

The Economics of Fair Trade*

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I. Introduction

It has happened to nearly all of us. Buying coffee at the local grocery store or a cup at the coffee shop down the street, we see the Fair Trade logo and wonder whether purchasing Fair Trade coffee rather than conventional coffee really helps farmers in developing countries. In other words, does Fair Trade work?

This article examines precisely this question. Fair Trade is an initiative that aims to improve the living conditions of producers in developing nations. It attempts to achieve higher prices for producers, greater availability of financing for producers, longer-term and more sustainable buyer-seller relationships, the creation and/or maintenance of effective producer or worker organizations, improved social goods and community development, and the use of environmentally friendly production processes. Fair Trade works through a certification process that requires that producers and suppliers adhere to a set of requirements that aims to achieve Fair Trade's objectives. The Fair Trade label that is displayed on certified products informs consumers that the product was produced in a socially and environmentally responsible manner.

We provide an overview of the theory and empirical evidence about Fair Trade. In particular, we provide an overview of the primary requirements of Fair Trade, as well as the potential benefits and pitfalls from a theoretical and practical point of view. Throughout, we also discuss the empirical evidence for whether Fair Trade is successful in accomplishing its goals of helping lift Fair Trade certified farmers out of poverty, providing stability, and encouraging farmers to engage in environmentally-responsible production. In the end, we hope to provide readers information that allows them to answer in their own minds whether Fair Trade "works".

II. Overview of Fair Trade

The first phase of organized fair trade was initiated in the mid-1950s when European Alternative Trade Organizations started to trade directly with “disadvantaged” producers in developing countries. To market these products, an ideological business model was created, with several thousand volunteer-staffed retail “World Shops”, located primarily in Europe and North America.

The emergence of a Fair Trade label can be traced back to 1988, when a church-based NGO from the Netherlands began an initiative that aimed to ensure growers were provided “sufficient wages”. The NGO created a fair trade label for their products, Max Havelaar, named after a fictional Dutch character who opposed the exploitation of coffee pickers in Dutch colonies. Over the next half decade, Max Havelaar was replicated in other countries across Europe and North America, with a number of similar organizations, such as TransFair and Global Exchange. In 1997, the various national labeling initiatives formed an umbrella association called the Fair Trade Labelling Organizations International (FLO). A common Fair Trade Certification mark was launched in 2002.¹ Since this time, Fair Trade has gained legitimacy, growing exponentially and evolving into the most widely recognized ethical label globally. As of 2013, Fair Trade certified organizations operate in 70 countries and encompass over 1.3 million farmers and workers (Fair Trade International, 2013).

Perhaps because Fair Trade began in the coffee industry, today coffee is quantitatively the most commonly certified product. This can be seen in Table 1, which reports the total number of Fair Trade certified producers and workers involved in each of the top nine products. This can also be seen in monetary terms. Figure 1 shows the total premium payments made by

¹ Its largest adherent (Transfair USA) split from the organization in 2012 to launch a parallel label, Fair Trade USA, primarily because of differences in their views about whether large producers and plantations should also be certified. FLO holds the view that certification should be primarily, though not exclusively, for smaller producers.

the largest of the national Fair Trade bodies, Transfair USA (which is now called Fair Trade USA) by product for each year between 1998 and 2012. Consistent with Table 1, it shows that the primary Fair Trade commodity is coffee. The figure also provides an overview of the significant growth in Fair Trade over the past decade.

Table 1. Number of Fair Trade producers and workers by product.

Product	Number of producers and workers
Coffee	580,200
Tea	258,100
Cocoa	141,800
Seed Cotton	66,500
Flowers and Plants	37,500
Cane Sugar	37,200
Banana	20,300
Fresh Fruit	18,700
Nuts	14,300

Notes: Data are from "Monitoring the Scope and Benefits of Fairtrade, Fourth Edition, 2012," Fair Trade Labelling Organizations International (2012).

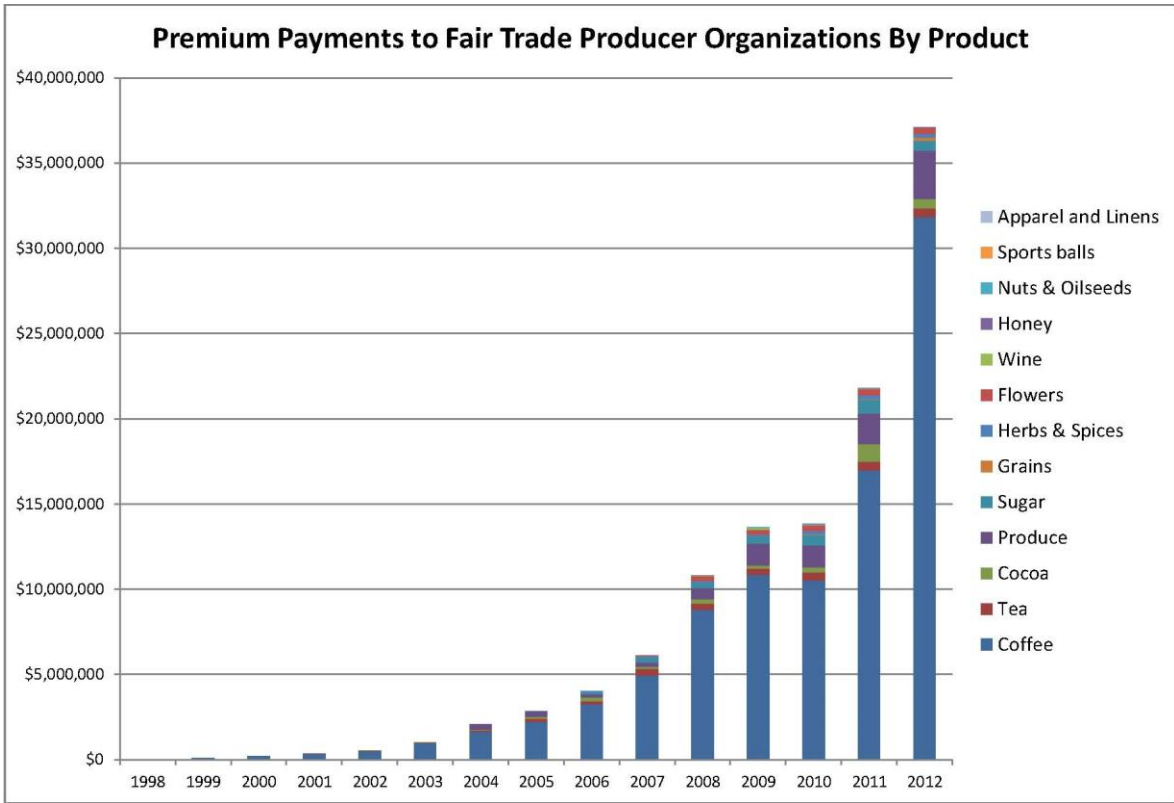


Figure 1. Fair Trade premium payments by product, 1998-2012 (Source: Transfair USA).

Since coffee is the most important single product in the Fair Trade market, our discussion here focuses on the specifics of this industry. Although the general goals and certification requirements are similar across commodities, there are some important differences, which we will point out in our discussion.

The stated goal of Fair Trade certification is to improve the living conditions of farmers and workers in developing countries. In practice, this is accomplished through a number of different requirements for certification, which we summarize here.

1. **Prices:** Producers are guaranteed a minimum price for the good, as well as an additional fair trade premium. The price floor and premium are set separately for each good.²
2. **Workers:** Workers must have freedom of association, safe working conditions, and wages at least equal to the legal minimum and regional averages. Child labor (defined as a worker that is less than 15 years of age) is prohibited.³
3. **Institutional structure:** Farmers must organize as cooperatives, where decisions are made democratically and with a transparent administration that can effectively export their product and administer the premium paid to the organization in an accountable manner. For some products larger enterprises can become fair trade certified. Here, joint committees of workers and managers must be formed and democratically structured.
4. **Environment:** Certain harmful chemicals and GMOs are prohibited. The environmental criteria are meant to ensure that the members work towards including good environmental practices as an integral part of farm management by minimizing or eliminating the use of

² Prices vary for different types of coffee. Prior to 2009, the price for washed conventional Arabica coffee was \$1.25 per pound and \$1.40 per pound for washed organic Arabica. Currently, the minimum prices are \$1.40 and \$1.70 per pound, respectively.

³ Fair Trade is one of the only certifications that has a formal system to actively address the discovery of child labor that goes beyond de-certification.

less desirable agrochemicals and replacing them, where possible, with natural, biological methods, as well as adopting practices that ensure the health and safety of the cooperative members and the community. Producers must provide environmental reports summarizing their impacts on the environment.

5. **Stability and access to credit:** Fair Trade buyers agree to long-term contracts (at least one year) and to provide advance crop financing to producer groups (up to 60%) if it is requested.

The central characteristic of Fair Trade is the minimum price, which is intended to meet a broadly determined living wage in the sector (originally set in accordance with the data of the International Coffee Organization) and to cover the average costs of sustainable production. The Fair Trade buyer agrees to pay producers at least the minimum price when the world price is lower, and to pay the world price when this is above the Fair Trade minimum. In both situations, producers and traders are still free to negotiate higher prices on the basis of quality and other attributes.

By providing a guaranteed minimum price for coffee sold as Fair Trade, the price floor is intended to substantially reduce the risk faced by growers. As we discuss in more detail below, there is no guarantee that all coffee that meets the certification requirements and is eligible to be sold as Fair Trade is indeed sold as such. Therefore, simply producing and certifying a product does not guarantee that buyers will purchase it as Fair Trade and provide the expected benefits, including the guaranteed minimum price.

The relationship between the guaranteed minimum price and the market price between 1989 and 2010 is shown in Figure 2. Although in recent years, the market price of coffee has been higher than the Fair Trade minimum price, data from the price crashes of the late 1990s and early 2000s indicates that the price floor was well above the market price.



The Arabica Coffee Market 1989-2010: Comparison of Fairtrade and New York Prices

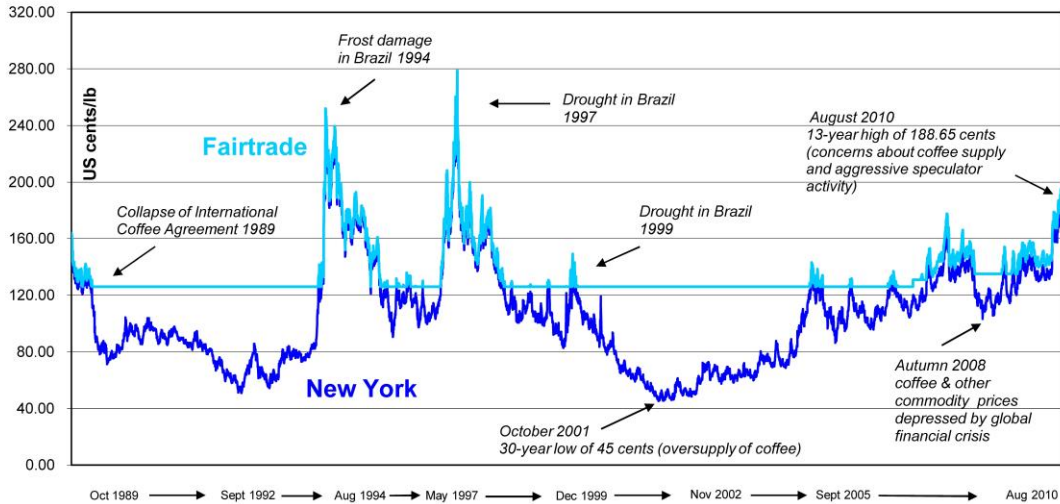


Figure 2. Fair Trade and market price for coffee, 1989-2010.

Another important characteristic is a price premium, often termed the community development or social premium, which is paid in addition to the sales price. Prior to 2008, for coffee this was set at 10 cents per pound, but is now 20 cents per pound with 5 cents earmarked for productivity improvement. The premium is designed to foster the associativity and democratic process that are tenets of the Fair Trade philosophy for small producers to improve their conditions. Therefore, the specifics of how the premium is to be used must be decided in a democratic manner by the producers themselves. Projects that are funded with the Fair Trade premium include investments in community infrastructure such as the building of schools, health clinics and crop storage facilities, offering training for members of the community, the provision of educational scholarships, improvements in water treatment systems, conversion to organic production techniques, etc.

For a product to be sold under the Fair Trade mark, all actors in the supply chain, including importers and exporters, must obtain the Fair Trade certification. On the production side, the certification is open to small farmer organizations and cooperatives that have a democratic structure, and for some products, like tea, bananas, pineapples, and flowers, larger commercial farms and plantations as well.⁴ The standards are tailored to be different for each crop and group of the actors involved in the chain. For most of the global fair trade system, FLO is responsible for setting and maintaining the Fair Trade standards for all commodities, and an independent certification company FLO-CERT is in charge of inspecting and certifying producers.

To obtain the Fair Trade certification, producer organizations need to submit an application with FLO-CERT. If the application is accepted, the organization goes through an initial inspection process carried out by one of the FLO-CERT representatives in the region. If the minimum requirements are met, the organization is issued a certificate that is usually valid for a year and can be renewed following re-inspection. During the early years of Fair Trade, inspection and certification were free of charge. However, since 2004 producer organizations must pay application, initial certification, and renewal certification fees. The certification fees, which are set based on actual administrative costs, can be significant.⁵ For example, Saenz-Segura and Zuniga-Arias' (2009) case study of a Fair Trade coffee cooperative in Costa Rica (*Coopermontes de Oro R.L.*) found that about one-third of the total Fair Trade premium received was used to pay for certification.

In addition to Fair Trade, there are a large number of certification standards, together classed as Voluntary Sustainability Standards (VSS). Examples include Organic, Rainforest

⁴ An exception is the recent Fair Trade USA decision to also certify large coffee farms and plantations, not only organized smallholders.

⁵ According to FLO-CERT (2011), the current initial certification fee for an organization with less than 50 members is 1,430 Euros and the annual certification fee is 1,170 Euros. Producers also pay the administrative costs of a Follow Up Audit if one is required. The cost of this is 350 Euros per day plus travel costs.

Alliance, Forest Stewardship Council, Ethical Tea Partnership, UTZ Certified, Marine Stewardship Council, and Global GAP. The basic logic behind the certifications is that they provide credible information to consumers about the attributes of products. They also provide a means for firms to operationalize their Corporate Social Responsibility commitments to the consumers and communities they interact with (Giovannucci, von Hagen, and Wozniak, forthcoming).

An overview of five of the more popular certifications - Fair Trade, Organic, Rainforest Alliance, UTZ, and Shade/Bird Friendly - is provided in Table 2. Although the certifications share some common overlapping goals, each has its own set of priorities that shape the specifics of their standards. While the primary goal of Fair Trade is to improve the lives of the poor in developing countries by offering better terms to producers and helping them to organize, Organic certification sharply focuses on environmental issues and aims to promote adoption of ecologically sustainable agriculture, particularly through the use of less chemical-intensive farming methods. Bird-Friendly has a well-defined ecological goal, to protect bird habitat as an indicator of ecological health, accomplished by encouraging the production of shade-grown coffee. The aims of Rainforest Alliance are also ecological, but broader in scope: to protect the ecosystem, people, and animals through the promotion of good land-use practices. UTZ, like Fair Trade, also has a strong economic objective: to improve livelihoods in a socially and environmentally healthy manner.

Table 2. Overview of Common Certifications.

Initiative	Fair Trade	Organic	Utz Kapeh	Rainforest Alliance	Shade / Bird Friendly
Year Established	1980s	1970s	2002	1996	1997
Standard Setting Body	NGO (Fairtrade Labeling Organizations International)	Initially NGO; now state/NGO (International Federation of Organic Agricultural Movements)	Initially industry; now industry/NGO (Utz Kapeh)	NGO (Sustainable Agriculture Network)	State/NGO (Smithsonian Migratory Bird Center)
Monitoring Body	Autonomous non-profit certifier; one private certifier approved by initiative	Private Certifiers regulated by state and accredited by NGO	Private certifiers approved by initiative	Certification by member organizations	Private certifiers approved by initiative
Monitoring Procedure	Annual monitoring and certification of producer groups and importers	Annual monitoring and certification of land; chain of custody monitoring	Annual monitoring and certification of farms; chain of custody monitoring	Annual monitoring and certification of farms	Annual monitoring and certification of land
Market Strategy	Mainstream marketing with use of consumer labels	Mainstream marketing with use of consumer labels	Mainstream marketing; consumer labels often used	Mainstream marketing; consumer labels rarely used	Mainstream marketing with use of consumer labels
Production Strategy	Small farmers	Mostly Small farmers; some plantations	Mostly plantations; some small farmers	Mostly plantations; some small farmers	Mostly small farmers; some plantations
Social production specifications	Standards for democratic organization, collective use of social premium, and upholding 10 ILO conventions (right to association and collective bargaining, freedom from discrimination and unequal pay, no forced or child labor, minimum social labor conditions, rights to safe and healthy working conditions). ^a	No social standards required for certification, but IFOAM members are expected to uphold key social standards. ^b	Standards upholding eight ILO conventions (rights to association and collective bargaining, freedom from discrimination, no forced or child labor, minimum social and labor conditions). ^c	Standards for fair treatment and good conditions for workers upholding key ILO conventions (freedom from discrimination and unequal pay, no forced or child labor), occupational health and safety, and community relations. ^d	None
Ecological production specifications	Standards for reduction in agrochemical use, reduction and composting of wastes, promotion of soil fertility, prevention of fires and avoidance of GMOs.	Standards barring use of synthetic herbicides, fungicides, pesticides and GMO and chemically treated plants; land clearing restrictions.	Standards for protection of primary and secondary forests.	Standards for ecosystem and wildlife conservation, integrated crop management and integrated management of wastes.	Requires organic certification. Additional standards for shade cover, canopy structure, secondary plant diversity and stream buffers.
Trade specifications	Standards for trade relationship, long-term contracts, and credit advances.	None	None	None	None
Producer price premiums (Arabica in 2004)	Guaranteed price floor (US\$ 1.21 per pound) and social premium (US\$ 0.05) corresponding to a US\$ 0.59/lb. Additional US\$ 0.15 per pound guaranteed for organic coffee.	Varies with the market: estimated at US\$ 0.15-0.35/lb.	Varies with the market: estimated at US\$ 0.01-0.15/lb.	Varies with the market: estimated at US\$ 0.10-0.20/lb.	Varies with the market: estimated at US\$ 0.07-0.10/lb.

Notes: Information is from Reynolds, Murray and Heller (2007) and are based on interviews with initiative representatives and initiative documents. ^A These are FLO entry requirements. They also have progress requirements in these areas. ^B IFOAM members are expected to uphold key ILO conventions (rights to association and collective bargaining, freedom from discrimination), and employed children are to be given educational opportunities. ^C These are Utz Kapeh major requirements. They also have additional minor requirements. ^D These are Rainforest Alliance critical criteria. They also have numerous additional expectations.

III. The Economics of Fair Trade and other Certifications

Certification as the provision of credible information

An important rationale for the Fair Trade initiative is that it provides credible information to the consumer. There are a host of product characteristics that are important to the consumer other than those that are easily observable and verifiable – e.g., freshness, taste, smell, etc. – that affects our utility. These have to do with the manner in which the good is produced rather than simply the physical characteristics of the final product. Many prefer to consume a product that was produced in a way that was less detrimental to the environment, did not use child labor, and paid adequate wages to the farmers and their workers.

Although many consumers would prefer to purchase goods produced in a socially and environmentally responsible manner (and would be willing to pay more for these goods) and many producers would be willing to produce in this manner (particularly for the higher price), without a credible way to differentiate between responsible and conventional production, a market for products differentiated in this way may not exist. Farmers producing in a less costly conventional manner can claim to have produced in a responsible manner. Consumers, knowing this, will not purchase these products. The Fair Trade label, as well as other third-party certifications, attempts to address this by providing the consumer (and the intermediary buyers or firms) with information about the nature of the production process.

Viewed in this light, certifications like Fair Trade can increase market efficiency. By providing information, they create new products and help create markets that facilitate mutually beneficial transactions that otherwise would not occur.

The other side of Fair Trade is that it actively helps Fair Trade producers engage in production that is socially and environmentally responsible. Better financing, longer-term contracts, the premium, and the price floor are all intended to provide higher incomes and

greater financial stability to farmers, and to help develop stronger buyer-seller relationships. The requirements that farmers form cooperatives that are democratically elected and that premiums must be directed towards projects that benefit the farmers and their communities is meant to strengthen local communities and improve farmers' knowledge and productivity. Finally, the environmental regulations promote production that occurs in an environmentally responsible manner.

A number of studies have formally modeled the logic of Fair Trade, showing theoretically that if consumers value the nature of the production process, then voluntary certifications unambiguously improve aggregate welfare. For example, Podhorsky (2010) focusing on environmental standards, shows that in an environment with heterogeneous firms and no production externality, a voluntary certification program can never decrease consumer welfare. In the model, firms invest in more environmentally friendly production or sourcing of such production and choose to become certified if this increases their profits. Due to free entry of firms to the industry, rents earned from environmentally friendly production are then, in part, passed onto consumers in the form of greater product variety.⁶

The key assumption behind the logic of Fair Trade is that consumers care about the nature of the production process. This raises a crucial question: do consumers in fact care whether goods are produced in a socially or environmentally responsible manner? A number of studies have tackled this question, attempting to quantify how much more (if at all) consumers are willing to pay for socially and environmentally responsible production. Hertel, Scruggs, and Heidkamp (2009) survey 258 individuals and find that 75% of coffee buyers report that they would be willing to pay 50 cents extra for a pound of coffee (approximately 15% of the sales price) if it was Fair Trade certified. Over half would be willing to pay one dollar more. However,

⁶ Also see Podhorsky (2013b) for a similar result. In her two-country model of North-South trade with differentiated products, she shows that voluntary certifications improve aggregate welfare.

an important concern with this evidence is that it is based on self-reports rather than actual actions.

More recently, studies also use innovative field experiments to observe actual behavior, rather than self-assessments or intentions. Hainmueller, Hiscox, and Sequeira (2011) conduct a number of experiments in 26 stores belonging to a major U.S. grocery store. The authors randomly placed Fair Trade labels on bulk bins of coffee that were Fair Trade certified. In a second experiment, the authors also randomly varied the prices of the coffee. Each treatment lasted four weeks. The authors found strong evidence for greater demand for Fair Trade coffee. Sales were 10% greater when the coffee was labeled as Fair Trade. They also found that demand for more expensive (and arguably higher quality) Fair Trade coffee was insensitive to price.⁷ Interestingly, demand for a cheaper and lower quality coffee was sensitive to the price: a 9% increase in price resulted in a 30% decline in demand. In a follow-up experiment using coffee sold on eBay, Hiscox, Broukhim, and Litwin (2011), find that on average, consumers are willing to pay a 23% premium for coffee labeled as Fair Trade.⁸

This finding shows two things. It shows that consumers value ethical production. However, it also shows that the Fair Trade label conveys credible information. If consumers were willing to pay more for ethical production, but did not find the Fair Trade labels credible, then both studies would not have found an effect. Thus, the findings suggest that the Fair Trade

⁷ This is consistent with an earlier finding by Arnot, Boxall and Cash (2006) for brewed coffee sold at a Canadian University.

⁸ In a series of auxiliary experiments, Michael Hiscox and various coauthors have accumulated a large amount of additional evidence that confirms the findings from Hainmueller, Hiscox, and Sequeira (2011). Examining fair labor standards for candles and towels sold in a large retail store in New York City, Hiscox and Smyth (2011) find that the label increased sales by 10%, and when combined by a price markup of 10-20% sales rose even more (16-33%). Examining consumers' willingness to pay for goods using an auction environment on eBay, Hiscox, Broukhim, Litwin, and Wolowski (2011) find that consumer paid a 45% premium for polo shirts labeled as being certified for fair labor standards.

labels convey information about the production process and that this affects consumers' demand for products.

Does Fair Trade work?

Perhaps the most important question to potential consumers of Fair Trade is: does it work? Given the price floor and the premium associated with Fair Trade, the most natural outcome to examine is prices. There is overwhelming evidence that, as intended, Fair Trade certified producers receive higher prices than conventional farmers for their products. We summarize the nature of this evidence here.

Mendez et al. (2010) surveyed 469 households for 18 different cooperatives in four countries (El Salvador, Guatemala, Mexico, and Nicaragua) during the 2003/2004 coffee harvest. In all four countries, they find a significant positive relationship between average sales price for coffee and both Fair Trade and Organic certification. In a study of 845 coffee farmers from southern Mexico during the 2004/2005 season, Weber (2011) finds that farmers that were Fair Trade and Organic certified received an average of 12 cents more per pound of coffee sold.

Bacon (2005) examines the sales price of coffee during the 2000/2001 harvest for a sample 228 coffee farmers from Nicaragua and finds that Fair Trade certified farmers obtained significantly higher prices for their coffee. Farmers selling coffee as Fair Trade received an average price of \$0.84 per pound (this is net of costs paid to the cooperative for transport, processing, certification, debt service, and export). Farmers selling coffee as Organic received \$0.63 per pound, while farmers selling conventional coffee to a cooperative received \$0.41 per pound. Since Fair Trade (and/or organic) farmers are not able to sell all of their coffee as certified, the average price certified and conventional farmers received for their harvest differs from the figures above. The farmers that were Fair Trade and/or Organic received an average

price of \$0.56 per pound, while conventional farmers received an average price of \$0.40 per pound. In a follow-up study that attempts to better determine the causal impact of Fair Trade certification, Bacon et al. (2008) examine the same treatment farms but a different control group. They find that 100% of the farmers belonging to the Fair Trade certified cooperatives felt that the cooperative helped them obtain higher prices. By contrast, this figure was only 50% for farmers belonging to conventional cooperatives.

It is perhaps not surprising that Fair Trade certified farmers receive higher prices given that this is the aim of the label. Given the premium and price floor, it is difficult to think of why farmers wouldn't receive higher average prices. Less obvious is how production volumes, and as a consequence, total incomes are affected by certification. In general, studies also tend to find that Fair Trade is associated with higher yields and higher incomes. Arnould, Plastina, and Ball (2009) examine 1,269 farmers from Nicaragua, Peru, and Guatemala in 2004/2005 and find that in addition to higher prices, Fair Trade certified farmers also have greater sales and higher incomes. Jaffee (2009) also finds the same pattern for 51 coffee producers (26 Fair Trade certified and 25 conventional) from Oaxaca, Mexico, surveyed between 2001 and 2005.⁹

Although informative, there are concerns with cross-sectional evidence comparing certified and non-certified farmers at a point in time. Characteristics that cause farmers to become Fair Trade certified may also cause farmers to sell more, produce better quality coffee that sells for a higher price, and to earn more income as a result. Therefore, it is far from clear that we should be confident that the relationships found in these studies are causal.

Well aware of these empirical difficulties, a number of studies have attempted to reduce the bias in their estimates through the use of matching methods. Intuitively, rather than compare

⁹ He also shows that they were less likely to experience food shortages and have diets that contain more meat, milk and cheese. It is important to note, however, that the years of Jaffee's sample were a period of very low coffee prices. For this reason, the magnitude of the estimated impacts may be particularly large and not generalizable to other time periods.

Fair Trade farmers to non-Fair Trade farmers, matching estimates instead match each certified farmer to other farmers that are similar based on observable characteristics, like educational attainment, age, family size, farm size, specialization of production, farm tenure, value of assets, etc. The hope is that by matching on these characteristics, one is comparing a Fair Trade certified farm to an otherwise similar conventional farm.¹⁰

Beuchelt and Zeller (2011) examine 327 coffee cooperatives in Nicaragua. Using a matching estimator, they find that Fair Trade certified cooperatives are able to obtain higher prices for their coffee (as are Organic producers). Fort and Ruben (2009) and Ruben and Fort (2012) examine 360 coffee farmers from three Fair Trade certified cooperatives and three non-certified cooperatives in Peru. They find no robust evidence that Fair Trade certified farmers receive higher prices, using either OLS or matching estimates. Price differences between matched farmers in the two groups are statistically insignificant.

A third strategy, although much less commonly employed, is to examine a panel of producers over time rather than just a cross-section in one time period. By doing this, one examines whether a producer begins to obtain higher prices (for example) just after they become Fair Trade certified. Dragusanu and Nunn (2013) undertake such an exercise, examining an annual panel of 262 coffee mills from Costa Rica between 1999 and 2010. They find that Fair Trade certified farmers receive 4 cents more per pound for exports than conventional farmers. They find no difference between Fair Trade certified and conventional farmers in terms of the quantity sold or exported.

¹⁰ Although arguably an improvement over simply examining relationship in the data (i.e., using Ordinary Least Squares (OLS) estimates), matching estimates do have a number of shortcomings. First, like OLS, matching still relies on differences between farmers being observable. If important differences are unobservable and not necessarily highly correlated with observables, then the estimates will still be biased. Second, it is often unclear which variables should be used to match farmers. Arguably certain pre-determined variables are suitable such as the household head's age, experience or educational attainment, but others, like farm size, specialization of production, farm tenure, value of assets, are endogenous to the certification process themselves. Therefore matching on these will lead to biased estimates and may understate the impacts of Fair Trade certification.

Interpreting the evidence: Causality and selection into certification

An important, yet understudied, aspect of Fair Trade is the determinants of selection into certification. Since the existing empirical evidence is based on conditional correlations in the data, it is important to understand the nature of selection into certification.

The primary concern is that the “best” farmers are the ones that become certified and that they also produce more and obtain higher prices – i.e., that there is positive selection into Fair Trade. Once one begins to think about the realities of Fair Trade, it is unclear whether we expect there to be positive or negative selection into Fair Trade. On the one hand, certain aspects of reality suggest negative selection. Because of its objectives, Fair Trade intentionally targets producers who are small and economically disadvantaged. These farmers tend to have limited capital, market access and bargaining power. On the other hand, certain aspects suggest positive selection. Targeted farmers tend to have greater management and organizational capabilities, which generally sets them apart from the poorest producers.

In an attempt to better understand the nature of selection into Fair Trade, Dragusanu and Nunn (2013) conducted interviews with members of Fair Trade certified cooperatives and conventional mills in Costa Rica. They found four important determinants of certification. First, they found significant variation across mills in the cost of following Fair Trade requirements. They cite the specific example of a requirement that forbids the use and sale of certain chemicals (primarily pesticides). Many mills in Costa Rica also operate a store that sells agricultural products. Mills that obtain greater revenues from selling banned chemicals find Fair Trade more costly and are less likely to certify. Second, the authors found that the perceived benefits of Fair Trade varied significantly depending on how mills forecast the path of future prices. For mills that forecast lower prices in the future, the perceived benefit from Fair Trade’s price floor is greater. Third, they also found the values of individual farmers to be important. A

personal belief in the importance of environmental or socially responsible farming practices increases the appeal of Fair Trade. Finally, they found that access to information about the logistics of becoming certified and managerial ability were also important.

A number of studies explicitly estimate the relationship between the probability of certification and various determinants. Typically, this is done in studies when estimating a propensity score used to match certified and conventional producers. These studies tend to find evidence that point towards negative selection. For example, Saenz-Segura and Zuniga-Arias (2009) estimate a very strong negative relationship between Fair Trade certification and experience, education, and income within a sample of 103 Costa Rican coffee producers. This finding is echoed in Fort and Ruben (2009) and Ruben and Fort's (2012) study of 360 Peruvian coffee farmers. In their sample, farmers that are less educated and own smaller farms are more likely to be certified.

Overall, the absence of evidence suggesting positive selection into Fair Trade provides some assurance that the evidence of the impacts based on correlations has value. Further, if we are convinced that, if anything, we tend to observe negative selection, then the correlational evidence may typically understate the effects of Fair Trade.

The Benefits of Fair Trade in the Long-Run: Dynamics and the Role of Free Entry

For many, the theoretical logic behind Fair Trade is appealing. Consumers in developed countries value the consumption of goods that provide better livelihoods to the producers in developing countries and are willing to pay more for these products. Fair Trade provides credible information that differentiates Fair Trade products from conventionally produced products. Thus, consumers gain access to new goods that they value and producers earn higher incomes.

However, this description is static. In a recent study, de Janvry, McIntosh, and Sadoulet (2012) argue that things become more complicated once dynamics are considered. They develop a model that highlights the effect that free entry has on higher net incomes earned through Fair Trade. The logic is as follows. Consider the case where there are a small number of producers in a country that are Fair Trade certified. For the same yield and quality of coffee, certified farmers earn more than the other producers in the region. The authors argue that other producers will see this and also want to become Fair Trade certified. There will be entry. Over time, as more producers become Fair Trade certified, there is the possibility that the supply of Fair Trade certified products outgrows the demand. In this case, not all farmers are able to sell all their product as Fair Trade. With additional entry, then the proportion that can be sold as Fair Trade declines further. In their model, entry continues until the expected benefits of Fair Trade certification just equals their costs. In their model, despite the extra money that consumers are willing to spend on Fair Trade products, in the end, farmers are no better off than before. The benefits of Fair Trade are just equal to the costs. The excess rents that arise from the greater utility consumers obtain from consuming certified products all go towards certification costs.¹¹

de Janvry, McIntosh, and Sadoulet (2012) argue that free entry represents the death knell for Fair Trade. However, there are many reasons to be hesitant before coming to this conclusion. First, in reality there are a number of barriers to certification that prevent entry. An important barrier is limits on farm sizes. For example, within coffee, FLO targets small family-run farms that do not hire full-time permanent workers. In addition, an important role played by FLO is to connect Fair Trade certified producers with Fair Trade certified buyers. As part of the application process, producers must first demonstrate a certified buyer's willingness to purchase their coffee. In other words, the network structure of Fair Trade certified buyers and sellers acts

¹¹ The dissipation of rents due to free entry that characterizes the model of de Janvry, McIntosh, and Sadoulet (2012) is a more general phenomenon that is well-known in economics.

as an entry barrier. Producers are not able to become certified and then begin searching for buyers to purchase their coffee. As is well-known, barriers to entry such as these create rents.

Second, their conclusion also ignores the many non-monetary goals of Fair Trade (and other certification standards): creating better conditions for hired workers, creating democratic and transparent cooperatives, encouraging environmentally sustainable production, improving access to credit, and establishing stable long-term buyer-seller relationships. To the extent that these are the goals of Fair Trade, greater entry is a good thing. Even if higher-than-normal economic rents do become fully dissipated, the free entry that causes this is also causing the spread of these important outcomes within the farming community. Greater entry into Fair Trade means more democratic cooperatives, more environmentally sustainable production techniques being used, better conditions for workers, more long-term buyer-seller relationships, more access to advanced credit for farmers, etc. Therefore, even if the monetary benefit of Fair Trade is an elusive shrinking carrot that draws farmers into certification, it serves an important and beneficial purpose. This is likely to be even more so the case for other certifications, like UTZ, Organic, Bird Friendly, and Rainforest Alliance, which have an even greater focus than Fair Trade on goals other than increased incomes for farmers.¹²

The link between free entry and rents provides an interesting dilemma for certification agencies. On the one hand, one wants to induce the spread of socially and environmentally responsible production as much as possible, but on the other, one also wants to put some structure and limits on entry to maintain higher-than-average rents for certified producers.

Does Fair Trade Provide Greater Stability to Farmers?

¹² This is exactly the mechanism in Podhorsky (2010). Firms choose environmentally friendly production and certify if doing so yields a higher profit than conventional farming. However, excess profits are competed away by free entry. In the end, consumers are unambiguously better off because they inherently value environmentally sustainably produced products.

One of the primary goals of Fair Trade is to create increased stability for certified farmers. In practice, this is done through a number of mechanisms. First, higher prices paid to farmers provide greater financial stability. Second, the Fair Trade system strives to create and strengthen long-term ties between producers and buyers. Purchasers are expected to engage in more than just short-term opportunistic relationships. Third, the system aims to provide farmers greater access to credit. Purchasers are required to provide up-front credit – up to 60 percent of the final price – if producers request the support. As well, co-operatives often provide credit to their members, with a portion of the premiums often used for this purpose. Fourth, the price floor guarantees a minimum price below which Fair Trade certified coffee cannot be sold.

At a conceptual level, it is easy to see the logic behind each of these aspects of Fair Trade. However, there are some practical and conceptual concerns with certain aspects of the system. In particular, although FLO attempts to strongly promote the creation of long-term buyer-seller relationships and the provision of credit by buyers, in practice it is not always possible to do this perfectly. For example, a study by Reynolds (2009), which collects information from interviews and focus groups with members and leaders of four cooperatives in Peru and Mexico, finds some imperfections with these aspects of the system. She reports that corporate buyers of coffee, which she calls “market drive” buyers – e.g., importers that sell to Starbucks, Nestle, and Costco – in practice often refuse to buy from cooperatives that request credit. She also finds that these market-driven mainstream buyers, unlike other Fair Trade buyers, are less willing to enter into longer-term stable contracts. They sign one-year contracts as required by FLO, but do little else to create longer-term partnerships with suppliers. However, despite these problems arising from corporate buyers, she still finds that the producer cooperatives view advanced credit as the most beneficial aspect of Fair Trade next to the price floor.

Evidence from a number of other studies also confirms that Fair Trade has generally been successful in increasing the credit available to farmers. Bacon et al. (2008) finds that, within a sample of 177 Nicaraguan coffee farmers, 77% of the Fair Trade certified farmers reported that their cooperative provided pre-harvest credit, while this figure was only 33% for farmers belonging to conventional cooperatives.

Mendez et al. (2010), examining data from 469 households from four Latin American countries, find that Fair Trade certified farmers are more likely to report having access to credit than conventional farmers. Interestingly, they find no relationship between Organic certification and access to credit.¹³ This finding actually provides interesting evidence about the likelihood that the link between Fair Trade and credit is causal. If the relationship arises because “better” farmers certify, then one would also expect a relationship to exist with Organic certification. If the relationship reflects a causal impact of certification on the availability of credit, then one would not expect an association with Organic certification since Organic buyers are not required to provide advanced credit.

Perhaps the most important tool through which Fair Trade aims to provide greater stability to farmers is the price floor, which is meant to provide a safety net to farmers in the event that coffee prices fall significantly. However, although the price of products sold as Fair Trade is guaranteed to be equal to or above the price floor, there is no guarantee that they will be able to sell their coffee as Fair Trade. It is well known that setting a price that is below the market price results in an excess supply of the product. When the price floor binds, there is the potential that this occurs and the quantity of Fair Trade coffee supplied is greater than the quantity demanded.

¹³ They also find a positive relationship between Fair Trade certification and savings, most likely due to higher prices and incomes from Fair Trade.

In reality, we observe that not all coffee produced by Fair Trade certified farmers can be sold as Fair Trade (although it is unclear whether this is because of frictions and imperfections in the matching of buyers and sellers or differences between supply and demand).¹⁴ As well, recent empirical evidence from coffee producers in Guatemala suggests that as the market price falls below the price floor, the proportion of coffee that the producers sold as Fair Trade also falls (de Janvry, MacIntosh and Sadoulet, 2012). In other words, when the benefits to Fair Trade increase it becomes harder to sell coffee as Fair Trade. It is unclear exactly why this relationship exists. The authors argue that it is because of free entry, but it could also be due to a shift in final demand from Fair Trade to conventional coffee due to changing relative prices. Therefore, although the price floor is meant to provide stability, farmers may still face some risk and uncertainty due to fluctuations in the quantities they can sell as Fair Trade.

The upshot of this is that it is not a foregone conclusion that the price floor fully insulates farmers from the impacts of significant price declines. Given this, empirical evidence on the link between Fair Trade and increased stability is particularly valuable. The empirical evidence generally indicates that Fair Trade certified farmers perceive and experience greater economic stability than conventional farmers. For example, Bacon (2005) examines a sample of 228 coffee farmers from Nicaragua and finds that Fair Trade farmers report being less concerned about losing their farm in the coming year than conventional farmers.

The Impacts of Certifications on the Environment

A number of studies have tested whether Fair Trade has been successful at promoting environmentally friendly farming practices. For example, Jaffee (2009) finds that among a

¹⁴ In the Mendez et al. (2010) sample of FT certified farmers from four Latin American countries, 60% of certified coffee was sold as Fair Trade. Among the four Fair Trade cooperatives interviewed by Dragusanu and Nunn (2013), the proportion of coffee sold as Fair Trade in the previous year was 10, 40, 53 and 80%.

sample of 51 Mexican coffee farmers (26 Fair Trade and 25 conventional), there is a very strong association between Fair Trade certification and environmentally friendly farming practices, such as composting, building live plant barriers, and building terraces. The differences in these practices are shown visually in Figure 3, which reports the proportion of Fair Trade producers and proportion of conventional producers in his sample that were engaged in each practice. The figure also reports 95% confidence intervals, allowing one to visually judge whether the differences between Fair Trade and conventional farmers are statistically significant. Fair Trade certified farmers, relative to conventional farmers, are more likely to undertake each of the five environmental practices. In addition, in all five cases the differences between the two groups are statistically significant.

Based on a sample of 177 coffee farmers from Nicaragua, surveyed in 2006, Bacon et al. (2008) find that Fair Trade certified farmers are much more likely to engage in more environmentally friendly farming practices. In their sample 68% of Fair Trade farmers had implemented ecological water purification systems, while this figure was 40% for conventional farmers. As well, 43% of Fair Trade farmers had implemented soil and water conservation practices, while only 10% of conventional farmers had.

There is evidence that other certifications – namely, those that target the environment – also result in more environmentally friendly farming practices. For example, Blackman and Naranjo (2012) examine the impacts of Organic certification among 2,603 coffee producers in Costa Rica (36 of them certified organic). Using propensity score matching, they find strong evidence that organic farmers are less likely to engage in the use of pesticides, herbicides and chemical fertilizers and are more likely to use organic fertilizers, shade trees, and windbreaks, and to undertake a variety of soil conservation measures.

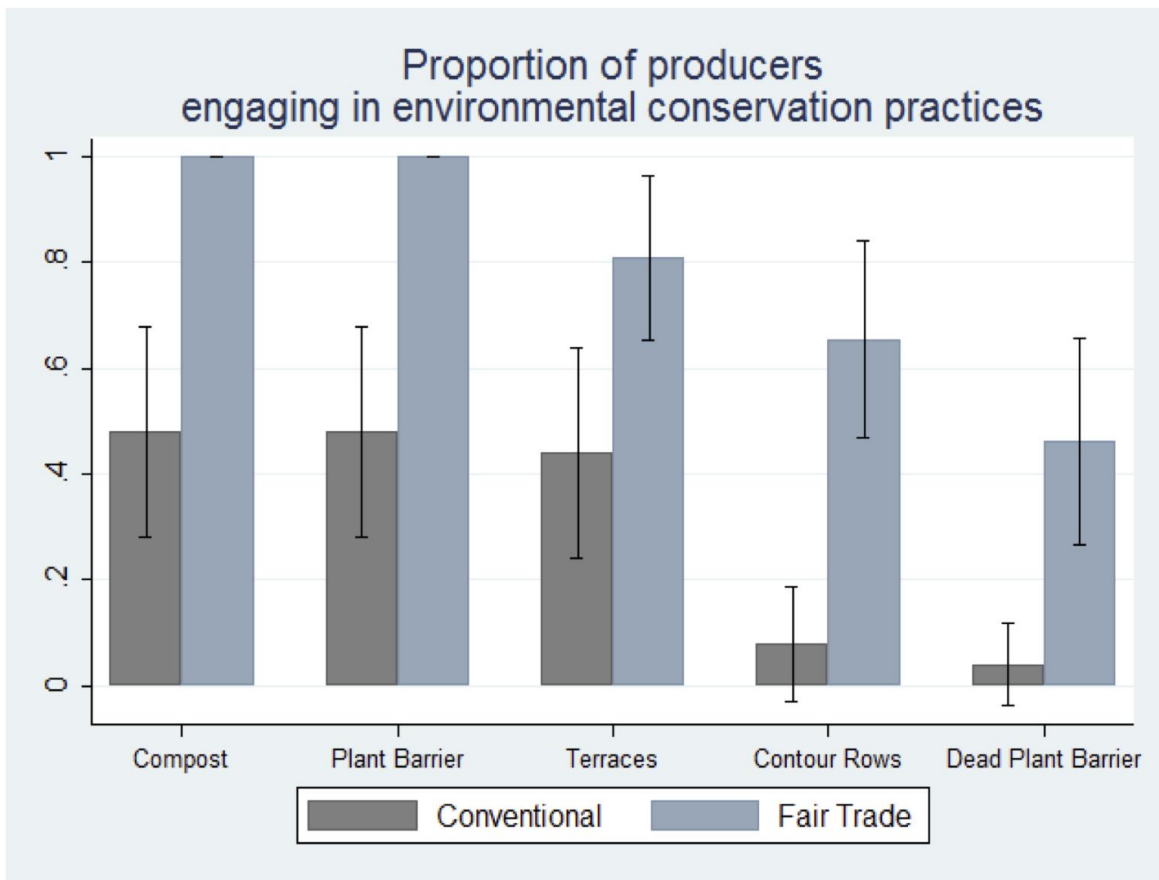


Figure 3. Differences in environmental practices between Fair Trade and conventional coffee producers in Oaxaca, Mexico. Averages (and 95% confidence intervals) are reported for 25 Fair Trade farms and 26 conventional farms. Source: Jaffee (2009), Chapter 9, Table 6.

Overall, the evidence indicates that Fair Trade and other environmental labels have been successful in promoting more environmentally friendly farming practices among certified farmers.

The Impacts of Certifications on Local Governance and Institutions

An intended benefit of Fair Trade and many other labels is the development of stronger and better-functioning local institutions. For example, until recently, all coffee farmers were required to democratically organize as cooperatives or associations in order to become certified (FLO, 2011).¹⁵ In addition, part of the Fair Trade premiums is put towards social development programs that are democratically selected and ideally serve to strengthen community institutions and social ties.

The empirical evidence on whether Fair Trade strengthens local institutions remains limited. We are unaware of evidence that finds strong institutions-building impacts of Fair Trade. One of the few pieces of evidence related to the strength of community ties or institutions is Elder, Zerrifi and LeBillon (2012). The authors examine 107 coffee farmers from Rwanda in 2009 and find that membership in a Fair Trade certified cooperative is not associated with more or less trust between the members of one's community. Further it is actually associated with less trust in the leaders of the cooperative.

Overall, more evidence is clearly needed before we are able to assess whether Fair Trade achieves its goals of strengthening communities and developing local institutions.

Distributional Considerations of Fair Trade

The primary goal for Fair Trade is to contribute “to sustainable development by offering better trading conditions to, and securing the rights of, marginalized producers and workers” (World Fair Trade Organization and Fairtrade Labelling Organizations International, 2009, p. 4). In the general discussion, producers (i.e., farm owners) and hired workers are often lumped together as being potential beneficiaries of certification. However, an important distributional

¹⁵ In 2012, Fair Trade USA changed its regulation to allow larger coffee farmers to also become Fair Trade certified.

question is how much of the benefits of certification are felt by the farm owners and how many reach the hired workers.

In the coffee industry, farms tend to be small and family-run, with a small number of hired workers, most of which are seasonal coffee pickers. In addition, there may be workers hired by the cooperative/mill. Unlike coffee (and cacao), for other commodities, like bananas, citrus fruits, and tea, certification has been expanded to also include large plantations. For these products, the same general principles of Fair Trade are followed, although certification standards vary by product and by organizational form (e.g. plantation vs. cooperative).

Although the evidence on the distribution of the benefits of Fair Trade remains limited, there are studies that have examined this issue. Valkila and Nygren (2009) examine information from interviews from 11 coffee cooperatives in Nicaragua over six months in 2005/2006. In total, the authors interviewed 94 producers and 64 hired workers. They found that although the records of Fair Trade farmers indicated that they received higher prices for their coffee, their qualitative research indicated no evidence that workers received higher wages or benefited in any way from certification. Like the rest of rural Nicaragua, workers were paid the minimum wage and were not given benefits like social security, medical care, vacations, pensions, paid sick leaves, etc.

Dragusanu and Nunn (2013) come to similar conclusion in their study of the impacts of Fair Trade coffee in Costa Rica. Examining a sample of over 110,000 individuals between 2003 and 2010, they find that while Fair Trade certification is associated with significantly greater incomes for farmers, it is not associated with increased incomes for hired workers.

Jaffee's (2009) study of 51 coffee farmers from Oaxaca, Mexico also finds that few of the benefits of Fair Trade are passed on to workers. Although he finds that Fair Trade certified farmers get 130% higher prices, the wage paid to hired workers is only 7% higher (47 vs. 44

pesos per day). In addition, labor costs as a percent of coffee sales was actually lower among the Fair Trade certified farms relative to the conventional farms (57.2% versus 68.3%).

Interestingly, the existing evidence seems to indicate that once one looks outside of coffee, the impacts of Fair Trade on workers are more noticeable. In particular, when large plantations are certified, Fair Trade regulations pay particular attention to workers (who comprise a larger group relative to farm owners in these products). Although Fair Trade standards of a minimum price, a premium, and longer-term buyer-seller relationships apply to all producers, there are also specific requirements for plantations. Rather than forming cooperatives of small producers a hired labor organization is formed, which includes both elected worker representatives as well as management appointees. The organization must protect workers rights and ensure there are safe and equitable working conditions, an absence of forced or child labor, and fair salaries that are at least as high as the established minimum wage.

Ruben and van Schendel survey 100 workers from two banana plantations in Ghana, one of which is Fair Trade certified and the other not. They found a low level of worker awareness about Fair Trade. They also found that workers in the conventional plantation received a higher base salary, but they worked longer hours and received less fringe benefits. The Fair Trade workers felt a greater sense of identity and co-ownership with the plantation.

Studying wine production in South Africa, Granville and Telford (2013) survey 381 Fair Trade and conventional workers. They find that Fair Trade workers are more likely to make more than minimum wage and as a result they are also able to save more of their income. Consistent with this, when surveyed 91% of Fair Trade workers believed that Fair Trade (and their membership in the joint body) was responsible for improving in their living standards. In particular, 95% of workers reported that their joint body provided help with education and/or health (which 51% reported being helped with both).

Another distributional concern is whether Fair Trade results in greater inequality between farmers that are certified and those that are not. Fair Trade certified farmers gain while conventional farmers do not. A number of papers have developed this logic theoretically (e.g., Kadow 2011). However, Podhorsky (2013a) also shows that this intuition does not always hold. She develops a model where conventional farmers are actually also better off because of the existence of Fair Trade certified farmers in the market. In her setting, there are a small number of oligopsonistic intermediaries that buy from local producers and sell to foreign buyers. In her model, the existence of Fair Trade certification decreases the market power of intermediaries, and as a result, even producers that are not Fair Trade certified benefit. In this setting, Fair Trade improves the incomes of all farmers, including those that do not become certified.

There is also the issue of the distribution of Fair Trade premiums among farmers within a cooperative. In a setting such as this, there is the concern that a small subset of the farmers within the cooperative may dominate decision making and funnel money towards projects that disproportionately benefit them. Although there is little empirical evidence on the extent to which premiums are distributed in an equitable manner, there are examples of tensions between individual farmers belonging to Fair Trade certified cooperatives and the cooperative itself.

Prevezer (2013), interviewing farmers belonging to Fair Trade certified coffee cooperatives in Tanzania, found significant dissatisfaction with the cooperatives and their board members. Farmers complained of a lack of communication about the use of the premiums, the reasoning behind decisions, and the decision-making process itself. Prevezer found evidence of elected farmers on the boards misusing the funds e.g., paying themselves for attending meetings. Overall, there was evidence of farmers' distrust over how the funds were being spent by the cooperatives.

Mendez et al. (2010) find evidence of dissatisfaction and concerns on the part of cooperative members (i.e., farmers) directed towards cooperative leaders in four Latin American

countries. The primary issues raised were a lack of transparency, accountability, and communication.

In their case study of a Fair Trade coffee cooperative in Costa Rica (*Coopermontes de Oro R.L.*), Saenz-Segura and Zuniga-Arias (2009) found a significant amount of distrust in the cooperative arising because of deficient management in the past. They also indicated that the cooperative could improve in their communication and distribution of information about the details and benefits of Fair Trade. Their survey evidence found that a third of the producers in the area did not know about the existence of a premium and about half felt that they did not receive any benefits from Fair Trade certification. This is commonly found in other studies. For example, Fort and Ruben (2009) find that among 180 Fair Trade-certified coffee farmers from Peru, 12% did not know about the existence of the Fair Trade premium and 77% felt that they did not receive any benefits from the premium. Interestingly, these statistics varied significantly by region. In one region (Ubiriki) 98% of farmers felt they received no benefit from the premium, while in another (La Florida) 48% felt they received no benefit.

An important issue that these findings do not consider is whether the level of distrust in the Fair Trade cooperatives was higher or lower than in conventional cooperatives. These findings might simply reflect a more general environment of low trust that exists in Tanzania. An explicit comparison of trust levels in Fair Trade certified cooperatives and conventional cooperatives can be found in Elder, Zerrifi, and LeBillon (2012) for Rwanda. Examining data from 107 farmers collected in 2009, the authors find lower levels of trust amongst leaders in Fair Trade certified cooperatives (relative to conventional cooperatives). It is difficult to think why Fair Trade certification would erode trust, although the increased resources to be distributed may generate distrustful behavior among leaders or generate suspicion among members of the cooperative.

Saenz-Segura and Zuniga-Arias (2009) also compare the satisfaction of Fair Trade and conventional farmers with their cooperatives. Relying on propensity score matching estimates for a sample of 103 farmers from Costa Rica, they find robust evidence that Fair Trade farmers identify less with their cooperative and perceive the organization to function less well than conventional farmers.

Multiple Certifications and their Costs and Benefits

Another important issue that is not yet fully understood is the consequence of having multiple, often competing certifications. From the producer's perspective, multiple certifications mean multiple reports, multiple audits, and greater administrative costs. It has also been argued that the existence of multiple standards may decrease how informative each individual certification is. For example, Valkila and Nygren (2009) found that Nicaraguan farmers belonging to Fair Trade-certified cooperatives had a poor understanding of Fair Trade, including its requirements and benefits. According to the authors, one reason was the multiplicity of certification schemes, quality standards, and rural development projects faced by farmers. They simply were not able to keep track of them all and to distinguish one program from another. Mendez et al. (2010) also found that farmers were often unclear or confused about certifications, particularly about Fair Trade. However, farmers did have a better understanding of Organic certification.

We are not aware of empirical studies that test whether the existence of more certifications decreases farmer's knowledge of each certification. At this point, it is still an open question whether this is a cost of multiple certifications.



Figure 4. Relationship between average profits (gross income minus expenses) and number of certifications among Colombian coffee farmers. Source: CRECE.

To obtain a better sense of the impacts of multiple certifications, we examine data from 3,033 coffee farmers in Colombia, surveyed by COSA in 2011. The average net income for farmers with no certifications, one certification, two certifications, and three or more certifications is shown in Figure 4, along with 95% confidence intervals. (The set of certifications in the sample include: Fair Trade, Organic, UTZ, Rainforest Alliance, Nespresso, 4C, and C.A.F.E. Practices.) Although producers with one certification have significantly higher average income than producers with no certifications, producers with more than one certification have similar incomes to producers with a single certification. In other words, in Colombia, we see evidence of significant declining benefits to farmers from multiple certifications.

Another important aspect of multiple certifications is how they affect the transfer of information about the production process to the consumer. An important rationale for certifications is that, by providing information, they are enhancing efficiency and increasing aggregated welfare for both producers and consumers. However, certification standards may be

less efficient and may introduce a measure of confusion if there are many different standards with distinct yet overlapping requirements.

A final issue is related to the incentives and potential agency issues that can arise. In general, it may not always be in the interest of the certifying agency to fully enforce certification requirements. Although this is potentially a concern with third-party NGO-based organizations, it is particularly a concern when large corporations create their own certifications. Examples include the Starbucks certification label Coffee and Farmer Equity (C.A.F.E.) Practices and Nespresso's AAA Sustainability Program. In these instances, there is a potential trade-off between having a stable and low cost source of coffee beans and socially responsible sourcing. The concern is that these newer private certifications may be little more than smart marketing and attempts to cash in on consumers' willingness to pay for sustainably produced products. Therefore, the existence of these additional certifications may affect consumers' views about the validity and reliability of third-party certifications generally. If this is the case, then more certifications may decrease their effectiveness.

IV. Conclusions

Our overview about the theory and empirics of Fair Trade and other voluntary certifications highlights a number of important points. First, the existing empirical evidence (e.g., the work by Michael Hiscox and coauthors) provides strong empirical evidence that consumers highly value goods produced in a socially and environmentally responsible manner. In addition, these same findings show that the existing Fair Trade label conveys credible information that affects consumer demand. The upshot of this is that there are efficiency and welfare gains to be had from credible third-party certifications, like Fair Trade, that provide consumers with information about the production process.

The existing empirical evidence, based primarily on conditional correlations, suggests that Fair Trade does achieve many of its intended goals. Studies generally find that Fair Trade farmers receive higher prices, have greater access to credit, perceive their economic environment as being more stable, and are more likely to engage in environmentally friendly farming practices.

This said, there are many aspects of Fair Trade and its consequences that are not yet well understood. The largest issue currently is the distribution of benefits. Virtually all of the empirical studies examined test for impacts on the average Fair Trade certified producer. However, much less is known about how the benefits of Fair Trade, and the premiums in particular, are distributed within Fair Trade cooperatives and communities. Some of the evidence reviewed suggests that within Fair Trade cooperatives there are concerns about the fair and equitable distribution of the premiums. Whether these concerns are greater in Fair Trade cooperatives is unclear at this point.

Another issue currently facing the Fair Trade community is the trade-off between limiting certification to small-scale disadvantaged producers and allowing larger plantation-style producers to also become certified. By scaling-up Fair Trade and increasing entry into certification, the increased entry may dissipate some of the monetary benefits of certification. In addition to issues related to the scale of Fair Trade, there are also questions about the consequences of increasing the number of third-party certifications with overlapping objectives. In particular, it is unclear how the informativeness and credibility of third-party certifications are affected, particularly when many of the newer certifications are private initiatives like Starbucks' C.A.F.E. Practices.

Some scholars have argued (e.g., de Janvry, McIntosh, and Sadoulet, 2012) that consumers may be better off directly transferring money to producers in developing countries rather than using market-based mechanism like Fair Trade. We are skeptical that anything

resembling direct transfers is preferable. It has long been recognized that direct transfers of money distort incentives, diverting effort away from productive activities and towards rent-seeking and corruption. For example, a number of recent empirical studies find compelling evidence of this, showing that foreign aid (whether it is economic, military or food aid) increases conflict (Croft, Felter and Johnston, 2012; Dube and Naidu, 2012; Nunn and Qian, forthcoming). In our view, the largest potential benefit of market-based systems like Fair Trade is that they do not distort incentives in as deleterious a way as foreign aid. Instead, they work within the marketplace and reward productive activities and production processes that are valued by consumers and that are good for the local environment and economy. Fair Trade, if it is implemented successfully, holds the possibility of being a market-based tool that can improve the welfare of consumers, the lives of producers, and the local environment.

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