

# **Macroeconomic Consequences of the Fair Trade Development for Exporters of Agricultural Commodities**

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## **Abstract**

This article presents the potential impact of the Fair Trade movement on the economic situation of underdeveloped countries specializing in agricultural commodities export. Particular emphasis has been put on the macroeconomic effects of the development of this movement. The conclusion contains suggestions for possible activities which can be undertaken with a view to limiting the problem of poverty of small farmers from the countries of the Global South.

## **Keywords**

Fair Trade, trade policy, Global South.

## **Introduction**

THE Fair Trade idea is based on the assumption that socially involved consumers from the developed countries support producers from less developed ones. Although the Fair Trade movement focuses on agricultural commodities, which account for ca. 90% of sales, new types of certified products are systematically appearing, also industrial ones. On the theoretical grounds, propagators of this movement point to the market imperfection as the economic justification of this type of support (Fitzgerald 2012, p. 378). Michael Barratt Brown claims that agricultural producers do not take advantage of free trade, because the free trade system is characterized by numerous market imperfections and that the neoliberal assumption of equal chances is erroneous (Brown 2006). It results from the fact that commodity markets, which are the main area of interest of the organizations promoting and organizing the Fair Trade sales channels, are dominated by the demand side: several big customers with a global range of action. The supply side is represented by millions of small farmers from the Global South. In the case of coffee, which accounts for over a half of the products certified as Fair Trade, five biggest producers controlled 69% of the world sales of instant and roasted coffee in 1998, whereas around 20-25 million producers were involved the production of the raw material (Bacon 2005, pp. 497-511). The bargaining power is on the side of the trader acting on behalf of multinational corporations (Nicholls and Opal 2005). According to the promoters of the Fair Trade movement, the existing asymmetry of information and market position does not allow suppliers from poor countries take advantage of free trade in the way promised by the neoclassical school theory.

Fair Trade advocates point to various benefits this movement brings to producers. These are, among others: obtaining prices higher than those on the conventional market, stability of prices and farmers' income (whereas on the free market prices fluctuate), ensuring them a minimum guaranteed income, even if they are unable to sell all their products, easier access to loans and smaller tendency towards migration [Fitzgerald 2012, p. 378; Dragusanu, Giovannucci and Nunn 2014, pp. 6-7). Another significant benefit for farmers certified within the Fair Trade system is the fact that they are paid earlier than other producers (Ruben, Fort and Zuniga-Arias 2009, p. 781).

Next positive effect of certifying products is the protection of natural environment, due to the ban on the use of numerous chemical substances. Propagators of Fair Trade underline the benefits for the farmers certified within this movement, consistently disregarding its effects on the remaining participants of the market, as well as on the local communities.

The Fair Trade movement was established as a form of support for the poor agricultural producers from the Global South countries offered by the socially sensitive consumers from the rich North. Initially, due to its small scale and a slight share of the certified products in the trade in particular commodity groups, it did not exert any influence on the macroeconomic situation of the exporting countries. Likewise, as a movement of a niche significance it did not arouse any interest of researchers of international economic relations.

Scientific research on Fair Trade focused mainly on the macroeconomic issues. The subject of the analysis was for the most part the influence of this movement on the certified farmers, whereas its impact on the producers from outside this movement, also local communities, economies of the exporting countries, as well as their competitors were disregarded. Both theoretical models and empirical analyses indicate that the Fair Trade beneficiaries, i.e. certified producers, obtain various kinds of benefits. The comparison of the results of 77 studies on the influence of Fair Trade on the producers in the Global South countries, conducted by I. Vagneron and S. Roquigny, shows that the positive conclusions clearly outweigh the negative ones (2011, pp. 15-17). It has to be added that these studies focus on the certified producers, disregarding the remaining participants of the market, both domestic and foreign.

The dynamic growth of sales in this distribution channel in the 21st century is the reason why for particular commodities Fair Trade has become a significant market segment. In the period 2005-2013 the sales value of products certified by the Fair Trade International rose by over 800%, i.e. from 615 million euros to 5,191 million euros (excluding the USA). The data do not include the USA because in 2011 the Fair Trade USA separated from the Fair Trade International and it no longer publishes data of its sales value. The share of the USA in the global sales of Fair Trade products decreased from ca. 31% in the period 2005-2007 to around 21% (1,031m euros) in 2011, the year for which the last estimates are available. The growth of the sales value follows a linear trend ( $R^2$  for the linear trend is 0.98). Maintaining the present dynamics of the sales value growth would mean that in 2020 it will reach the value of 9 billion euros (over 10 billion including the USA, where the sales of products certified by the Fair Trade USA is still developing). The extrapolation of the present linear trend indicates that the dynamics of the sales value growth will be systematically decreasing in the future. However, it is possible that the growing awareness of consumers from the Global North, coupled with the rising popularity of the CSR idea, will contribute to raising the sales value growth rate to several dozen per cent annually (table 1).

For the monocultural economies of the Global South countries, the sales of products certified as Fair Trade may be one of the major determinants of their macroeconomic situation, particularly in terms of their trade balance and its dynamics, as well as the labor market. The markets of the developed countries of the Global North are not considerably affected, due to the relatively low share of these products in their import structure.

### **Fair Trade vs. International Trade**

Contrary to the expectations of the socially sensitive consumers, who pay higher prices for certified products in order to support small farmers from the global South countries, the development of the Fair Trade movement may have numerous negative macroeconomic effects on the exporters of certified products.

While the purpose of the Fair Trade movement is to reduce the market imperfections, the exclusion of a certain segment of producers from the conventional market and creating more beneficial conditions of economic activity for this segment in fact does not solve any of the

observed problems. The objective of Fair Trade is not the elimination of the defects of the market functioning, but rather reducing their negative effects (Maseland and De Vaal 2011, pp. 15-17). Not only does the Fair Trade movement fail to eliminate the imperfections of the free market and the free trade, but it also contributes to the appearance of new disturbances with a potentially much stronger influence on the economies of the Global South countries.

**Table 1. The sales of Fair Trade products in the world (without USA) in 2005-2013 and forecast in mil. euro**

year (x)	empirical	dynamics	theoretical (y)	dynamics
2005	788		746	
2006	1124	43%	1283	72%
2007	1650	47%	1821	42%
2008	2196	33%	2358	30%
2009	2592	18%	2895	23%
2010	3424	32%	3433	19%
2011	3953	15%	3970	16%
2012	4734	20%	4508	14%
2013	5191	10%	5045	12%
2014			5582	11%
2015			6120	10%
2016			6657	9%
2017			7194	8%
2018			7732	7%
2019			8269	7%
2020			8807	6%
$y=-328,72+537,37x$		$R^2=0,98$		

It is often claimed that the main benefits from the Fair Trade movement are the higher prices obtained by certified producers in comparison to their local, uncertified competitors. However, in the macro scale, this phenomenon is not necessarily a positive one.

The increase in the sales volume of the certified products reduces the income of the producers from outside the certified sector (Narlikar and Kim 2013, p. 2). However, if in a given country certified farmers obtain higher profits than the remaining ones, it should lead to the inflow of producers to the certified group. Theoretically, it should result in the reduction of the additional profits of the certified farmers, to the point that the premium from the certification equals its cost (Dragusanu, Giovannucci and Nunn 2014, pp. 17-18). In such a case the only beneficiary would remain the certifying institutions, which certainly is not the purpose of the consumers of these products from the Global North countries.

The dynamic growth of the share of products certified as Fair Trade in the global trade may significantly influence the structure of international trade on the selected commodity markets. It may lead to the shifts in the export and import streams between countries, as well as to changes in the trade policy tools and exchange rates. The increasing export from countries with a high share of products certified as Fair Trade in its production volume will supersede export from countries where Fair Trade is less common among producers. The earlier experience shows that the cost of entering the Fair Trade program and of the temporary certification is very high. The high costs of

the adaptation to the program, the higher running costs resulting from complying with the program rules, as well as the certification costs consume the majority of the surplus obtained from the sales of goods at prices higher than those on the conventional market (Berndt 2007, p. 27). The substantial costs of entering the system may exclude poor farmers from the participation in the Free Trade movement (Dammert and Mohan 2014, p.11). The high entrance fees exclude those farmers who need support most of all: small farmers from the poorest countries (Africa and South Asia). The majority of the Fair Trade certified suppliers are from the countries at a medium level of development (Latin America). The biggest exporter of Fair Trade coffee is Mexico (Sidwell 2008, p. 15), a country which hardly needs support. Contrary to the expectations of consumers who pay higher than standard prices for Fair Trade products, for the small farmers from underdeveloped countries the cost barriers related to the certification are a serious obstacle to joining the system.

In this situation the main beneficiaries of the system would be the intermediaries involved in the certification, as well as relatively wealthy agricultural producers from the Global South countries. The empirical comparative study conducted by E.Nindl confirms the fact that those who benefit from the Fair Trade system are predominantly farmers from countries at a medium level of affluence (mainly big, catholic, former Spanish colonies), as opposed to countries with lower medium and low level of development (2014, p. 22).

The substantial growth in the production value of products certified as Fair Trade may have another consequence: it may lead to the division of the agricultural commodities market into two parts: Fair Trade and regular market. Buying goods offered within the Fair Trade system does not raise the global demand, but only contributes to changing suppliers. The increase in the sales of agricultural products certified as Fair Trade, given the limited global demand for this type of products, may result in the decrease in demand for the goods sold on the conventional market. Producers certified within the Fair Trade system do not reduce their production in the time of the excess supply (Davidson and Wilson 2008, p. 4). In this way they contribute to the excessive fall in prices on the conventional market. It may negatively affect the income of farmers from outside the Fair Trade system.

Contrary to the expectations of the socially sensitive consumers from the Rich North countries, the growth in the volume of sales in the Fair Trade channel may contribute to the deterioration of the living conditions in the poorest countries of Africa and Asia, for which it would be much better if Fair Trade remained a market niche, instead of becoming the major format of the market organization. The movement may improve the situation of particular producers in the Global South countries, but it should not be seen as a global, long-term development strategy (Mohan 2010, p. 117).

### **Labor Market and Allocation of Resources**

The development of the sales of Fair Trade products in a country may contribute to the increase in unemployment. As the certifying institutions forbid suppliers to hire seasonal workers, in consequence unemployment will grow and the existing, often ineffective production technology and economic structure will be preserved. The regulations which impose a ban on the employment of children may, paradoxically, lead to shifting children workers from the export sector to industries producing for the local market, where the working conditions are worse (Dammert and Mohan 2014, p. 22).

The fact that the Fair Trade farmers are not allowed to hire seasonal labor force inhibits the development of even those farms which achieved success. It is a barrier to the growth in productivity and raising the affluence level.

Another factor which may negatively affect the labor market in the poorest countries of the Global South is shifting the production and export of the analyzed goods to semi developed countries, where it is easier for producers to join the certification system of Fair Trade.

Subsidizing certain economy sectors from the premium obtained from the Fair Trade certification may have a negative consequence for the allocation of resources. It constrains the possibility introducing pro-growth changes in the economic structure and contributes to the preservation of farmers' poverty in underdeveloped countries of the Global South. It weakens the economic incentives for food products processing on the spot, which could considerably increase the value of export and GDP of these countries. For instance, in the case of coffee sold on the European market, the share of producers and local intermediaries from the Global South countries in its added value is only one fourth. According to the estimates for Norway, for the 2006/2007 season it was merely 24-26%, whereas the process of roasting coffee beans accounts for about 60% of the retail price (Johannessen and Wilhite 2010, pp. 531-534). Maintaining the present structure of production and processing of agricultural commodities is beneficial for producers and intermediaries from the Global North countries. Due to various trade policy tools used by developed countries, the export of processed food faces stronger barriers than the export of agricultural raw materials. Such organization of the international trade system substantially inhibits the efforts of countries producing goods with a low added value towards economic development (Mendoza and Bahadur 2002). In spite of the continuing negotiations within GATT, the situation has not visibly improved in this respect.

### **Fair Trade as a Tool for Solving the Problem of Poverty in Countries Specializing in the Export of Agricultural Raw Materials**

Another negative macroeconomic effect of the Fair Trade movement is the fact that it diverts attention away from seeking real long-term solutions to the problem of poverty of farmers in underdeveloped countries. The main reason for the poverty of farmers from the Global South is the protectionist foreign trade policy in relation to food products (especially processed ones) from the developed countries (Mruk, Jerzyk, Stefańska, Stefański and Nestorowicz 2015, p 191). The protection of their domestic markets consists in creating numerous tariff systems, as well as non-tariff barriers to import of food products from underdeveloped countries, which do not belong to integrative organizations in Europe, North America, or South Asia. Rich countries subsidize their own farming with huge sums of money. As the majority of the tools of the foreign trade policy are concealed and hard to interpret, the elimination of such barriers is a very slow process (Stefański 2000, pp. 59-61).

In 2010 the premium obtained by farmers from all over the world was estimated as 66 million dollars, which accounts for 1.2% of the value of Fair Trade sales. At the same time, the value of the subsidies for farming in the OECD countries in 2011 was 252 billion dollars (Narlikar and Kim 2014, p. 2).

Part of the subsidized food products from the developed countries find their way to the markets of the poor countries from the Global South, contributing to the decrease in the profitability of agricultural production in these countries and deepening the problem of poverty there. As the Fair Trade movement focuses on agricultural commodities not cultivated in the rich countries, it does not affect the interests of food producers from the Global North.

In the case of food-agricultural goods it should not be claimed that the free trade theory failed. In spite of the fact that the negotiations within WTO (World Trade Organization) are in progress, the protectionism towards the markets of the developed countries prevents farmers from the underdeveloped countries from taking advantage of the chances offered by free trade. This view is represented by, among others, J.E. Stiglitz and A. Charlton (2005).

Many researchers dealing with the Fair Trade movement are of the opinion that it is an ineffective way of transferring income from consumers to producers: a direct transfer would bring far better results (Boto and La Peccerella 2014, p. 14). Nevertheless, A. Podhorsky's theoretical model based on the Pareto model shows a possibility of shaping the sales price of Fair Trade products and the premium obtained by producers in such a way that this system would turn out to be much more effective than charity help. At the same time, however, the author makes a point that these estimations should be based on thorough empirical research (2014, p. 40).

The promoters of the Fair Trade idea spread the image of satisfied farmers from poor countries, exporting their produce. However, this image diverts the public's attention away from the real situation of millions of poor farmers. Therefore, to some extent the Fair Trade movement is used to soothe the conscience of consumers from the highly developed countries from Europe and North America. In reality it makes it more difficult to implement solutions to the problems and promote fair trade in the general sense of this word.

## **Conclusion**

Fair Trade disrupts the rules of free trade. The question arises if it is a justified disruption. It seems that this question could be answered positively only if the costs would be borne exclusively by the conscious consumers from developed countries. In this case it would be a form of pro-development support of agriculture in underdeveloped countries, financed by voluntary donations. Such support should be evaluated as more beneficial than charity help from the point of view of long-term socio-economic development. However, in the situation when also other producers from underdeveloped countries as well as local producers from outside the Fair Trade movement are negatively affected by the system, the positive answer to the question is no longer obvious. In fact, the negative effects of the Fair Trade movement development seem to outweigh its positive macroeconomic results.

The Fair Trade movement can be treated by consumers from the Rich North as a substitute for the reducing the protection of their internal markets. It may inhibit activities toward liberalization of international trade in highly-processed food commodities. The Fair Trade movement reduces the pressure placed on the governments of developed countries by socially involved consumers for undertaking real, effective actions meant to liberalize trade in agricultural-food products, which could contribute to solving the problem of poverty in the Global South countries.

A long-term improvement of the macroeconomic situation of the underdeveloped countries from the Global South, whose economies are based on the export of agricultural products, could be achieved mainly by constraining the protectionism in the developed countries, as well as by implementing the rules of free trade. Unfortunately, a strong lobby of agricultural producers from developed countries, as well as the political power of voters associated with agriculture create serious barriers to implementing such solutions.

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