



The Centre for Business Relationships,
Accountability, Sustainability and Society

Comment and Analysis

Questioning the Standard Macro-Economic Critique of Fair Trade



Alastair M. Smith



Disclaimer

The views in this document in no way represent the institutional view of the Centre for Business Relationships, Accountability, Sustainability and Society. The work here is only representative of the opinion and work of the author, Alastair M. Smith.

Copyright

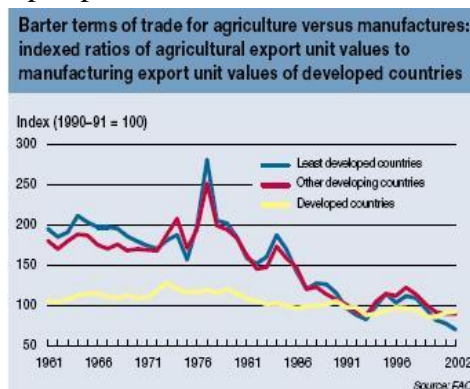
While we encourage the circulation, consideration and citation of views put forward in this document, we naturally request due acknowledgement and would appreciate a copy of material citing this work.

Questioning the Standard Macro-Economic Critique of Fair Trade

Alastair M. Smith

One of the most persistent critiques of Fair Trade is that guaranteed minimum prices incentivise producer livelihoods that are not beneficial in the long-term. However, this position can be strongly questioned from theoretical and empirical perspectives.

The reasoning of the critique is that the low prices received by southern producers are caused by high levels of supply in the face of limited demand. Furthermore, the “real” value of agricultural commodities are declining vis-à-vis the exports of wealthier countries and this leads to a long-term decline in the “terms of trade” between north and south (see graph). On this basis, southern economies must diversify out of lower and into higher value economic exports.



Naturally, producers cannot switch straight from growing coffee to producing cars. Transition has to be incremental as economies accumulate resources needed for long-term strategic investments. In the short-term however, agricultural income must increase to generate resources need for more fundamental change.

Specifically, current knowledge identifies that increased returns can come from: 1) improving quality and efficiency (producing better quality oranges for less), 2) processing raw goods at source (making apples into juice), and, 3) shifting to higher-value agriculture goods (say from bananas to avocados). However, it is still necessary to stimulate diversification into higher income sectors within agriculture and it is on this question that pro- and anti-fair traders disagree.

Critics argue that guaranteed minimum above-market prices will incentivise producers to remain in low-value sectors. However, Fair Trade organisations recognise that prices are not set simply by the ratio of producers to end consumers. Instead, international and local buyers use ‘oligopsonistic’ markets (where there are many sellers and few buyers) to drive down prices. Furthermore, while “incentives” are clearly important in organising the economy, this does not mean that the market price mechanism alone will facilitate diversification – and there are three well established microeconomic realities why this is the case.

Firstly, while poverty is clearly a “push” incentive to leave low-value sectors, it cannot be assumed that there are “pull” factors towards other livelihoods. While we know prices for avocados in European supermarkets are higher than coffee for example, this will not be known by producers. Even if it was, it there is no guarantee that they have access to export avocados as commercialisation channels tend to be strongly historically conditioned.

Secondly, even if world prices were communicated to producers, farmers require resources to respond. In the example of moving from the production of raw coffee beans to roasting the final product, farmers will need both financial capital and knowledge. Unfortunately however, the very definition of poor producers means that they will not have such resources to hand – and it is unlikely that they can get a bank loan as an entrepreneur would in the UK.

Thirdly, even where farmers can access the resources necessary to respond to price incentives, they will factor in the ‘risks’ associated with the investment. The price for any product is only realised when it can be sold. In the developing world new investments are incredibly risky given the myriad natural (land slides and droughts) and human (political and economic volatility) disasters which bring great probability of failure. Also, producers will not assume that they will be effective in new livelihoods, and there will be a time lag between diversification into a new product and economic remuneration for its sale. For these reasons, plus the fact that the cost of failure is so high for those in poverty (as captured by the theory of declining marginal utility), developing world producers are renowned for being conservative in their investment decisions as they accept lower remuneration for greater stability.

For the above reasons it is clearly inappropriate to assume that developing world producers will simply respond to price incentives and diversify – and instead other support mechanisms are necessary to facilitate this process of transformation. Fair Trade was established to help producers deal with the real life limitations on livelihood development and pays guaranteed minimum prices as well as offering long-term trading relations to provide the necessary stability for long-term planning and eventual diversification into higher-value products and processes. This stable income can also act as collateral for raising loans to carry out business development that would otherwise not be possible for marginalised producers. Furthermore, the payment of a social premium allows for the development of wider human capital in the areas of health and education. While this could theoretically be achieved through simple aid transfer, such an arrangement would not allow producers to “learn by doing” in terms of what it takes to be self-sufficient in an internationalised economy. Finally, ‘gold standard’ fair trade organisations (such as Divine Chocolate & Café Direct) that go above and beyond requirements of Fairtrade certification proactively tutor producers in improving business practices and raising product quality.

Furthermore, not only does empirical evidence demonstrate that Fair Trade certified producers have increased the quality and hence the price of their products, but also that they have diversified away from growing basic ingredients into producing more highly processed exports. In the Windward Islands producers have diversified into other crops and are now developing a very high value tourism sector; in Africa producers of cocoa for Divine Chocolate have moved into artisan soap production; and in Mexico, Fair Trade cooperatives have diversified from coffee into marketing of cocoa, honey and organic preserves, and even set up a clothes factory. While these changes might look small they are staggering concrete steps for building local economies and helping the transition towards the export of more highly processed and manufactured goods.

In conclusion, Fair Trade agrees that southern producers must diversify into higher return activities. For this reason, it seeks to remove the obstacles to producer development by increasing remuneration and capacity in southern communities and providing the stability needed for long-term planning. One limitation of this argument however, is its theoretical nature and limited empirical base. For this reason, impact assessments must take seriously the issue of livelihood diversification. A final issue of urgent importance is that the current weakening of certified standards in the pursuit of wider markets is halted and reversed, to ensure that fair trade principles remain a tool of development and not just ethical consumer satisfaction.