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TRUST IN FAIRTRADE: THE "FEEL-GOOD" EFFECT

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Abstract

Fairtrade is nurtured with stories aimed at making consumers feel good by buying Fairtrade products. This 'feel-good' factor may vary when it is found that, the proportional division of the benefits between producer and other potential gainers is biased towards the distributors. There is, therefore, an incentive to verify whether the trust accorded to Fairtrade is justified. If trust and therefore the feel-good factor are undermined or enhanced as a result of the validation of the stories, then the whole Fairtrade movement could potentially crumble or burgeon. Drawing on elements in Glaeser (2005)'s model, this paper analyses the factors behind the recent expansion of Fairtrade. (JEL: F19, I39, Q17)

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INTRODUCTION

"I was at pains to consider the miserable condition of the old man; and now my alms, giving some relief, doth also ease me."

- Thomas Hobbes on why he gives sixpence to a beggar

The importance of benevolence has been recognized in the long tradition of economics treated as a moral science, dating back at least to Adam Smith (1759). Notable modern exponents include Becker (1974); Boulding (1969); Frank (1990), Hausman and McPherson (1993); Kolm and Mercier Ythier (2006); Sen (1995). Benevolence as a moral disposition is driven chiefly by concern for the welfare of others. The expected benefits, though, are also mutual – that is, the benefactor as well as the beneficiary would elicit gains. Moralists have often questioned the extent of altruism involved in benevolent acts which may be motivated to a larger extent by self-righteousness. Such an example is the story of the widow's mite (Mark 12, pp.38-44, Luke 20, pp.45-47, 21, pp.1-4), in which the sacrificial altruism of the poor person who gives everything she has to others is contrasted with the less meritorious motivation of benevolence – namely, the desire to 'feel good' about oneself. The latter motivation may be more relevant to the subject of this paper – that is, the analysis of the factors behind the recent expansion of Fairtrade (FT).

This paper deals exclusively with "Fairtrade", the labelling channel for marketing FT products. It is written in one word to distinguish it from the overall fair trade movement. FT aims to protect small producers against price volatility and inadequate incomes as well as to provide community benefits (health care, education). It relies on consumer purchases of FT products carried out at agreed minimum prices.

These purchases measure the trust accorded to the scheme which is founded on a system of certification comprising a series of recommended producer welfare-enhancing standards that FT products must satisfy. These standards conform to a code developed by the members of the International Social and Environmental Accreditation and Labelling Alliance (ISEAL)[1]. The Fairtrade Labelling Organization International (FLO), created in 1997, defines and applies these standards through two organizations. FLO International establishes FT norms, while FLO-cert endeavours to ensure that the actors involved comply with them.[2]

In this paper, a Fairtrade consumer (FTC) buying FT products is assumed to be motivated by a sense of fairness, reflected in the FTC's willingness to pay more for the same product "in order to avoid large deviations from what they consider a fair solution" (Cappelen et al., 2007, p.818).[3] This motivation leads some authors to label the FT consumer as "ethical" (see for example Bird and Hughes 1997, Leclair 2002, Levi and Linton 2003, Maseland and de Vaal 2002, Raynolds 2002). The belief or knowledge of contributing to an improved standard of living for poor producers in the South elicits satisfaction in the FTC. The components of this agreeable feeling may include self-esteem, the perceived membership of a desired social stratum, and enjoying praise, gratitude, esteem and admiration from others.[4] The overall satisfaction resulting from some combination of these elements is called in this paper the "feel-good" factor.

Fairtrade organizations (FTOs) instil this feel-good factor by supplying stories to accompany FT product sales which aim to appeal to the potential FT consumer's humanitarian sentiments (Renard, 2003, p.90).[5] An example of this is the core proposition of the Fairtrade Fortnight 2008, which states "Feel-good by changing your choices and changing people's lives".[6] However, FT is defined by the exchange of

"positive and negative stories" about it, and "accuracy is a nicety more than a requirement for these stories" (Burt, 2008, p.1). Indeed, the activity of FTOs is based on the assumption that FT is always good whatever the product or the location. They do not carry out diligent studies claiming to measure whether FT has indeed improved the living standards of small farmers (Masseland and de Vaal, 2002, p.269).

Given that FT relies on feel-good stories to evolve and to build the reputation of its brand as an alternative trade model, it becomes relevant to analyse how these stories are disseminated and how stable the acquired reputation is. Section II reviews the literature dedicated to describing the incentives and actual effects corresponding to FT. At this point, it is worth noting that various authors express doubts with regard to the actual benefits generated by this form of trade. Section III builds on Glaeser (2005)'s to develop a model for investigating the role of feel-good stories in the development of FT. Section IV applies the model to understand why FT has expanded but also why it could collapse. Finally, section V concludes.

II. THE DEMAND FOR FT PRODUCTS

Commodity prices are highly volatile and this volatility affects the living conditions of farmers around the world. To address price volatility, numerous schemes aimed at stabilizing commodity prices have been conceived, ranging over price controls, marketing boards, stabilization funds and international commodity agreements such as STABEX, the International Coffee Agreement (ICA) and the retention plan of the Association of Coffee Producing Countries (ACPC)[7]. The preferred market instrument is the futures market. While widely used by importers, and mutual funds, futures markets cannot easily be accessed by small farmers, due to the large trading

volumes on those markets and lack of training facilities (Ronchi, 2006, p.10).

Consumers do not seem to be affected by price volatility to the same extent as producers. When producer prices are low, consumer prices remain high. This phenomenon has been termed the "coffee paradox", (Daviron and Ponte, 2006). FT aims to exploit this paradox by reducing the gap between producer and consumer price and the most commonly cited welfare gains for producers resulting from such FT actions are increased incomes, price stability, capacity building and long term social benefits.

A. Price Stability and Increased Income

Price stability and increased income are ensured by providing a minimum FT price, which varies by product and community. In all cases the aim is to cover the cost of production, the cost of living and the cost of complying with FT standards (Nicholls and Opal, 2005, p.41). The cost of production is based on surveys. The cost of living in each country is estimated through proxies such as daily interest rates and daily minimum wages. The costs of complying with FT standards include those of belonging to a co-operative, organizing a workers assembly, paperwork associated with inspections and reporting to FLO, and attending world and regional FT assembly meetings. At the outset, the FLO system was able to fund the initial costs of certification for producer groups. This practice was later abandoned as it became financially unsustainable.

The views in the literature on the benefits that this minimum price provides are mixed. In his study of farmers in Northern Nicaragua, Bacon (2005) concludes that participation in organic and FT networks does reduce vulnerability to low coffee prices. Vihinenen and Lee (2004, p.5, Table 2) note that the unit price earned by

producers operating within the FT scheme is almost four times higher than the price they receive per unit of conventional coffee. Similarly, Pariente (2000) observes that setting a base price affords a significant benefit to a co-operative of coffee producers in Costa Rica.

While not contesting these results, Leclair (2002) and Maseland and de Vaal (2002), however, raised concerns about the risk of market distortion. If producers are paid above the value of their marginal product, they observe that this would encourage higher output with risks of overproduction and of locking farmers into unprofitable activities. Such distortions are observed for instance by Castro (2001) in his Guatemalan case study. Indeed, most of the commodities targeted by FT are oversupplied. For coffee, this means that less than 20% of coffee can be sold at the FT price (Giovannucci with Koekoek, 2003). Bacon (2005, p.505) found that most farmers sell coffee to organic, FT and conventional markets, reducing the average price for all coffee sold far below the price paid by the FT scheme. Berndt (2007, p.16) mentions that Fedecocagua, the largest FT co-operative in Guatemala, sells only about 23 percent of its production to FT buyers and that Coocafe, a FT co-operative in Costa Rica, sells 20 percent as FT coffee. With regards to chocolate, the percentage of cocoa sold to FT companies is currently less than 3 per cent (Berlan, 2006, p.8). Therefore much of the cocoa produced by FT farmers is sold in the mainstream market. Dankers with Liu (2003) report that excess supply of FT bananas forced Agrofair, a Dutch Fair Trade organisation, to sell bananas at prices below the cost of production. The same authors cite the case of a coffee co-operative operating in Tanzania where the proportion of FT coffee sold is so small that the FT price hardly affects the average price received by individual farmers. This is liable to occur when producer groups that are FT certified are not guaranteed a FT purchaser.

The reason for this to occur is that FT remains a small movement. Its most widely sold product, coffee, has achieved no more than a 1-2% share of the retail coffee market in most OECD markets (Vihinen and Lee, 2004, Table 1).

Setting minimum prices above the free market price risks leaving poor producers dependent on products for which no viable market exists outside the FT system. FT may thereby prolong producers' economic dependence by reliance on a niche market of socially-conscious consumers (Leclair, 2002; Maseland and De Vaal 2002). For these authors, therefore, FT is seen as an inefficient means of transferring income from consumers to producers compared with an economically efficient direct transfer.

One solution for FT would be to focus on these products that are labour intensive with inelastic demand curves such as high quality coffee beans (Bates 1997). Maseland and de Vaal (2002) found that the price elasticity of the product determines the relative benefit of FT to producers. If demand for the product is relatively inelastic, the product will be exported even if the price of the raw material is high, thus the allocation of resources to inefficient production processes due to increased prices is not very relevant. Berndt (2007) evidenced that high quality coffee commands prices much higher than the minimum FT price, with a similarly positive effect in the volume traded. The evidence the author obtains also shows why some co-operatives, such as Coope Llano Bonito in Costa Rica, manage to sell around 40 percent of their production to FT traders, due to their location in prime growing conditions ensuring higher quality coffee, while most of the other FT co-operatives are located in low quality production area (Berndt, 2007, p.16).

An argument in favour of FT is the fact that these products have been produced by FT producers, which is in itself positive. For Becchetti and Costantino (2006) the

FT movement supports the rise of socially responsible consumers, and data provided by the "2003 Corporate social responsibility monitor" seems to support this conclusion (Business and Sustainable Development, 2003). For Krier (2005, p.5) as well, FT has become much more than a "niche market" for socially-aware and middle-class Northern consumers. FT can therefore be seen as a conveyor of positive externalities. This may be behind the decision taken by four main coffee companies, which together represent 80 per cent of the international coffee market, to implement a 'Common Code' for the Coffee Community. This decision may in part reflect the consumer education programs undertaken by the FT organizations (Williamson, 2004) that is, their influencing the behaviour of mainstream companies when sourcing their products (Tallontire, 2002). The 'Common Code' requires coffee farm workers to receive fair wages and working conditions as well as protecting their rights to join trade unions.

B. Capacity building and long-term social benefits

Capacity building and long-term social benefits are ensured by the social premium. The premium is paid to the local co-operative or farm worker association. It is considered "social" because the funded projects must involve community benefits, such as providing for health care and education (although dividend payouts are also allowed). Once the minimum FT price is calculated, the total FT price results from the sum of the minimum FT price and the social premium. In the case of coffee, for example, the minimum FT price tracks the world price determined on the New York Coffee Exchange (NYCE). It is set at $1.21/lb. The social premium was initially fixed at $0.05/lb, but increased on 1 June 2007 to $0.10/lb.[8] This guarantees that the total FT price is always *at least* 10 cents higher than the world price and never below

$1.31/lb.

For some, this premium leaves open the question of whether it makes sense to offer long-term support to local FT associations which may be inefficient, and may, thus perpetuate dependency and be a development trap (MacMillan, 2006, p.19). The counterargument is to point out that the social premium has a significant impact on investment in education as shown by Becchetti and Costantino (2006) in their study of 120 Kenyan farmers. This may suggest that the next generation will not be "trapped" and will be able to decide whether to stay on the farm or to leave based on economic considerations. Hopkins (2000) draws the conclusion from his analysis of 18 separate case studies that FT's greatest developmental strength is to be found in the area of 'capacity building'. For Raynolds (2002), there is an organisational benefit from the farmers getting together to discuss how the premium should be put to use.

We have seen in this section that views on FT are divided, with some authors more disposed than others to see benefits in the initiative. Whatever the pros and cons, nobody can deny that FT products are increasingly conspicuous on the shelves of Western supermarkets.

III. THE MODEL[9]

The FT scheme relies on creating large and sustainable demand for FT products, which requires raising public awareness to create consumer demand and thus prompt retailers to offer FT products (Levi and Linton, 2003, p.419). Some consumers may be persuaded by the positive accounts of the welfare effects of FT; for others, the decision to buy FT products can be made only after verifying the truth of the claims about FT in public awareness programmes. However, the consumer does not have at

her disposal a "large laboratory, ready to deliver current information quickly and gratuitously" Stigler (1961, p.224). This is why it is important to incorporate into the model the costs which must be born by consumers who decide to investigate the validity of the claimed benefits of FT.

A. The Demand for feel-good stories

Adapting Glaeser's (2005) model to the specific features of FT, this section analyses how FTOs make FTCs aware of FT products by organising campaigns and diffusing stories about the benefits of FT to poor producers from developing countries. Campaigns and slogans such as "the Fair Trade success story" (see Krier, 2005, p.8) are designed to shift rightwards consumer demand curves for FT products (Levi and Linton, 2003, p.408). Conditioned by FTOs stories, the FT consumer drives the expansion of FT by her demand for products certified as FT goods.

FTOs are defined as organisations promoting FT through product certification and sheltered under the FLO. The FTO stories carry little or no direct information other than that FT is beneficial. Accordingly with Nelson (1974) and Milgrom and Roberts (1986) FTOs are assumed to be only interested in selling FT, not in providing information.

FTCs are broadly defined as consumers preferring a higher price for a given quantity of a product, because they accept as true that some of the sale proceeds go to the FT producer group thereby improving their living conditions. Informed by these stories, FTCs base their purchase of the FT product on maximizing their expected payoff defined as follows:

Payoff = Income increment of FTPs + Feel-good from subsidizing FTPs – search

costs – price mark up.

FT producers (FTPs) may be farmers or workers in an association or a cooperative who join the FT scheme to improve their standard of living but have no role in this model aside from joining FT. The sale of FT products is beneficial to FTPs with probability θ. With probability $(1-\theta)$ FTPs do not benefit from FT (given the controversy in the literature reported in the previous section on the actual benefits of FT).

FTCs can assess the true extent of the benefits enjoyed by FTPs only if they undertake research which will have a cost (the search cost – s), for instance, in terms of foregone leisure time. ϕ is the probability (belief) that FTCs assign to FT stories. This probability indicates that these stories from FTOs are not enough to conclude that FT is overwhelmingly beneficial. Therefore a FTC will believe that FT products are beneficial to FTP with the following conditional probability $\theta/(\theta+\phi(1-\theta))$.

The FTC is then faced with the option of investigating the veracity of FTO stories. If she believes a story to be true without research, her feel-good factor will amount to $d\tilde{y}_0$ ($d\rangle 0$); d is the perceived positive effect of the FT scheme and $\tilde{y}_0$ is the average after tax income of FTPs. But if, after researching, she establishes beyond doubt that FT is beneficial then the certainty stemming from having verified the exactitude of the story has the effect of increasing the feel-good factor to $\delta d\tilde{y}_0$ ($\delta > 1$) but with the expense of the search cost, s. δ is the FTC's definitive assessment of the benefits of the FT scheme.

Therefore the decision whether to research depends on the search cost, characterized by a density function h(s) and its cumulative distribution H(s), which differs among FTCs according to income, location, access to internet, transportation

costs (Nelson, 1974, p.730) , tastes and time (Stigler, 1961, p.216).

For the FTC, purchasing FT product means spending the price mark up on FT goods. The margin by which FT goods on average are more expensive is denoted here as r. To make sure that spending r is optimal both for the FTC who, after research, is happy that FT is beneficial, and for the FTC who has not done any research but is nevertheless willing to buy FT products, the expected payoffs in both cases are assumed to be large enough to make them willing to buy FTPs, which implies

$$d\tilde{y}_0(\delta - \theta/(\theta + \phi(1-\theta)) \geq s$$

If a FTC does not conduct any research, her expected payoff from buying FT goods and spending r equals $\theta d\tilde{y}_0/(\theta + \phi(1-\theta)) - r$, this is assumed to be greater than zero so that FTCs want to buy FT products.

If FTC does conduct research and discovers that FTPs are not better off under FT, the net benefit is negative and equals –*s*. If she finds out that FTPs are better off, her net benefit equals $\delta d\tilde{y}_0 - s - r$. Therefore the total expected gains for FTCs from research is $\theta(\delta d\tilde{y}_0 - s - r) - s(1-\theta)$.

The FTC who has undertaken research and learned that FTPs do not benefit from FT will not buy FT products and therefore will not spend the price mark-up, saving herself net expenditure of $r - s$.

<u>Proposition 1</u>. *Investigating the veracity of the alleged FT benefits in FTOs' feel-good stories is optimal for FTCs if and only if s is less than the threshold search* costs $s^* = d\theta\tilde{y}_0(\delta - 1/(\theta + \phi(1-\theta)) + r(1-\theta)$.

Proof. For research to be undertaken by FTCs, the expected payoff of searching for proofs of FT benefits must be greater than or equal to the expected payoff from not

searching, or: $\theta(\delta d\tilde{y}_0 - s - r) - s(1-\theta) \geq \theta d\tilde{y}_0 /(\theta + \phi(1-\theta)) - r$. After transformation, this yields the following expression: $s \leq d\theta\tilde{y}_0(\delta - 1/(\theta + \phi(1-\theta)) + r(1-\theta)$.

Assuming that FTOs disseminate feel-good stories, the proportion of FTCs not doing research because they consider search costs to be too high but nevertheless accepting that FT is beneficial equals: 1 - $H(d\theta\tilde{y}_0(\delta - 1/(\theta + \phi(1-\theta)) + r(1-\theta))$.

If the FTOs' stories are not validated, then the trust placed by FTCs in FT will diminish over time, reducing FTCs' willingness to buy FT products. If FT benefits are widely acknowledged, all FTCs will want to buy FT products and pay r. FTCs who do not research will expect to gain $\theta d\tilde{y}_0 /(\theta + \phi(1-\theta)) - r \geq 0$ from buying FT products and their fraction of the FTC population is 1-H(s*). Those who search get the payoff $\theta(\delta d\tilde{y}_0 - s - r) - s(1-\theta)$. The income $\tilde{y}_0$ associated with improving the standard of living of FTPs would be at least:

$$\tilde{y}_0 = (\theta + \phi(1-\theta))((H(s^*)\theta + 1)r + (s-r)H(s^*)/(\theta d(1 - H(s^*)(1-\delta)))$$

This assumes that all r spent by FTCs goes straight to FTPs, in other words there is no dissipation of the transfer. In this setting FTPs would benefit as long as there is a continuing supply of positive stories that increase the belief of FTCs ϕ in the FT scheme.

B. The supply of feel-good stories

This section focuses on the FTO's decision to disseminate feel-good stories and their impact on FTCs' decision to buy FT products. FTOs aim to boost FT sales by making FTCs feel good about themselves by buying FT. Krier (2005) gives many examples such as the Oxfam organisations in Belgium staging 300 different activities around the "Fair Play? Fair Pay!" One initiative is often repeated in several countries (for

example the Fair Trade Town scheme which operates in the UK, Ireland and Belgium) or the FT weeks/fortnights which are now organised on an annual basis in France, the UK, Ireland and Germany.

FTOs appeal to various emotions in the materials used to develop the FT brand. One example is the label "Max Havelaar" – the main character in Eduard Douwes Dekker's 1860 novel of the same name. Max is a colonial officer who championed the cause of impoverished coffee farmers and battled against a corrupt colonial trading regime in Java (Nicholls and Opal (2005, p.10). The stories disseminated often concern one individual or a small group of FTPs. Such stories lack any tracking of how FTPs performed over time as a result of joining the FT scheme. Data are too sporadic to permit any demonstration that FT is overwhelmingly beneficial. Below typical extracts from such stories to be found on the Fairtrade website are reproduced:

> "The guarantee of the minimum price brings stability. We, producers, are not totally subjected to the law of supply and demand. We know that we will be paid at least US$69 the quintal. This guarantee makes it possible to plan long term, to invest, to develop technical support, in one word, to develop our business", says Felipe Cancari Capcha, a producer from El Ceibo Cooperative, a Fairtrade cocoa producer in Bolivia. (Source: http://www.fairtrade.net/impact.htm).

Or this one:

> "In 2001 and 2002, during the world coffee crises, our situation was desperate. We received between 20 - 25 dollars per quintal (quintal = 100 pounds, 25 US$ per quintal = 0.25 US$/lb) ... many of the Ecuadorian coffee producers

> left. We did not have any other choice but to abandon the coffee culture" explains Valentín Chinchay, a member of FAPECAFES, a Fairtrade Certified Coffee Cooperative in Ecuador. "We are currently selling 80 % of our total coffee production under Fairtrade terms. But more important than the higher prices is the stability that Fairtrade brings. We are not as vulnerable to market volatility as we used to be." (Source: http://www.fairtrade.net/coffee.htm).

As in Glaeser (2005, p.58) FTOs disseminate these stories at a cost *K*. *K* denotes campaign spending. Examples of the range of these campaign costs can be found in Krier (2005, p.31) reporting that more than €18.3m is spent annually on education, public relations and marketing by FTOs (€11.4m by importing organizations, €1.7m by Worldshops associations, and €5.1m by labelling initiatives). *K* also varies depending on the organizations' capabilities in terms of experience and on the difficulty of raising funds which is denoted by the variable *c*. *c* depends on the size of FTOs – the larger the organization the lower values of *c*. It also depends on the location, for instance it seems easier for European FTOs to raise funds than for American ones. France, Germany, the UK and the EU support such campaigns by directing financial assistance to FTOs aimed at enhancing consumer awareness of FT products (European Commission (2003). Nicholls and Opal (2005, p.136) mention that Max Havelaar France received more than 40 per cent of its 2002 budget from the French ministries of Foreign and Social Affairs. These authors also mention that the UK Department for International Development (DFID) has provided aid to Fair Trade schemes through Traidcraft. Sidwell (2008) gives the figure of £1.8 million granted by DFID to the Fairtrade foundation between 1999 and 2007.

Membership in the FT scheme offers benefits to FTPs in the form of higher a

farm gate price and social premium. This is a transfer of income from FTCs to FTPs denoted t_R. From this unit transfer must be deducted the certification and annual inspection fees that FTPs have to pay in order to be part of FT at level t_A. The certification basis fee varies depending on the number of farmers or workers in the producer group (Table 1).

Therefore, the total benefit per unit of FT product going to FTPs equals $(t_R - t_A)y$, where y stands for the FTPs' previous income. The average income difference between FTPs and non FT producers (NFTPs)' equals $(1-nftp)\Delta_y$ where 1-*nftp* is the share of producers belonging to FT and Δ_y is the previous mean income of FTPs minus the mean income of NFTPs. The FT story aims to increase FTPs income by $(t_R - t_A)(1-nftp)\Delta_y$ relative to NFTPs.

<u>*Proposition 2.*</u> *Feel-good stories benefit FTPs if and only if*

(1) $(t_R - t_A)(1-nftp)r(1-H(s^*)(1-\theta))>0$

Proof. With feel-good stories, a proportion *1-H(s*)* of FTCs buy FT goods on the strength of feel good stories, because it is too costly for them to carry out background research on FT (proposition 1). Thus, the expected net gain for FTPs is $(t_R - t_A)(1-nftp)r(\theta+(1-\theta)(1-H(s^*)))$, which must be positive to make FTPs interested in taking part in the FT scheme.

Glaeser (2005, p.65) mentions that considerations other than income are important in many examples of hatred. Similarly, FTCs's motivation for buying FT may be conditional not only on income but also on other concerns such as religious

beliefs. These beliefs are appealed to by FTOs as shown by Levi and Linton (2003, p.420) who refer to an article in the National Catholic Reporter reminding its parishioners that "when the coffeehouse craze meets the demands of contemporary Catholic identity, young Catholics have a unique responsibility to conform their coffee purchases to a tightly formed conscience." These authors also mention one Seattle synagogue buying from Equal exchange because its social action committee singled out buying FT products as a way to combat injustice. Therefore FTCs' buying of FT is conditioned both by FTCs' income *I* and another variable *x*, along the cumulative distributions $F_0^x(.)$ and $F_I^x(.)$, respectively, and where $\hat{x}$ denotes the average level of *x* among FTCs. With parameter *x*, the transfer from FTCs to FTPs is proportionate to the difference in, for example, religious beliefs of that individual to the average level among FTCs $\tau(x-\hat{x})$. τ is a coefficient of proportionality between FTCs' religious or benevolence impulses and how much they want consequently to spend on FT.

If positive stories are disseminated by FTOs, the proportion *P* of FTCs buying FT goods equals (1-*H(s*))* $\theta/(\theta+\phi(1-\theta))+\theta$*H(s*). Then, assuming independent distribution of religious beliefs and income among FTCs, the total transfer of income to FTPs from FTCs with above average religious commitment is

(2) $(1-nftp)P(F_0^x(X|x>\hat{x})-\hat{x})\tau F_I$

Assuming that the sale of FT products is always beneficial to FTPs, FTOs disseminate feel-good stories at a cost *K* implying:

<u>Proposition 3</u>. *There exists a value of K, denoted K*, and also a value* θ^* *at which FTOs are indifferent between disseminating feel-good stories and not disseminating them.*

Proof. By definition, FTOs maximize the positive value of the net transfer to FTPs: $(1-nftp)P(F_0^x(x)-\hat{x})\tau F_I$ - Kc. If FTOs do not send any stories at all, then P, the proportion of FTCs who buy FT goods, becomes identical with θ the probability that FT benefits FTPs. The K* which satisfies $(1-nftp)P(F_0^x(x)-\hat{x})\tau F_I$ - K^*c = $(1-nftp)(F_0^x(x)-\hat{x})\tau\theta F_I$ generates the same outcome for FTPs. That is to say spending more and more on advertising FT leads ultimately to the same outcome for poor producers as does not advertising at all. This is because the money used for advertising is diverted from poor producers. Hence at K^*, FTOs are indifferent between sending or not communicating stories to FTCs. Consider equation $\theta = P\text{-}Kc/((1-nftp)(F_0^x(x)-\hat{x})\tau F_I)$. The right hand side of this equation is a continuous function with $0 \le \theta \le 1$. If nftp <<1, F_I>>0 and $F_0^x(x)-\hat{x}$>>0 then according to Brouwer's fixed point theorem, there exists a solution θ^* to this equation. If θ is too small, FTOs will not disseminate any story. For a large enough θ , FTOs can start raising funds to finance their campaigns.

For values of K above K^*, the payoff is negative and FTOs prefer not to incur the costs of a campaign. For values of K below K^*, FTOs will engage in a campaign of "success stories" as reported by Krier (2005).

The probability ϕ that FTCs assign to FTOs' stories at equilibrium equals some function G(K*). FTOs' maximum campaign spending, *K**, is taken to mean an increase in the supply of FT stories at a given price. As *c* the cost of raising funds falls, *K** rises, making FTOs spend more on the dissemination of feel-good stories. FT becomes more popular. FTOs with more resources – which at present are the European–based ones (Levi and Linton, 2003, p.419) – are more likely to disseminate feel-good stories than poorer FTOs such as those in the US. With the FTC's perceived positive effect of the FT scheme, *d*, rising, FTCs who want to help poor producers are increasingly convinced that the FT scheme is good for FTPs. They feel good about it and buy the FT product. Similarly when FTC's definitive assessment of the benefits of the FT scheme, δ, rises, FTCs are more willing to pay a price mark up.

θ determines the conditional probability $\theta/(\theta+\phi(1-\theta))$ that FTCs place in the feel-good story being accurate. A high probability means that FTCs have less incentive to probe FT stories as they are already convinced that FT is beneficial to FTPs. Such conviction should ensure the success of FT's campaigns.

IV. TRUST AND FT

If "Fairtrader's first challenge has been to get consumers to ask," (Levi and Linton, 2003, p.419) – in the sense of questioning the conditions in which the items they purchase are produced – then this same spirit of enquiry and concern for accountability will also incline consumers to ask questions about FT. Indeed, trust may be shaken if benefits which small producers or workers get out of the FT arrangement are perceived as being relatively small or at least not as important as claimed by the FTOs.

For a start, FT affects very few producers. FLO reports on its site that there were 241 certified coffee producers' organizations at the end of 2006 (see http://www.fairtrade.net/coffee.htm). Assuming with Kohler (2006, p.23) that each coffee producing association comprises on average 500 workers; this means that FT will have benefited 120,500 workers out of the 25 million coffee producers, or 0.48 percent. These beneficiaries may even be concentrated in the larger producing organisations, because of the difficulties faced by small producer groups in certifying their conformity with standards. (Note that high prices and limited accessibility of imported services usually operate preventing small producers to achieve such standards). Even though the FLO does employ a spectrum of grades and categories (see Table 1), the costs of certification may pose a significant barrier to entry for the inclusion of small producer groups.

[TABLE 1 HERE]

While FLO is responsible for establishing producer guidelines and minimum pricing in order for any product to carry the FT mark, the complexity and resource consuming nature of this process mean that only a few new product groups succeed in being certified each year. Registration of additional groups meeting FT standards can be difficult due to insufficient demand for their products, or else their inclusion further dilutes the benefits for other FT producers (Redfern and Snedker, 2002). FT can give certain groups advantages over others because it is not a universally accessible scheme. Tallontire (2002, p.18) builds on this in arguing that FT appears to embrace a 'natural selection' perspective which, for Oswald de Rivero (2001) is the very feature of conventional trade that is most blameworthy for its aggravation of

global social injustice.

Howse and Trebilcock, (1996, p.61) mention that the relatively small impact of FT leads some authors to view fairtraders as 'charlatans, protectionists masquerading as moralists'. This view is furthered by stories such as the one reported by Hal Weitzman (2006) of Coronel Vasquez Bernardino, a coffee labourer from Peru, unaware that he is paid below the minimum wage and unaware that he is picking FT coffee. In a similar line, Berndt's (2007) thorough analysis of FT in coffee production in Costa Rica and Guatemala supports this view showing that the FT scheme excludes the seasonal labourers who constitute the poorest segment of the coffee industry. The author remarks that according to FT rules members of FT are small landowners, not seasonal labourers who supply the bulk of labour during the harvest season. She demonstrates that that while FT recommends that seasonal labourers should be paid the minimum wage, no documentation is insisted upon to certify that this is what occurs.

So if the FT scheme is not as beneficial to the poor as claimed by the FTOs, whom does it benefit? The FTOs are bound by their status as non-profit or charity organizations. Kohler (2006, pp.27-28) finds that 83 per cent of Fairtrade foundation expenses are attributable to traders' and manufacturers' certification fee income. He also points out, though, that benefits drawn by FTOs from the scheme can be viewed as a necessary externality and these are not on a scale to undermine the trust that consumers have in the scheme. More damaging, however, may be the benefits accruing to retailers, this being the one factor which may undermine the willingness of FTCs to buy FT products.

In contrast to FTOs, retailers are not charities and seem to be doing well out of the FT scheme either financially or as a marketing tool to improve their reputation,

what Kohler (2006, p.29) calls image improvement or "clean washing". Vihinen and Lee (2004, p.6) quote a report undertaken by Max Havelaar (2003) in France suggesting that the FT price mark up not only covers the increased margin which FTPs obtain under the scheme, but also allows retailers to increase their margins. Some UK supermarket chains such as Sainsbury and Tesco may charge higher margins on FT goods than on non-FT goods, because they know that consumers are expecting to pay more for FT (Stecklow and White, 2004). Interestingly, Kohler (2006, footnote 45, p.29) reports that the Fairtrade Foundation's response to such findings has been to indicate that its role is to ensure a fair price for producers, not to check supermarkets' practices. However applicable this may be, though, the Fairtrade Foundation risks damage to its brand from even anecdotal evidence about such practices by retailers.

Once again, this paper does not claim to provide a measure of FT impacts, but it rather seeks to gauge the impact of stories on the development of FT. One way to undermine FT would be to use the same methods as FT itself that is to spread stories about how FT may actually not be so beneficial to FTPs. Let us take the example of the claim that FT is a lucrative niche for retailers (FTRs).

With feel-good (and uniform densities) support for FT, margins increase when the FT scheme is shown to benefit poor producers. The assumption is that FTRs enjoy a profit margin from using the FT brand and that they keep χ_r for themselves and redistribute χ_a to FTPs. The FT scheme is at risk when $\chi_r > \chi_a$ as FTCs might see the FT scheme as beneficial primarily for retailers rather than producers. Support for the FT scheme is assumed to rise if and only if the scheme is shown to be more favourable to producers than to retailers:

(3) $\chi_a + (t_R - t_A)(1 - nftp) > \chi_r$

If χ_r rises, FTCs' propensity to buy FT products declines.

Having access to information through research, non FT organizations (NFTOs) such as journalists, academics, think tanks and competitors can either challenge or support the FTOs' dissemination of feel-good stories. For example Sidwell (2008, p.11) from The Adam Smith Institute alleges that FTRs retain most of the profit margin: "Fairtrade is an inefficient way to transfer money with 90% of the premium paid going to retailers."

The cost entailed by both the FTRs/FTOs and NFTOs of spreading positive/negative stories is denoted $A+\alpha$. The FTC and the NFTO know the value of A which is a constant. They also know that α is distributed with a cumulative distribution $J(\alpha)$.

<u>Proposition 4</u> *There exists a value of α, denoted α^*, at which NFTOs are indifferent towards the spread of FT feel-good stories; at values of α below α^* the NFTOs strictly prefer denigrating the FT scheme; and for values of α above α^* the NFTO prefer to support and reinforce it.*

Proof. Assuming that NFTOs are concerned that the inequality (3) should hold:

$\chi_a + (t_R - t_A)\ (1-nftp)P(F_0^x(x)-\hat{x})\tau F_I$ - Kc >χ_r, - (A+α), which implies

α> $\chi_a + (t_R - t_A)\ (1-nftp)P(F_0^x(x)-\hat{x})\tau F_I$ - Kc +A-χ_r = α^*. The value of α^* is falling with increasing H(s) and the value of K^* is rising with A and c, and if $H = \tilde{H}(s) + \overline{H}$ then the value of α^* is falling with average $\overline{H}$.

Diffusing negative stories against FT is deterred by an increasing feel-good

factor, as shown by the comparative static on $\overline{H}$. FTCs who feel good are unlikely to react to negative stories. The price of challenging this feel-good factor rises as the factor spreads among the population. This explains why, despite a certain amount of noise about retailers' margins and doubts about the actual benefits of FT to producers, the FT scheme is developing and spreading successfully. This result accords with the literature on social influences on prices and behaviour (Becker, 1991).

V. CONCLUSION

This paper has shown how the FT movement is able to capitalize on the feel-good factor by spreading stories about improvements in the living conditions of poor producers as a result of their participation in the FT scheme. By being confronted with stories of good deeds, consumers with a natural inclination to benevolence can be convinced that the FT scheme is beneficial to small producers in developing countries. The supply of feel-good stories is generated by the FT scheme opposing itself to conventional international trade. FTOs will build stories to entice consumers to buy FT products, arguing that buying FT products is ethical. The probability which the FT consumer assigns to FT stories is determined by the strength of the feel-good effect. If that effect is intense, negative stories about FT will have only minor impacts.

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TABLE

Table 1 - Certification Basic Fee

Category	Indicator	Full Inspection	Inspector days		Surveillance Inspection		
Farmers		Total days	On site	Fee	Total days	Inspector days on site	Fee
A	< 50	2	0.75	€ 700.00	2	0.75	€ 700.00
B	50 – 100	2	0.75	€ 700.00	2	0.75	€ 700.00
C	101 – 250	2.25	1	€ 787.50	2	0.75	€ 700.00
D	251 – 500	2.5	1.25	€ 875.00	2.25	1	€ 787.50
E	501 – 1000	3	1.75	€ 1,050.00	2.5	1.25	€ 875.00
F	1000	3.5	2.25	€ 1,225.00	2.75	1.5	€ 962.50

Note: The certification basic fee is calculated for one product. For each additional product €175.00 (in case of surveillance inspection: €87.50) is added to the certification fee. If the promoting body or the producer group run a processing installation a fee of between €87.50 - €350.00 is charged by FLO-CERT. The size of the fee depends on the number of workers employed at the processing installations. Additional fees for additional products or processing installations are included in the fee system to allow the inspector sufficient time to inspect the additional cultivation areas and processing units. In addition, the amount of the certification fee can change due to one or more of the following modifications: in cases where the promoting body supports more producer groups, the inspection of individual contract production projects may be combined. The number of days the inspector spends at the central inspection of the promoting body may be reduced and deducted from the certification fee. The deduction will be disclosed in the certification invoice.

Source: FLO-Cert (January 2007).

Appendix I: Variable Definitions

Variables	*Definitions*
FT	Fairtrade
FTO	Fairtrade organisations
FTC	Fairtrade consumer
FTP	Fairtrade producer
θ	probability that the sale of FT products is beneficial to FTPs
1-θ	probability that the sale of FT products is not beneficial to FTPs
s	search cost
ϕ	probability that FTCs assign to FT stories
$d\tilde{y}_0$	FTC's feel good factor
d	FTC's perceived positive effect of the FT scheme
$\tilde{y}_0$	average after tax income of FTPs
$\delta d\tilde{y}_0$	increased feel good factor after search
δ	FTC's definitive assessment of the benefits of the FT scheme.
r	price mark up on FT goods
K	FTOs' campaign spending
K*	FTOs' maximum campaign spending
c	FTOs' cost of raising funds
tR	transfer of income from FTCs to FTPs in the form of higher a farm gate price and social premiun
tA	certification and annual inspection fees that FTPs have to pay in order to be part of FT.
y	FTPs' previous income
1-nftp	share of producers belonging to FT
Δ_y	previous mean income of FTPs minus the mean income of NFTPs
x	religious beliefs or benevolence impulses.
$\hat{x}$	average level of x among FTCs
τ	coefficient of proportionality between FTCs' religious or benevolence impulses and how much they want consequently to spend on FT.
P	the proportion of FTCs buying FT goods
χ_r	share of FTRs' profit margin from using the FT brand kept by FTRs
χ_a	share of FTRs' profit margin from using the FT brand redistributed to FTPs
$A+\alpha$	cost entailed by both the FTRs/FTOs and NFTOs of spreading positive/negative stories.
A	constant

[1] See ISEAL Alliance, http://www.isealalliance.org/

[2] For details on FLO, see http://www.fairtrade.net/.

[3] See Rabin (1993) for a formalization of fairness.

[4] An analysis of the role of emotions can be found in Frank (1988).

[5] See Vihinen and Lee (2004, pp. 11-13) and Nicholls and Opal (2005, pp. 8-9) for a detailed exposition of FTOs.

[6] http://www.fairtrade.org.uk/includes/documents/cm_docs/2008/f/fortnight2008_commercial.pdf.

[7] For a clear discussion of these schemes, see Leclair, (2002, p.957), Bacon, (2005, p.498), Kohler, (2006, p.3) and Levi and Linton, (2003, p.415).

[8] See http://www.fairtrade.net/coffee.html.

[9] Variable definitions are reported in Appendix I.