producers have the ability to benefit from the sales of their product through traditional market channels.<sup>17</sup>

In fact, fair trade markets for major commodities like coffee and bananas have become oversaturated, meaning there are a large number of players all looking to share a small return. As a result, only a limited number of products can be sold through the

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<sup>15</sup> Jeremy Weber, “How much more do growers receive for Fair-Trade-organic coffee,” Elsevier, October 2011, <https://www.sciencedirect.com/science/article/pii/S0306919211000716/>, accessed March 2019.

<sup>16</sup> Raluca Dragusano, Daniele Giovannucci, and Nathan Nunn, “The Economics of Fair Trade.” July

2014, [https://scholar.harvard.edu/files/nunn/files/dragusanu\\_giovannucci\\_nunn\\_jep\\_2014.pdf](https://scholar.harvard.edu/files/nunn/files/dragusanu_giovannucci_nunn_jep_2014.pdf), accessed December 2018.

<sup>17</sup> Kohler Pierre, “The Economics of Fair Trade Coffee: For Whose Benefit?.” 2007, [http://repec.graduateinstitute.ch/pdfs/Working\\_papers/HEIWP06-2007.pdf](http://repec.graduateinstitute.ch/pdfs/Working_papers/HEIWP06-2007.pdf), accessed January 2019.



\*Model represents cost of Fair Trade Arabica Coffee/pound

*Source: Adapted from Pura Vida*

fair-trade channel. With an average of 30% of products produced moving through the fair-trade channel, the remaining 70% are forced to be sold on the traditional market, resulting in an increased exposure to the price volatility of the respective commodity.<sup>18</sup>

Free trade, on the other hand, has the ability to incentivize a producer to produce a higher quality product. Steven Macatonia, owner of Union Coffee Roasters and a fair trade distributor, refers to the difference between fair trade and free trade as “protection” versus “aspiration.”<sup>19</sup> As previously stated, the fair-trade model was developed to protect disadvantaged producers from all traditional market forces including competition and market volatility. Other than organic standards associated with some fair trade commodities, with a guaranteed price, fair trade producers do not

have an incentive to produce a product with an abnormal level of quality. A comparison of the pricing models can be seen in the flow chart below.

According to the principles of competition, the market forces associated with free trade pushes producers to aspire to produce a higher quality product. Instead of scraping by incurring minimum costs, the free trade market pushes producers to consider expending more monetary and human resources in order to sell a superior product compared to others.<sup>20</sup> All things considered, the “protection” versus “aspiration” models suggested by Macatonia, can be thought of as “guaranteed profit” versus “greatest profit,” and it is up to the producer to decide which channel to sell their product through depending on their combination of utility and resources

<sup>18</sup> Kohler Pierre, “The Economics of Fair Trade Coffee: For Whose Benefit?.” 2007, [http://repec.graduateinstitute.ch/pdfs/Working\\_papers/HEIWP06-2007.pdf](http://repec.graduateinstitute.ch/pdfs/Working_papers/HEIWP06-2007.pdf), accessed January 2019.

<sup>19</sup> Steven Macatonia, “Going beyond fair trade: the benefits and challenges of direct trade.” March 13, 2013, <https://www.theguardian.com/sustainable->

[business/direct-trading-coffee-farmers](https://www.theguardian.com/sustainable-business/direct-trading-coffee-farmers), accessed January 2019.

<sup>20</sup> Steven Macatonia, “Going beyond fair trade: the benefits and challenges of direct trade.” March 13, 2013, <https://www.theguardian.com/sustainable-business/direct-trading-coffee-farmers>, accessed January 2019.

available, the market for the respective product, and the ongoing costs associated with the production process.

### *Certification and the Threat of New Entrants*

Considering principles of competition, supply and demand, and barriers to entry, it is important to study the impact of elements of the fair trade model in the long-run. One of the most important elements is the fair trade certification that is achieved by fair trade producers, which allows them to sell their goods with the fair trade label and benefit from the previously mentioned economic mechanisms.

Certification of fair trade producers is regarded as either “positive selection” or “negative selection”<sup>21</sup> Positive selection is often associated with the “best” farmers who produce higher amounts of goods and receive high prices. These producers tend to have social cohesion and organizational ability. On the other hand, negative selection is associated with economically disadvantaged and limited resource producers. The fair trade

model intentionally targets this group of people but with the presence of a price floor and fixed price premium, the negative selection producer sells a lower-quality product as a result of guaranteed incentive. According to economist Raluca Dragusano of Harvard University, at a theoretical level, it is unclear whether the certification selection should be positive or negative.<sup>22</sup> However, empirical studies show that the fair trade model points toward negative selection. A study done by economists Guillermo Zuniga-Arias and Fernando Saenz-Segura in Costa Rica in 2009 revealed that farmers who are less educated, have less farming experience, and own smaller farms are more likely to become fair trade certified, suggesting a very strong negative relationship.<sup>23</sup> To understand the selection of fair trade certification beyond positive and negative, further analysis must be conducted of the motivating factors that drive farmers to become fair trade certified.

Fair trade producers currently produce less than 1% of total products sold globally but the fair trade model in the long

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<sup>21</sup> Raluca Drausano, Daniele Giovannucci, and Nathan Nunn, “The Economics of Fair Trade.” July 2014, [https://scholar.harvard.edu/files/nunn/files/dragusano\\_giovannucci\\_nunn\\_jep\\_2014.pdf](https://scholar.harvard.edu/files/nunn/files/dragusano_giovannucci_nunn_jep_2014.pdf), accessed December 2018.

<sup>22</sup> Raluca Drausano, Daniele Giovannucci, and Nathan Nunn, “The Economics of Fair Trade.” July 2014, [https://scholar.harvard.edu/files/nunn/files/dragusano](https://scholar.harvard.edu/files/nunn/files/dragusano_giovannucci_nunn_jep_2014.pdf)

[\\_giovannucci\\_nunn\\_jep\\_2014.pdf](https://scholar.harvard.edu/files/nunn/files/dragusano_giovannucci_nunn_jep_2014.pdf), accessed December 2018.

<sup>23</sup> Fernando Saenz-Segura & Guillermo Zuniga-Arias, “Assessment of the Effect of Fair Trade on Smallholder Producers in Costa Rica: A Comparative Study in the Coffee Sector,” *The Impact of Fair Trade*, 2009, <https://www.wageningenacademic.com/doi/abs/10.3920/978-90-8686-647-2#page=118>, accessed March 2019.

run offers significant threats to incumbent fair trade producers as product output continues to increase. All other factors held constant, a fair trade producer in a given country will achieve a higher yield for the product produced compared to the traditional producer. As traditional producers begin to witness the premium associated with fair trade, assuming they qualify, it will be in their best interest to also become fair trade certified. In the market for just a single commodity, this can happen quickly and on a large scale. With few barriers to entry, there is a high threat of new entrants. As new entrants begin to enter into the industry, fair trade producers will see a decline in the amount of production output that can be sold in the fair trade market, holding demand constant. With this information, economic models suggest that entry into the industry will continue until the benefits of fair trade certification (price floor, social premium, etc.) equal the cost to producers.<sup>24</sup>

In addition to being fair trade certified, the Fairtrade International Organization reported in 2011 that 80% of fair trade producers also held additional certifications from Organic, Rainforest Alliance, and UTZ labels. With more “do

good” labels available to producers, there is significant concern that there is confusion regarding the overall requirements of each label, essentially making them less effective. Heavily fueled by the waves of consumer trends, we must question the future outlook of these “do good” consumption habits. While consumers may still pay high premiums, fair trade retailers, or the companies selling the end product, are facing tighter margins and are looking to cut costs. As a result, UK based companies like Mondelez International and Sainsbury are removing the fair trade label from select products and instead are developing similar schemes that promote the same principles as the fair trade model, citing increasing supply chain and certification costs.

Overall, the fair trade certification process brings into question the long run outlook of the fair trade model. In order to accurately estimate the economic impact that fair trade has on farmers in the long run, further analysis must be conducted of initial and ongoing certification costs, nonmonetary goals associated with fair trade, certification requirements, and other barriers to entry.

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<sup>24</sup> Raluca Drausano, Daniele Giovannucci, and Nathan Nunn, “The Economics of Fair Trade.” July 2014,

[https://scholar.harvard.edu/files/nunn/files/drausanu\\_giovannucci\\_nunn\\_jep\\_2014.pdf](https://scholar.harvard.edu/files/nunn/files/drausanu_giovannucci_nunn_jep_2014.pdf), accessed December 2018.

#### IV. Other Mechanisms

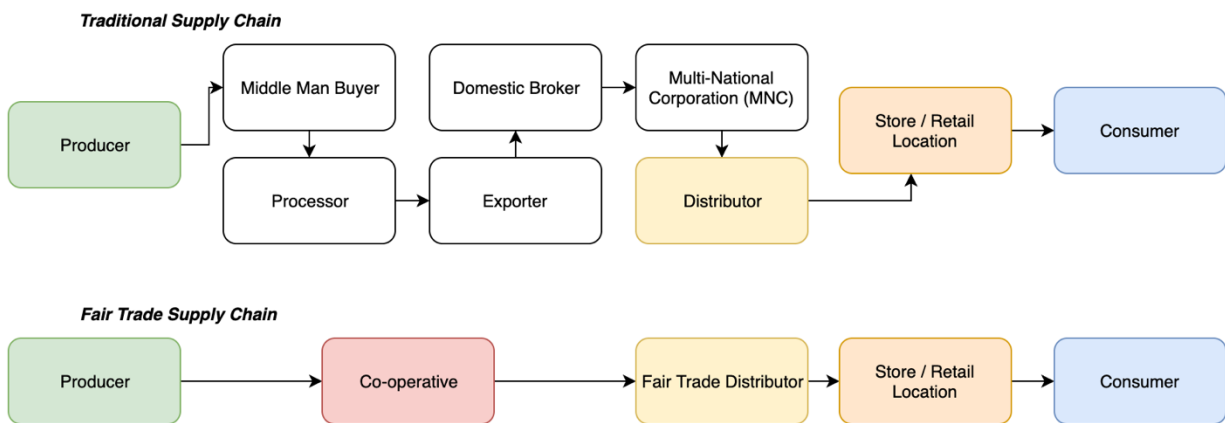
Outside of the economic mechanisms associated with the fair trade model, the initiative also places significant emphasis on information transparency. Fair trade products have seen a significant increase in demand over the last decade as a result of consumers, specifically the millennial generation, deriving utility from the way or process in which a product is produced rather than just the final characteristics of the product. With a free-flow of information between producers and consumers, the fair trade model creates “mutual beneficial transactions that otherwise would not occur.”<sup>25</sup>

To further reinforce the importance of this mechanism, a study was done by Shareen Hertel, Lyle Scurggs, and Patrick Heidkamp

from the University of Connecticut to quantify the extent to which consumers will pay for responsible production.<sup>26</sup> It was found that 75% of individuals who purchase coffee would be willing to pay an additional 15% on top of the original sales price if the coffee was fair trade certified. Over 50% stated they would pay an additional 30% on top of the original sales price.<sup>27</sup>

#### V. Supply Chain Analysis

Since first being cultivated in the early 15<sup>th</sup> century, coffee has become the most popular beverage around the world as individual consumption combines for a total of four hundred billion cups of coffee very year. Although coffee is the most valuable and widely traded tropical agricultural



Adapted from Zee Bee Market LLC-Fair Trade (2016)

<sup>25</sup> Raluca Drausano, Daniele Giovannucci, and Nathan Nunn, “The Economics of Fair Trade.” July 2014, [https://scholar.harvard.edu/files/nunn/files/dragusanu\\_giovannucci\\_nunn\\_jep\\_2014.pdf](https://scholar.harvard.edu/files/nunn/files/dragusanu_giovannucci_nunn_jep_2014.pdf), accessed December 2018.

<sup>26</sup> Cindy Weiss, “Fair Trade Goods Popular Despite Recession,” UConn Today, December 22, 2009,

<https://today.uconn.edu/2009/12/fair-trade-goods-popular-despite-recession/>, accessed March 2019.

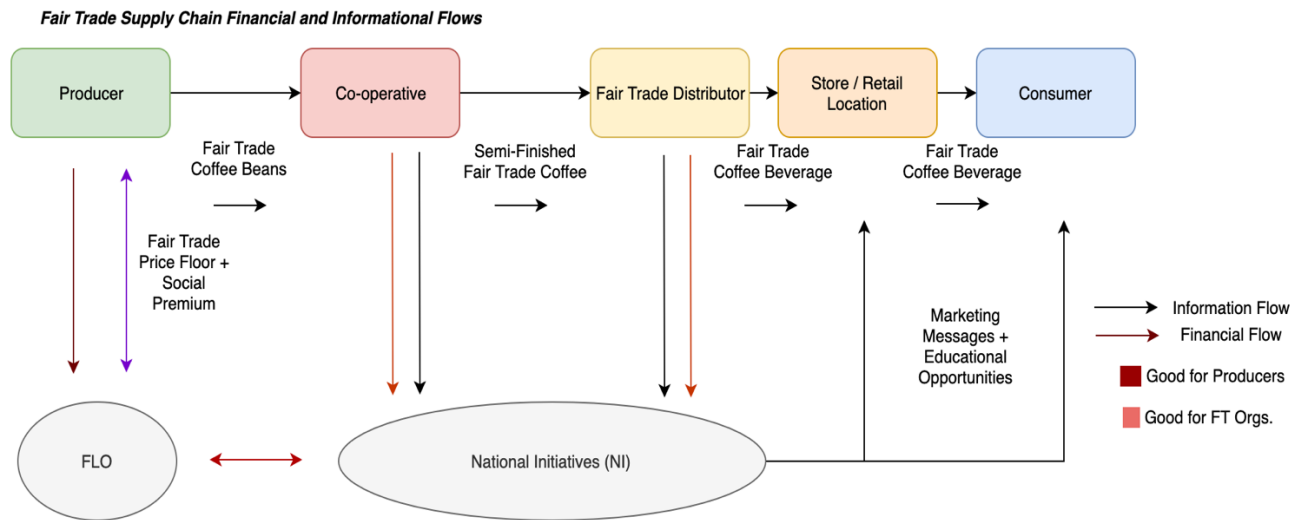
<sup>27</sup> Cindy Weiss, “Fair Trade Goods Popular Despite Recession,” UConn Today, December 22, 2009, <https://today.uconn.edu/2009/12/fair-trade-goods-popular-despite-recession/>, accessed March 2019.

products, an extensive and imbalanced supply chain has resulted in the exploitation of labor and natural resources in places like Latin America, Africa, and Asia.<sup>28</sup> As stated in the introduction, the overall goal of the fair-trade model is to provide disadvantaged producers with increased income through the elimination of supply chain power imbalance. The chart above breaks down the traditional, free trade supply chain as well as the fair-trade supply chain.

For the average product produced by a fair-trade producer that is sold within the free trade market, it must process through roughly 45% more intermediaries within the supply chain. With more players in the supply chain, income is spread thin, generally

leaving little income for the actual producers of the product. The fair-trade model eliminates unnecessary intermediaries and instead, focuses on the direct relationship between producers, co-operatives and fair-trade distributors.<sup>29</sup> The following chart is an example of the flow of financial and non-financial assets in the fair-trade model

In addition to the increased income received by producers as a result of a more efficient supply chain, the fair-trade model supply chain also allows for producers to benefit from long term partnerships, producing on credit, and increased market transparency.<sup>30</sup> When combined these benefits give producers increased information flows as well as freedom to



*Adapted from Zee Bee Market LLC-Fair Trade (2016) and Nicholls, A., Opal C. (2005)*

<sup>28</sup> Fairtrade Foundation, “Coffee Farmers.” 2017, <https://www.fairtrade.org.uk/Farmers-and-Workers/Coffee>, accessed January 2019.

<sup>29</sup> Kevin M. Herrell, “Honduran Coffee Trade: Economic Effects of Fair Trade Certification on Individual Producers.” 2017, <http://ageconsearch.umn.edu/bitstream/252729/2/Hon>

[duran%20Coffee%20Trade-SAEA.pdf](http://repec.graduateinstitute.ch/pdfs/Working_papers/HEIWP06-2007.pdf), accessed January 2019.

<sup>30</sup> Kohler Pierre, “The Economics of Fair Trade Coffee: For Whose Benefit?.” 2007, [http://repec.graduateinstitute.ch/pdfs/Working\\_papers/HEIWP06-2007.pdf](http://repec.graduateinstitute.ch/pdfs/Working_papers/HEIWP06-2007.pdf), accessed January 2019.

identify and experiment with parts of their production process that can become more efficient.

In past research, the importance of the relationship between the fair-trade distributor and the fair-trade producer has often gone unmentioned. It is important to recognize that the fate of producers often lies in the hands of the distributors. For example, price floors ultimately promote long-term trade relationships, but these are not required.<sup>31</sup> Additionally, fair trade distributors face very low switching costs.<sup>32</sup> The combination of these two things requires producers to produce the highest quality product, sometimes by incurring additional costs, simply in order to maintain the relationship. Another part of the relationship between producers and distributors is the fair trade producers' ability to request credit. Although producers are able to request credit, a study done by Laura Reynolds from Colorado State University in 2019 revealed that large corporate buyers, often referred to as "market motivated" buyers, including Starbucks and

Nestle, refuse to buy from fair trade cooperatives that request credit.<sup>33</sup> Increased access to credit can be extremely helpful in making the production process more efficient, leading to maximum profit. However, the aforementioned study can explain why producers have been fearful to express these requests as fair-trade buyers can often threaten to terminate the trade partnership.<sup>34</sup>

In order to understand the true impact of the fair-trade model, an understanding of these dilemmas is vital. Although the fair-trade model seeks to benefit undeserved producers in developing parts of the world, they are still very much subjected to traditional market forces including competition and other barriers to trade when interacting with developed nations.

## **VI. The Future of Fair Trade: Market Driven Restoration**

In the early 1990's the idea of fair-trade labels spread throughout the rest of Europe and eventually to North America and

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<sup>31</sup> Kohler Pierre, "The Economics of Fair Trade Coffee: For Whose Benefit?." 2007, [http://repec.graduateinstitute.ch/pdfs/Working\\_papers/HEIWP06-2007.pdf](http://repec.graduateinstitute.ch/pdfs/Working_papers/HEIWP06-2007.pdf), accessed January 2019.

<sup>32</sup> Kohler Pierre, "The Economics of Fair Trade Coffee: For Whose Benefit?." 2007, [http://repec.graduateinstitute.ch/pdfs/Working\\_papers/HEIWP06-2007.pdf](http://repec.graduateinstitute.ch/pdfs/Working_papers/HEIWP06-2007.pdf), accessed January 2019.

<sup>33</sup> Laura Reynolds, "Mainstreaming Fair Trade Coffee: From Partnership to Traceability,"

ResearchGate, June 2009, [https://www.researchgate.net/publication/46507306\\_Mainstreaming\\_Fair\\_Trade\\_Coffee\\_From\\_Partnership\\_to\\_Traceability](https://www.researchgate.net/publication/46507306_Mainstreaming_Fair_Trade_Coffee_From_Partnership_to_Traceability), accessed March 2019.

<sup>34</sup> Kohler Pierre, "The Economics of Fair Trade Coffee: For Whose Benefit?." 2007, [http://repec.graduateinstitute.ch/pdfs/Working\\_papers/HEIWP06-2007.pdf](http://repec.graduateinstitute.ch/pdfs/Working_papers/HEIWP06-2007.pdf), accessed January 2019.

South America.<sup>35</sup> With more widespread adoption, FINE, the fair-trade umbrella organization, was developed. This umbrella organization consisted of the Fairtrade Labeling Organizations International (FLO), the International Federation for Alternative Trade, the Network of European World Shops, and the European Fair-Trade Association.<sup>36</sup> Today, these organizations are responsible for assigning the Fair-Trade Certification mark to companies and their products, showing they were produced according to fair trade standards. While fair trade labels were originally only available to smaller businesses and producers, organizations, specifically in the United States, have pushed for fair trade labels to be available to all businesses and producers, regardless of their size.<sup>37</sup> As consumer preferences continue to change, global companies are realigning themselves according to this model to not only reap the economic benefits but to also drive social and environmental change.

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<sup>35</sup> Raluca Dragusano, Daniele Giovannucci, and Nathan Nunn, "The Economics of Fair Trade." July 2014, [https://scholar.harvard.edu/files/nunn/files/dragusanu\\_giovannucci\\_nunn\\_jep\\_2014.pdf](https://scholar.harvard.edu/files/nunn/files/dragusanu_giovannucci_nunn_jep_2014.pdf), accessed December 2018.

<sup>36</sup> Raluca Dragusano, Daniele Giovannucci, and Nathan Nunn, "The Economics of Fair Trade." July 2014, [https://scholar.harvard.edu/files/nunn/files/dragusanu\\_giovannucci\\_nunn\\_jep\\_2014.pdf](https://scholar.harvard.edu/files/nunn/files/dragusanu_giovannucci_nunn_jep_2014.pdf), accessed December 2018.

One company that is driving change across multiple industries is Guayaki Yerba Mate. This company, based in the United States is developing a refined fair-trade business model for the main alternative of coffee, yerba mate. Yerba mate is a naturally caffeinated beverage that not only delivers good energy but also offers nutritional benefits.<sup>38</sup> Made from the holly tree species, the natural product can only be found in the Amazon rainforest. As a result of proximity and popularity, Yerba Mate has become the national drink of Argentina, Paraguay, Uruguay, and Southern Brazil.

Guayaki became the first Fair Trade Certified yerba mate company in 2009. Since then, the company has focused on protecting and restoring South American rainforests while further economically empowering native producers in the region beyond the incentives provided by the fair-trade model. Determined to fulfill their mission, Guayaki launched a market-driven restoration business model.

<sup>37</sup> Robin Michelle Odegard, "Fair Trade in Transition: Evolution, Popular Discourse, and the Case of the CADO Cooperative in Cotopaxi, Ecaudor." January 2014, <https://scholarcommons.usf.edu/etd/5287/>, accessed January 2019.

<sup>38</sup> Jillian McCoy, "Guayaki Pioneers Market-Driven Restoration Business Model" August 27, 2012, <https://rsfsocialfinance.org/2012/08/27/guayaki-pioneers/>, accessed December 2018.



The market-driven restoration model was established with the goal of restoring 200,000 acres of rainforest and providing 1,000 living wage jobs in the Amazon region by 2020.<sup>39</sup> The business model was born with the goal of minimizing the deforestation that occurred in the yerba mate production process and instead Guayaki incentivized producers to grow shade-grown mate, a process in which tree shade is required. In return, producers earned increased living wages that went beyond that which the basic fair model guarantees. The market-driven restoration process started slow but as of 2018, 81,066 acres of rainforest had been restored and 670 living wage jobs had been created.<sup>40</sup> In addition, 60 different families in this region were served by newly built schools with native language instruction and 22 acres of land has been dedicated to food sovereignty programs across two indigenous communities.<sup>41</sup>

It is clear that many of the elements featured in Guayaki's market-driven restoration program are very similar to the elements of the fair-trade business model. For example, the guaranteed living wages that are

earned by producers is very similar to the price floor of the fair-trade model and the benefits received by families and groups, similar to co-operatives, like education and food sovereignty programs, can be compared to the same social premiums received by producers. While the company has proven its ability to make significant social, economic, and environmental changes in Latin America, from an economic standpoint there is cause for concern. The business model is fully reliant on consumers "voting with their dollars" and as the cost of those votes continues to increase, the company faces market share and long-term profitability risk. To properly assess the long-term sustainability of the model, a deeper analysis of the economic trade-offs associated with the Guayaki business model should be conducted.

This market driven restoration is the first of its kind and as a result, other businesses are looking to Guayaki to lead the way in the evolution of this niche business practice with a mission that still falls under the same fair-trade umbrella. As consumers continue to demand more transparency from

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<sup>39</sup> Jillian McCoy, "Guayaki Pioneers Market-Driven Restoration Business Model" August 27, 2012, <https://rsfsocialfinance.org/2012/08/27/guayaki-pioneers/>, accessed December 2018.

<sup>40</sup> Guayaki Yerba Mate, "Guayaki Global Impact Report 2017-2018." 2018,

<file:///Users/dukeschillaci/Downloads/guayaki-global-impact-report.pdf>, accessed December 2018.

<sup>41</sup> Guayaki Yerba Mate, "Guayaki Global Impact Report 2017-2018." 2018, <file:///Users/dukeschillaci/Downloads/guayaki-global-impact-report.pdf>, accessed December 2018.

companies as well as believe that their dollars are making a difference, more and more firms will adopt similar niche fair-trade models that further refine the production process and producer benefits. Fair trade labeled products make up less than 1% of all products sold around the world. Given this information, as modern businesses begin to rethink the idea of “profit,” the fair-trade model will become more widely adopted and evolve even further.

## **VII. Conclusion**

The idea of fair trade was conceived roughly 30 years ago with the goal of improving the lives of disadvantaged workers and restoring the lands in which they inhabit through basic economic mechanisms and sustainable production process requirements. Defined by the factors of a price floor and a social premium, the fair trade model gives

producers access to price premiums while driving positive social change and environmental sustainability. The studies included in this paper show the short-term success of the fair trade model in accomplishing these goals, evidenced by increased income and enhanced infrastructure of fair trade co-operative communities. However, with only a small percentage of the world’s producers being fair trade certified, economic models must continue to be developed and studied to further assess the long-term sustainability of the fair trade model and the associated economic mechanisms. In addition to reviewing the fair trade certification process, analysis of alternative “do good” label certifications and consumer trends should be conducted to calculate the economic benefits and ramifications in the long run for both fair trade as well as traditional producers.

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