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Unfair Fair Trade

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Ideological trolley

Politics is everywhere, not only in the White House or in Congress, but even in your fridge. Every day, when we shop, we vote with our wallets who should and should not produce and deliver products we buy. To make the vote we estimate which products represent the best quality for the best price and make a decision. But the revolution is coming. The leaders of the consumer revolution propose morally higher factors that should drive our consumer behavior. For example, we should consider poor people who produce the products we buy and “if the message is frequent, loud and consistent enough, then they (consumers – JS) can actually change practices, and we see that happening on the ground”¹, says Chris Wille of the Rainforest Alliance, a conservation group. The assumption that not only price and quality but the bad situation of marginalized producers in the developing world should drive the consumers' behavior is the base for the new proposition for world trade.

One of the strategies to challenge the “injustice of low prices” is Fair Trade. Fair because the main goal of this movement is to provide “fair wages” for producers. FINE is the umbrella organization that unites four major fair trade groups (Fair Trade Labeling International, International Federation for Alternative Trade, Network of European World Shops, and the European Fair Trade Association). FINE defines fair trade as a

¹ „Voting with Your Trolley”, The Economist, December 7, 2006

”Trading partnership, based on dialogue, transparency and respect, that seeks greater equality 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”²

But the essence of the Fair Trade movement is the way they seek to address these issues. It is the idea of providing a “fair price”, that does not depend on market fluctuations and secure producers and their “living wage”. The area where the Fair Trade label plays the most important role is the coffee market, and therefore I will focus on it in this paper. Farmers who are certified as Fair Trade producers receive a fixed minimum rate of \$1.26³ per pound for their coffee, or \$0.05 above it if the market price is higher than the floor rate. According to the promises of the certifying organization, the special benefit should go to the producers and be spent according to the wishes of the cooperative’s membership⁴. The market for Fair Trade products is constantly growing but is based mostly on Western European countries and the United States.

The promises of Fair Trade sound very interesting to western people, who believe that through this smart institution they could help poor people and at the same time reward their good work. Unfortunately, the reality is much more complicated, as any of these goals could be met through Fair Trade, which seems to be the next purely ideological project with the

² www.fairtrade-advocacy.org/.../FAIRTRADEFINITIONnewlayout2.pdf

³ <http://www.transfairusa.org/content/resources/faq-advanced.php#minimum>

⁴ Colleen Berndt „Is Fair Trade in coffee production fair and useful?”, Mercatus Policy Series, Mercatus Center, George Mason University, June 2007, p.14

only goal being to destroy free market capitalism. As the evidence shows, Fair Trade not only does not improve the living situation of poor people, but it preserves the undeveloped state of third world economies. Moreover, fair trade is actually unfair, because it provides a better price only for a limited number of farmers, leaving the others who could not meet their standards in a worse position. In place of sustainable development, Fair Trade supports corruption, bad quality production, and economic inefficiency. But the worst side of it is the great lie that constitutes its relatively good market position. Consumers are being assured in marketing material that Fair Trade is the best way to improve the standard of living in poor countries. If they knew that 90% of the profits from Fair Trade comes to the retailers' pockets, they would even not pay 1 cent for this initiative. The purpose of my paper is to uncover this great lie to prevent prospective consumers, and broader, politicians from implementing Fair Trade as law in future.

Cheated consumers, cheated producers

The old notion underlying Fair Trade is the Acquinian doctrine of “just price”. It assumes that the free market does not provide just prices for goods and therefore there is a need for government intervention. In the case of Fair Trade, we don’t deal with government, but with a voluntary system which tries to set “just” standards of trade to make poor producers better off. Even young people in Great Britain think that

“More and more people are keen to support Fair Trade because it really makes a difference in the lives of the people who make the goods we consume.”⁵

This shows the important role of propaganda. The goal of the movement is to make people feel guilty if they buy lower price products, by showing them how much it hurts poor people. By linking buying cheap products with ethical issues they want to pressure consumers to buy Fair Trade products. Harriet Lamb, Director of the Fairtrade Foundation says:

“It is so important that we have one open and rigorous system. If people really want to help, then they should buy Fairtrade”⁶

Such misleading information led many conscious coffee drinkers to buy Fair Trade products even though these assumptions were not examined⁷. Does Fair Trade really help poor people?

By any measure there is a large gap between promotional materials in defense of Fair Trade and the reality the producers face. In fact, Fair Trade cannot guarantee anything to producers.

Free Trade suggests a minimal price for cooperatives which represent groups of producers.

Cooperatives, as democratic bodies, decide in elections how to distribute the funds.⁸ They may spend this money on different ends, but according to Fair Trade rules, the decision is made by members who are small landowners. But laborers who are not small landowners are

⁵ „Fairtrade in Your School”, April 2005, Fairtrade Foundation, p. 5

⁶ „Fighting the Banana Wars”, 2008, Rider Books, p. 134

⁷ Jeremy Weber „Fair Trade Coffee Enthusiasts Should Confront Reality”, Cato Journal vol. 27, p. 110

⁸ Colleen Berndt „Is Fair Trade in coffee production fair and useful?”, Mercatus Policy Series, Mercatus Center, George Mason University, June 2007, p.27

actually the poorest part of coffee industry. Fair Trade rules make them even poorer by requiring small landowners not to hire full-time employees. That drives farmers to employ seasonal workers who very often work for less than the minimum wage.⁹ Another organization, FLO, does not oblige farmers to show payment records or to verify wages during the inspection process or certification¹⁰ As migrant workers are not members of cooperatives, they are not verified by inspection. This example shows the difficulty of defending the thesis about Fair Trade serving the poorest class.

The other interesting case in this aspect is the origin of the Fair Trade farms. Mexico, where the average salary is \$9000 per year, is the biggest producer of Fair Trade coffee. At the same time, most of the undeveloped economies that people think produce Fair Trade goods are represented slightly or not at all. African countries, in comparison with central and southern American countries, represent a very small percentage of the whole Fair Trade production.¹¹

But the greatest demand on producers and uninformed consumers is the percent of the premium that goes to retailers. According to the Adam Smith Institute, only an estimated 10% of premiums reaches producers, while 90% of the revenue goes to retailers. Marc Sewell summarizes: "Given that the consumer very likely pays the large Fair Trade premium on the understanding that it is a direct charitable contribution, he would be willing to send far more to poor farmers than farmers receive through the farmers certification process. The Fair Trade

⁹ Marc Sidwell "Unfair trade", Adam Smith Institute, London 2008, p.15

¹⁰ Colleen Berndt „Is Fair Trade in coffee production fair and useful?", Mercatus Policy Series, Mercatus Center, George Mason University, June 2007, p.27

¹¹ Marc Sidwell "Unfair trade", Adam Smith Institute, London 2008, p. 11

tendency to discourage individuals from donating directly to charity arguably draws them away from the most efficient way to give, in favour of Fair Trade, losing the producers' money”

Myth of fixed price

It is not necessary to be a great economist to demonstrate that price controls mean economic failure. Setting minimum prices was never a successful solution historically. Basic economic principles tell us that the only consequence we should expect is artificially high supply and lower demand that leads to overproduction. The case of Fair Trade coffee is not different. The fixed price, which is in fact a subsidy, sets the average price of coffee artificially high, which leads to overproduction. This results a lower price for non-Fair Trade coffee, and makes these farmers poorer. Tyler Cowen described it in these words:

“What happens if there is an adjustment to world supply or demand and prices in one part of the market are fixed? Prices in other parts of the market must fall by more – others suffer. What happens to employees of large producers when fair trade consumption shifts away from them towards small producers? They may have no alternative employment.”¹²

Fair Trade though gives false signals to the market that result in too much coffee production, and therefore prevent farmers from growing other crops that might be economically

¹² „Who benefits from Fair Trade?”, Marginal revolution website, available at http://www.marginalrevolution.com/marginalrevolution/2005/12/who_benefits_fr.html

reasonable.¹³ The effect of such a policy is a surplus of Fair Trade coffee, resulting in price drops and unsold inventories, and eventually the sale of Fair Trade coffee on the open market. The significant difference between Fair Trade coffee supply and demand existed for more than 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 demand of only 11,000 MR¹⁴. That means that consumers on the market ordered only 13 percent of all Fair Trade coffee supplies.

Another part of the story related to fixed price is a lack of incentive to innovation. The Fair Trade system supports farmers who do not innovate. The Fair Trade system does not push people to innovate, to look for new market niches, but rather rewards them for being undeveloped¹⁵. Inefficient, badly managed cooperatives are subsidized, so that they will never get out of poverty. According to Oxfam, in the time it takes five hundred people in Guatemala to fill a large container with coffee, the same amount of coffee can be picked in Brazil by five people and a mechanical harvester.¹⁶

Cooperatives were designed as a tool to eliminate “unnecessary” agent costs between producer and consumer. Actually, the reality proved to be more complicated than designers predicted. The cost of sorting and processing coffee, and others related to export logistics,

¹³ „Voting with Your Trolley”, The Economist, December 7, 2006

¹⁴ Thomson B. „Lesson Learned: Fair Trade and CED”. Paper available at www.globalexchange.org/campaigns/fairtrade/coffee/coffeebib.html

¹⁵ Marc Sidwell” Unfair trade”, Adam Smith Institute, London 2008, p. 13

¹⁶ „Mugged: Poverty In your coffee cup”, Oxfam International, 2002, p.18

generated sums of money that in many cases consume a larger part of Fair Trade extra profits so that this money does not reach farmers.¹⁷

The fixed price causes not only technological stagnation, but leads to bad quality of coffee production as well. In Costa Rica, most of the Fair Trade cooperatives are located in the places where prime coffee could not grow. These farmers would not be able to compete with farmers from the parts of the country where the climate for coffee growing is much better. Fair Trade with its fixed price mechanism gives them the opportunity to enter the market even though the quality of coffee they grow is very poor.

“Fair Trade directs itself to organizations and regions where there is a degree of marginality...we are talking about unfavorable climates (for coffee production)...regions which are not competitive” explains Sean Eliecer Urena Prado of The School of Agricultural Economics at the Universidad de Costa Rica¹⁸

The problem of the quality of the coffee is related to John Nash's game theory, as well. Cooperatives which accumulate many producers in one place are some kind of social property where nobody takes responsibility for the outcomes. The fact that all producers mix their beans with those of other producers causes a free-rider effect where everybody wants the maximum outcome with the minimal expense. Each producer will prefer to send the better coffee to the open market, and sell the bad one as Fair Trade. The result is poor quality of

¹⁷ Jeremy Weber „Fair Trade Coffee Enthusiasts Should Confront Realists”, Cato Journal vol. 27, p. 111

¹⁸ Colleen Berndt „Is Fair Trade in coffee production fair and useful?”, Mercatus Policy Series, Mercatus Center, George Mason University, June 2007, p.18

coffee which may get Fair Trade certificate but not satisfied consumers. Colleen Berndt describes this in a Mercatus research paper using this example:

“A producer has two bags of coffee to sell and only one can be sold as Fair Trade. He knows bag A would be worth \$1.40 on the open market and bag B \$1.20. Which should he sell as Fair Trade? If he sells A as Fair Trade, he earns \$1.31 + \$1.20, or \$2.51. If he sells B as Fair Trade, he earns \$1.40 + \$1.31, or \$2.71. Therefore, to maximize his income, he will choose to sell his worst beans, bag B, as Fair Trade”

This shows clearly how Fair Trade cares about its consumers selling them worse coffee for a higher price. This also shows how socialism works, by rewarding mediocrity and encouraging people to cheat the system. Thus the only market-based way to increase the price for products is through quality and innovation.

Fair Trade as a bureaucratic mechanism

There are very high entry barriers for new cooperatives who are willing to join the Fair Trade market. It is not only a question of meeting standards but as well questions related to the assistance of development organizations and money they have to pay to become a member. The fee at FLO is \$3,200 but the pending organization must have an export contract and enough money to export coffee. Most organizations need around \$15,000 in financing to export one container of coffee. Farmers need to spend their money to complement the pre-

financing 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 contract¹⁹

“These certifications are very difficult for us because they become more and more complicated due to the fact that there are many requirements that we can’t meet” explains cooperative member Jesus Gonzales. He adds “They want a record to be kept of every daily activity. With dates and names, products, etc. They want everything kept track of. The small producers, on the other hand, can hardly write their own name”²⁰

Moreover, there is some evidence of the danger of corruption in some Central American Fair Trade cooperatives. It happened that they purchased a harvest from farmers for a low market price, then sold it as Fair Trade and shared the premiums among cooperating managers. Another corruptive practice was linked to the certification process when bribed managers certified larger farmers who did not meet Fair Trade standards.²¹ Insufficiently clear standards of certification encourage farmers to cheat by selling non-Fair Trade products with the Fair Trade label for a higher price. Many industry insiders claimed that uncertified products were exported as Fair Trade.

Fair Trade as political project

¹⁹ Jeremy Weber „Fair Trade Coffee Enthusiasts Should Confront Realists”, Cato Journal vol. 27, p. 114

²⁰ Colleen Berndt „Is Fair Trade in coffee production fair and useful?”, Mercatus Policy Series, Mercatus Center, George Mason University, June 2007, p.25

²¹ Ibidem, p.26

Today Fair Trade is a volunteer-based project: only people who are willing to join, do so. However, it is very important to inform them about the real effects of Fair Trade: the economically wrong rules of this project affect only some market game participants. But leaders of the Fair Trade movement do not hide the fact that their goal is to impose Fair Trade rules nationwide. This is closely related to the broader idea of general replacement of the global economic order – from free markets to “just” markets, with special agencies defining “just” prices and “just” rules of trade. For consumers, who do not notice the antagonism to the market in Fair Trade propaganda, this movement may present itself as very friendly and even market oriented. But the research done just on voluntary-based Fair Trade clearly shows us how big the economic damage can be the. The socialist theory of price controls sets the dangerous agenda of this movement. I believe that the primary task for every person with common sense today is to prevent, not spread, Fair Trade into new spheres of activity.

There is alternative

We can evaluate Fair Trade in two major respects: as an effective way to develop poor economies or as a charity. Actually, in both areas, Fair Trade fails. The only fair trade is free trade because only the free market system rewards the best (in consumers' eyes) players in the market, and this is just. Only free trade may be implemented as an effective strategy to reduce poverty in the third world. Developing countries have many strengths, with price competitive products at the head, to offer the developed world. Fair Trade strategy with artificial high

prices, bad quality of products and lack of incentives to develop is just a regressive strategy.

There is a big job to do with global markets: we need to abolish trade barriers, to make the market environment really open. The greatest threat for economic development of every country, not only poor ones, is economic protectionism of the welfare state with its hypocrisy manifested by the policy of defending domestic special interest groups on the one hand, and giving alms to the poor world on the other.

Fair Trade can be treated as a charity program as its main aim is to help poor people. But it does not work even in this sphere. As we saw, the vast majority of special profits go to retailers; the small part does not necessarily reach the poorest people in the industry; and finally, these coffee farms are not located in the economically weakest countries. However, fortunately Fair Trade is not the only strategy to help people by contracting them to work. Rainforest Alliance is one of them. The main difference between Fair Trade and Rainforest Alliance is that the latter pursued innovation by providing training, advice and better access to credit. People are willing to pay more for products with the RA logo, and not as a result of price control. . Promoting greater efficiency by working with farmers and thus increasing quality of the coffee is the main objective of Technoserve, another initiative working with farmers in East Africa. Rise of quality may be the best answer for the farmers seeking for market reward even higher than those provided by Fair Trade. Jeff Teter, the president of Allegro Coffee, argues that market incentives and a focus on quality offer farmers a better deal”

“To get great quality coffee, you pay the market price. Now in our stance, it’s a lot more than what Fair Trade floor prices are. One hundred percent of what we bought was more than \$1.41...it’s not the Fair Trade price, it’s much higher”²²

Fair Trade fails almost in every aspect it promise to make a difference. Researching every single presumption brings us new evidence that shows that Fair Trade propaganda is simply nothing more wishful thinking, if not to say: lies. Constantly rising number of people screwed by PR magicians hired to advertise Fair Trade as the best program providing efficient solution for poverty, tells us how confused people are. Our mission is to rectify this message to make consumers conscious about their market choice. If we skip doing it the next step will be political action and then we all will wake up one day in socialistic world with see of unintended consequences. That is why it is so important to explain to people that the best way to decrease the poverty in the world leads through free market incentives, the system based on truth, unlike the lying system of fair trade.

²² Ibidem, p.29

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