Fair Trade Coffee Enthusiasts Should Confront Reality

Jeremy Weber

From university cafeterias to supermarkets in the developed world, people are buying Fair Trade (FT) coffee certified by the FLO-Cert, the certifying entity of Fairtrade Labelling Organizations International (FLO). The assumption is that such purchases will contribute to the welfare of marginalized producers in the developing world. While sales of FT coffee in Europe have stabilized, the North American and Japanese markets are growing rapidly. Total sales increased 40 percent from 2004 to 2005, to a total volume of 33,992 metric tons (MT) (FTO 2005).

What is "Fair Trade"? According to FINE, the umbrella organization that comprises the four largest Fair Trade organizations (FLO, International Federation for Alternative Trade, Network of European World Shops, and the European Fair Trade Association),

> Fair Trade is a trading partnership, based on dialogue, transparency and respect, that seeks greater equity in international trade. It contributes to sustainable development by offering better trading conditions to, and securing the rights of, marginalized producers and workers—especially in the South [FINE 2001].

The FINE definition optimistically assumes that the trading partnerships and conditions promoted by Fair Trade necessarily "contribute to sustainable development." It is true that the Fair Trade coffee system—the producers, exporters, importers, and retailers operating by the rules and standards of FLO—has improved living standards for many participating coffee growers (Bacon 2005, Raynolds 2004). Yet the system faces vexing issues such as a disconnect between promotional materials and reality, excess supply, and the marginalization of

---

Cato Journal, Vol. 27, No. 1 (Winter 2007).

Jeremy Weber is a graduate student in the Agricultural and Applied Economics Department at the University of Wisconsin-Madison. He spent 10 months in Peru researching Fair Trade coffee and working with coffee producer organizations with the support of a Fulbright grant.

economically disadvantaged producers and groups. Those involved in Fair Trade coffee debates and governance must address these issues if Fair Trade is to be an effective mechanism for rural development in coffee producing regions.

The Search for Culprits

Unfortunately, many of those close to the movement prefer to blame profit-seeking corporations for hijacking Fair Trade instead of objectively analyzing the workings of the Fair Trade coffee system. For example, the financial manager of a Peruvian Fair Trade coffee exporter explained to me that his company's critique of FLO is that it will allow companies like Nestle to participate, even though such companies are only in Fair Trade for the profit. Never mind that the company he works for is a privately owned, for-profit export company. As Adam Smith so well noted, the interest of the merchants (including coffee exporters) is always to narrow the competition and expand the market. Likewise, the executive director of a major retailer of Fair Trade coffee assured me that the problem with Fair Trade is the participation of too many ideologically uncommitted entities. Even though this director was new to the job and had never visited a Fair Trade coffee cooperative, he had already determined the cause of the problem. This knee-jerk, blame-greedy-corporations reaction is common among Fair Trade enthusiasts. At the 2nd International Fair Trade Colloquium held in Montreal in June of 2006 the hot topic was the participation of large corporations in the Fair Trade coffee system (Nebenzahl 2006).

The Gap: Promotional Materials and Reality

While the participation of large transnational companies may alter the dynamics of the Fair Trade coffee system, Fair Trade faces more serious practical issues. A large gap divides the story depicted by Fair Trade marketing materials from the standards of FLO and the advantages of producer participation. This misleading representation of Fair Trade has led many socially conscious coffee drinkers to hold unexamined assumptions about the benefits of Fair Trade.

In trying to boost sales many retailers claim that Fair Trade coffee guarantees a living wage to coffee growers. A major promoter of Fair Trade coffee, Global Exchange (2005), states on its website, "Fair Trade guarantees to poor farmers organized in cooperatives around the world: a living wage." While it remains to be seen what constitutes a "living wage," in reality, Fair Trade guarantees nothing to producers.

Fair Trade ensures a minimum price to *organizations* of producers, but not to individual producers. The organization serves as an intermediary between the producer and the market. Producers receive the price stipulated in the organization's export contract, which must meet or exceed the Fair Trade minimum price, minus the expenses of the organization. Since Fair Trade eliminates "unnecessary" intermediaries, producer organizations must perform the tasks previously conducted by those intermediaries. In this arrangement, an organization must obtain financing to buy coffee from its members, sort and process coffee, and coordinate export logistics. Each of those activities generates expenses which, if not managed effectively and efficiently, can consume much of the higher Fair Trade price before it reaches growers. In some cases, organizations' export costs have been high enough to induce member producers to sell to the local market instead of to their organization for the Fair Trade market.[1]

Many Fair Trade coffee drinkers also believe that hired laborers on a Fair Trade certified coffee farm receive a minimum wage of some sort. In the case of coffee sold by producer organizations, wage standards only apply to employees of the organization. Specific standards regarding temporary workers hired by coffee farmers do not exist. Most hired labor on small-scale coffee farms, however, is seasonal. Standards for small farmers' organizations state, "Where workers are casually hired by farmers themselves, the organizations should take steps to improve working conditions and to ensure that such workers share the benefits of Fair Trade" (FLO 2005). Hal Weitzman of the *Financial Times* visited five Fair Trade farms in northern Peru and found that four of the farms paid workers below the Peruvian minimum wage (Weitzman 2006).

Such payments do not violate Fair Trade standards. In its response to the Weitzman article, the Fair Trade Foundation reiterated its norms regarding workers hired by small-scale producers and recognized "that the members of these producer organisations are small farmers who struggle to earn a decent livelihood for themselves and their families" (The Fairtrade Foundation 2006). Unfortunately, Fair Trade promotional materials have lured coffee drinkers into believing that Fair Trade guarantees farmers and workers a fair or

[1]This situation is exacerbated as the price in the conventional coffee market rises. Higher costs associated with Fair Trade coffee require that the Fair Trade price maintain a significant margin above the conventional price. If the conventional price rises above the Fair Trade minimum price, according to Fair Trade rules the importer must offer the supplying organization at least the market price plus five cents per pound.

living wage, which most consumers probably interpret to mean a wage at or above the legal minimum in the coffee-producing country.

Trying to Strong-Arm the Market

Another pressing matter that has received little attention in Fair Trade circles concerns primary and secondary effects of the Fair Trade movement's attempt to strong-arm the market by establishing a minimum price of $1.24 per pound.[2] A price floor is created if the world coffee market price is less than $1.24. As anyone who has taken basic economics would predict, a minimum price set above the market price will act as a price floor, leading to excess supply. This has been the case in the Fair Trade coffee market. The above-market price, however, does little to increase coffee production as suggested recently in *The Economist* (2006). Most Fair Trade certified producers sell a fraction of their coffee to the Fair Trade market and the rest to the conventional market. FLO increases the supply of Fair Trade coffee by certifying additional producer organizations and channeling existing production into the Fair Trade market, not by inducing farmers to grow more coffee.

The imbalance between the supply of Fair Trade certified coffee and consumer demand has existed for at least 10 years. Bob Thomson, the former director of Fair TradeMark Canada, affirmed in 1995 that Fair Trade producers had a productive capacity of 250,000 MT of coffee for a demand of only 11,000 MT (Thomson 1995). In other words, the market only purchased around 13 percent of the production of certified coffee producers' organizations.[3] The imbalance between supply and demand was significant enough to cause FLO to temporarily close their registry to new members in 2002 (Vizcarra 2002). FLO estimated that the supply of Fair Trade certified coffee in Latin America, Asia, and Africa in 2002 was seven times greater than the quantity exported through Fair Trade channels (Murray, Raynolds, Taylor 2003).

The experience of the Peruvian coffee producer association, the Association of Ecological Producers (APROECO), confirms this

[2]This price includes the five cents per pound social premium given by Fair Trade and refers to Arabica-washed conventional coffee from South America.

[3]In most industries, capacity does not equal production. In the Fair Trade system, however, most certified organizations only sell a fraction of what they produce to the Fair Trade market even though all of their coffee is technically Fair Trade certified. In other words, excess capacity refers to Fair Trade certified coffee being sold in the conventional market as opposed to an unharvested crop or fallow land.

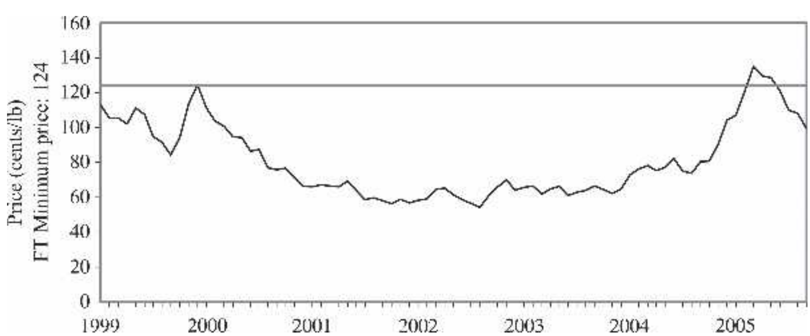
reality. When APROECO applied for certification in 2001, FLO told the association that it already had 280 pending applications, but that it could prioritize APROECO's application if the association had a buyer.[4] Because the global coffee market suffered a profound crisis in the beginning of this decade, it is not surprising that there were 280 applications before that of APROECO. At the end of 2000, coffee prices dropped from about $1.10 per pound to $0.65 per pound. Prices only began to rise in 2004.

Figure 1 depicts the Fair Trade minimum price and the conventional market price during the coffee crises. The large gap between the Fair Trade price and the conventional price represents the incentive to obtain the FLO certification and sell to the Fair Trade market. Of course, if there were a free market, new entrants would increase supply and decrease price. The minimum price of $1.24 per pound, by definition, prevents that outcome. The problem with an excess supply of certified coffee is not that large quantities of coffee are dumped on world markets. Rather, the problem is that an excess supply results in increased barriers to entry and increased competition among producer organizations for a limited number of Fair Trade contracts. In particular, the increased difficulty of entering the Fair Trade market threatens to exclude the marginalized coffee growers who Fair Trade supposedly supports.

With an excess supply of coffee, the Fair Trade market has increasingly demanded organic coffee. The dual certification of Fair

FIGURE 1

ARABICA COFFEE MONTHLY PRICES, 1999–2005



SOURCE: International Coffee Organization.

[4]Interview with Orlando Diaz, 9/10/2005. As a manager of the coffee export company Pronatur, Diaz coordinated the certification processes for APROECO.

Trade and organic has allowed coffee organizations to differentiate their coffee in a saturated market. Between 1996 and 2000, exports of dual certified coffee (Fair Trade and organic) grew from 86.25 MT to 5,096 MT, an increase of about 5,800 percent (Raynolds 2002). According to Fair Trade fast facts, approximately 85 percent of Fair Trade coffee sold in the United States is certified organic (TransFair USA 2006).[5]

Quality standards have risen significantly since 2000. Furthermore, beginning in 2004 FLO began charging producer organizations $3,200 to become certified.[6] These increasing demands are easily understood when viewed in a market context of excess supply. In other words, barriers to entering the Fair Trade market have intensified to equilibrate supply and demand in a market with a price floor.

Entry barriers affect who participates in the market. Entering the Fair Trade coffee market, especially the Fair Trade organic market, presents major difficulties for young producer organizations. Without assistance from development organizations or export companies, the very organizations and producers that Fair Trade targets have little chance of participating in the market. Obtaining the certification of the FLO requires someone within the organization to coordinate the involved certification process. The soliciting organization must also obtain an export contract and the necessary financing to buy and export coffee. Most organizations need around $15,000 in financing to export one container of Fair Trade coffee. That short-term financing is needed to complement the prefinancing offered by the Fair Trade importer. (The FLO requires Fair Trade importers to provide a minimum prefinancing of 60 percent of the value of the export contract.) In addition, the organization needs $3,200 to pay FLO for its certification (Weber 2006).

Since the Fair Trade coffee market is consistently demanding more and more organic coffee, many organizations find that they must become organic certified to obtain export contracts. The organic certification process is more expensive and demanding than that of FLO. Most organic certification programs last three years. Each year requires an external inspection from the certifying entity. An external inspection for an organization of 100 producers can generally cost

[5]TransFair USA is a member of FLO and is the only organization that audits Fair Trade transactions in the United States.

[6]This fee varies depending on the size and nature of the organization being certified. The current fee listed by TransFair USA is €2,000 for a first-level organization of less than 500 producers.

around $2,000. The more significant cost, however, is in providing technical assistance in organic production norms to participating farmers. The total cost of implementing an organic certification program in four Peruvian coffee organizations ranged from $300 to more than $1,000 per producer (Weber 2006).

Increased barriers to entry have made it increasingly difficult for marginalized producers, which Fair Trade supposedly targets, to participate. As in most industries, increasing barriers to entry benefits those already established in the market. Such is the case in the Fair Trade coffee market, which is dominated primarily by those privileged groups who entered the market in its less competitive days. The Fair Trade model based on a minimum price will inevitably produce a tension between concentrating market shares to a few groups, which leaves many out of the Fair Trade system, and distributing market shares to many groups, which results in each producer selling only a fraction of his production to the Fair Trade market.

Where to Go From Here? Get Comfortable with the Market

A troubling gap lies between the purported benefits of Fair Trade and reality. Nevertheless, participation in Fair Trade networks has undoubtedly generated benefits for many producers. Integrating new producer groups into Fair Trade, however, depends on the size of the market. Ironically, the most obvious way to increase coffee sales, enlisting the resources of mainstream coffee retailers, is seen by many enthusiasts as the biggest threat facing Fair Trade. The ideal of the Fair Trade movement is the participation of entities whose business is 100 percent Fair Trade certified. In reality, Starbucks is the largest purchaser of Fair Trade coffee in North America although Fair Trade coffee only comprises 3.7 percent of the company's purchases.[7]

Sue Mecklenburg, the vice president of sustainable procurement for Starbucks, believes that a pressing question is, "Can Fair Trade get comfortable in the competitive market?" The size of the Fair Trade coffee market and the competitiveness of the entities that link producers to the market affect Fair Trade's ability to generate benefits for producers. As stated previously, poor management of the export process by producer organizations can consume much of the higher Fair Trade price before it reaches growers. Some producer organizations such as APROECO in Peru have entered partnerships

[7]Interview with Sue Mecklenburg, September 11, 2006.

with companies to capitalize on the scale and expertise of private export companies. APROECO's relationship with a private export company also allowed the organization to overcome the entry barriers of the Fair Trade and organic markets (e.g., certification and contractual costs). A study of Costa Rican coffee mills by Loraine Ronchi of the World Bank suggests that such partnerships may increase prices paid to farmers. The study found that Fair Trade cooperative mills had lower price markdowns (defined as the difference between the price paid to mills and the price that mills paid to coffee farmers) than non-Fair Trade, nonforeign-owned mills. At the same time, vertically integrated multinational mills had a similar effect of lowering price markdowns when compared with nonforeign-owned mills (Ronchi 2006). FLO should welcome partnerships between producer organizations and private companies instead of insisting that producer organizations assume all export responsibilities. Social justice goals and efficiency can complement each other.

If Fair Trade is dominated by those who see mainstream for-profit companies as intrinsically destructive, the movement will remain a fringe, niche market that supports a few privileged groups. Fair Trade enthusiasts must spend more time asking hard, practical questions about how Fair Trade functions and less time searching for enemies. Only with a strong dose of practicality and self-critique can the Fair Trade movement create an effective mechanism for promoting development in coffee-producing communities.

References

Bacon, C. (2005) "Confronting the Coffee Crisis: Can Fair Trade, Organic, and Specialty Coffees Reduce Small-Scale Farmer Vulnerability in Northern Nicaragua?" *World Development* 33 (3): 497–511.

The Economist (2006) "Voting with Your Trolley: Food Politics." (9 December).

The Fairtrade Foundation (2006) "Fairtrade Foundation Response to *Financial Times* Article" (11 September). Available at www.fairtrade.org.uk/pr110906.htm.

Fairtrade Labelling Organizations International (FLO) (2005) "Delivering Opportunities: Annual Report, 2005–2006." Available at www.fairtrade.net/uploads/media/FLO_Annual_Report_05.pdf.

FINE (2001) "Fair Trade Definition and Principles as agreed by FINE in December 2001." Available at www.eFair TradeaFair Trade.org/pdf/Fair-TDAP.pdf.

Global Exchange (2005) "What is Fair Trade Coffee All About?" Available at www.globalexchange.org/campaigns/fairtrade/coffee/background.html.

Murray, D.; Raynolds, L. T.; and Taylor, P. L. (2003) "One Cup at a Time:

Fair Trade and Poverty Alleviation in Latin America." Available at www.colostate.edu/Depts/Sociology/Fair TradeResearchGroup.

——— (2004) "Building Producer Capacity via Global Networks." *Journal of International Development* 16 (8): 1109–21.

Nebenzahl, D. (2006) "Corporate Big Boys Smell the Coffee." *The Gazette* (16 June).

Raynolds, L.T. (2002) "Poverty Alleviation through the Participation in Fair Trade Networks: Existing Research and Critical Issues." Available at www.colostate.edu/Depts/Sociology/Fair TradeResearchGroup.

Ronchi, L. (2006) " 'Fairtrade' and Market Failures in Agricultural Commodity Markets." World Bank Policy Research Working Paper No. 4011 (September). Available at http://econ.worldbank.org.

Thomson, B. (1995) "Lessons Learned: Fair Trade and CED." Paper presented at the conference "Community Enterprise Development and Globalization" (November). Available at www.globalexchange.org/campaigns/fairtrade/coffee/coffeeBib.html.

TransFair USA (2006) "Fast Facts: Fair Trade Certified Specialty Coffee." Available at www.transfairusa.org/pdfs/fastfacts_coffee.pdf.

Vizcarra, G. K. (2002) "El Comercio Justo: Una Alternativa para la Agroindustria Rural en América Latina." Organización de las Naciones Unidas para la Agricultura y la Alimentación, Oficina Regional para América Latina y el Caribe (January). Available at www.rlc.fao.org/prior/desrural/agroindustria/pdf/comerjus.pdf.

Weber, J. (2006) "Rationing in the Fair Trade Coffee Market: Who Enters and How?" Paper presented at "The Second International Colloquium: Fair Trade and Sustainable Development," University of Quebec, Montreal, June 19–21.

Weitzman, H. (2006) "The Bitter Cost of 'Fair Trade' Coffee." *Financial Times* (8 September).