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**How Does Fairtrade Affect the Market?
A Case Study in South Africa.**

Master's Thesis
September 2007

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Table of Contents

1 Introduction:	3
1.1 Question.....	3
1.2 Background.....	3
1.3 Aim	3
1.4 Outline	4
2 What is Fairtrade?	5
2.1 Growth and function	6
2.2 Arguments for and against Fairtrade	6
2.2.1 Fairtrade as a violation of the free market:	6
2.2.2 Fairtrade as a fixer of the free market	8
3 Fairtrade in South Africa	9
3.1 Working standards in South Africa	11
4 Method.....	13
4.1 Limitations	13
5 Theory	14
5.1 Fairtrade as a violation of the free market:.....	14
5.1.1 Lowering the world market prices	14
5.1.2 Reducing the incentive to raise quality	22
5.1.3 Hired Labour producers vs Small co-operatives.....	23
5.1.3.1 Sustainable development.....	24
5.1.3.2 Disadvantaged workers	25
5.1.4 Inefficient help	28
5.2 Fairtrade as market imperfection fixer	30
5.2.1 Lack of access to market.....	31
5.2.2 Lack of information about the market.....	31
5.2.3 Lack of access to financial market and credits	31
6 The views at South African farms.	33
6.1 Lowering the world market prices.....	33
6.2 Reducing the incentive to raise quality.....	35
6.3 Hired Labour producers vs Small co-operatives	35
6.4 Inefficient help?	38
6.5 Fairtrade as market imperfection fixer	41
6.4.1 Improved access?	41
7 Conclusions	43
Future questions:	44
References	45
Internet sources:	46
Interviews in chronological order:	46

Abbreviations:

- FLO = Fairtrade Labelling Organization international
- FT = Fairtrade
- HL = Hired Labour producers

1 Introduction:

1.1 Question

How does Fairtrade affect the market? A case study in South Africa.

1.2 Background

As fairtrade (FT) production and consumption grow, understanding their direct as well as possibly unexpected indirect effects on FT producers and their surrounding becomes more important. The FT-related economic literature and theory are limited and several important questions remain to be thoroughly addressed (for example, can FT actually harm surrounding non-FT producers? Does FT mainly serve to give Western consumers a good conscience?). An article in *The Economist* dated 7th of December 2006 criticises FT for being unfavourable to non-FT producers. This article does not question the good intentions of FT but shows aspects of the shortcomings of how it is practised. An example of this is how support for FT producers leads to increased production which should result in a falling world market price, harming a vast majority of producers. Another problem is how only a small percentage of the added price on FT commodities trickles down to the producers, making the goodwill of FT ineffective¹. On the other hand, FT supporters, such as Oxford University professor Alex Nicholls, argue that FT is a market fixer rather than a market violator, as FT can help producers with availability to market information, access to market and credit². These arguments and others will be addressed thoroughly in this thesis.

1.3 Aim

The aim of this thesis is to give insight into what influence FT has on the market. FT is an alternative to the normal market trying to ensure dignity for the producers at the beginning of the market chain. As FT has recently been simultaneously criticised and praised, I will use the two standpoint arguments (used in *The Economist* article, and in the book *Fair Trade Market-*

¹The Economist 2006

²Nicholls & Opal 2006 p. 18.

Driven Ethical Consumption by Alex Nicholls and Charlotte Opal) to examine their accuracy in a South African context. The main research questions are:

- Will there be an incentive for the FT producer to produce more, which will lead to a lower world market price?
- Does the floor price reduce incentives to raise quality?
- Is there an assumption from FLO (the leading FT certifying organisation) that favours small farm organisations to enter the market, and is this then good or bad?
- Does the premium added on the market price reach down to the producer?
- Does FT fix market errors such as access to credits and information about the market?

To answer these questions I will use literature, interviews and trade theory models. As part of a Minor Field Study in South Africa, where I was able to investigate impacts of FT productions with my own eyes and with my own questions, this thesis will have a special focus on FT in South Africa. The academic literature on FT from an economic viewpoint is very limited. This thesis will contribute to the discussion regarding FT and its effects on the market.

1.4 Outline

The paper is organised as follows: Section 2 gives a brief description of what FT is and provides deeper explanation of the arguments for and against FT. Section 3 presents the structure of FT in South Africa. Section 4 gives a short description of the methodology. Section 5 analyses the arguments with a theoretical framework. Section 6 discusses the arguments using interviews with people involved in FT in South Africa. Finally, section 7 summarises and draws some conclusions.

2 What is Fairtrade?

FT can be seen as a way of ensuring that workers in exporting companies in developing countries are treated adequately, but there is no widely accepted definition of FT at present. FINE, an umbrella organisation comprising four main international FT networks, uses the following definition which can be seen as a developed country's point of view:

“a trading partnership, based on dialogue, transparency and respect, which seeks greater equity in international trade. It contributes to sustainable development by offering better trading conditions to, and securing the rights of marginalized producers and workers, especially in the South”³

Alex Nicholls and Charlotte Opal, authors of the book; *Fair Trade Market-Driven Ethical Consumption* do not see FT as charity, aid or just “doing good”, but as a way of recognising the global community as having rights and responsibilities⁴.

Compared to Ethical trade, FT goes much further. Ethical trade tries to ensure that workers and farmers have decent working conditions. FT includes decent working conditions but also contains a guarantee for fair prices, encourages workplace democracy and strives to empower people so they can take more control over their own lives⁵.

The importance of FT is growing, and, as a consequence, so is the debate around its relevance. FT is more available to individuals than international politics as a way of trying to change conditions in developing countries. When political goals, such as the millennium goals, seem to fail, people can take action themselves through e.g. buying FT products in order to contribute as individuals.

³de Ferran & Grunert 2007 p. 219

⁴Nicholls & Opal 2006 p. 5

⁵Litvinoff & Madeley 2007 p. 4

2.1 Growth and function

FT is one of the fastest growing markets in the world although it is still very small. Roughly 0.001% of world trade is FT according to an article published in 2007⁶. The estimated retail value of FT products in the world increased by 37% from 2004 to 2005, amounting to a total value of over 1.1 billion euros, with the USA, the United Kingdom and Switzerland alone standing for two thirds of the value. In Sweden the retail value increased by 69 percent to a retail value close to 10 million euro in 2005⁷. There are over 2000 FT-certified products on the market⁸. FT producers are divided into two categories; plantations and Co-operatives. A plantation has an owner who hires labour (HL) to work on the farm. A Co-operative is owned by small farmers who work on the farms.⁹ FT assures a fair price to the FT producer. The FT floor price equals the cost of production, the cost of living and cost of complying with the FT standards. If the market price exceeds the floor price, the FT minimum price corresponds to the market price. In addition to the FT minimum price, a social premium is also added, which must be spent on social development projects in the community.¹⁰ In an HL plantation the premium is managed by a Joint body where representatives elected by the farm workers decide in which way the premium is to be spent.¹¹

2.2 Arguments for and against Fairtrade

2.2.1 Fairtrade as a violation of the free market:

The FT concept has its critics and one of them is the weekly newsmagazine *The Economist*. In its article “Voting with your trolley”¹² the concept of FT is criticised, together with the labelling of “organic” and locally produced food. Under the headline “fair enough”, different arguments are presented explaining why the FT idea might result in effects that are opposite to what was actually desired in the first place. It is suggested that the supply of FT production may lead to lowering non-FT commodity prices even further, resulting in even worse conditions for the majority of poor workers that are not included in the FT safety network. The following is a standard economic argument against FT:

⁶de Ferran & Grunet 2007 p. 219

⁷FLO international 2006 p. 12

⁸Litvinoff & Madeley 2007 p. 17

⁹Nicholls & Opal 2006 p. 93

¹⁰Nicholls & Opal 2006 p. 41ff

¹¹Nicholls & Opal 2006 p. 93

¹²The Economist 2006

*“the low price of commodities such as coffee is due to overproduction, and ought to be a signal to producers to switch to growing other crops. Paying a guaranteed Fairtrade premium -in effect, a subsidy- both prevents this signal from getting through and, by raising the average price for coffee, encourages more producers to enter the market. This then drives down the price of non-Fairtrade coffee even further, making non-Fairtrade farmers poorer.”*¹³

So while subsidising the minority, the majority gets harmed by even lower prices. As a floor price gives a higher price and payoff to the producer, the initiative to produce more is higher. The question is: to what extent does this lowering of the world price actually occur?

Secondly, the minimum prices that exist for some commodities, such as coffee, are harmful for producers as they take away an incentive to improve quality. As the price is already set, there seems to be no danger in falling behind in quality as long as the quantity is reached.¹⁴

Thirdly, the article argues that the FT certification builds on political assumptions which favours small scale producers. In the case of some commodities, it is not possible to gain a certification if you are not a co-operative of small producers. This is seen as a problem since the majority of farm workers work in big plantations¹⁵.

Fourthly, it is argued that it is only a small amount of the mark-up prices that trickles down to the producers.

*“Perhaps the most cogent objection to fairtrade is that it is an inefficient way to get money to poor producers. Retailers add their own enormous mark-ups to Fairtrade products and mislead consumers into thinking that all of the premium they are paying passes on.”*¹⁶

A proof of this, used in *The Economist's* article, is a calculation by Tim Harford, author of *The Undercover Economist* (2005): Harford's study shows that only 10% of the premium paid for FT coffee at a coffee bar reaches down to producers, as the retailer uses FT labels to profit from price-insensitive consumers who are willing to pay more.

All of these arguments will be thoroughly analysed with trade theory in chapter 5.1 and discussed in a South African context in chapter 6.

¹³The Economist 2006

¹⁴The Economist 2006

¹⁵The Economist 2006

¹⁶The Economist 2006

2.2.2 Fairtrade as a fixer of the free market

The authors of *Fair Trade Market-Driven Ethical Consumption*, Alex Nicholls and Charlotte Opal, argue that FT is good for the market in that it helps the free market function better. They maintain that FT products are like any other product in the market and that FT actually improves the free-market mechanisms in the way that FT organises producers into co-operatives.¹⁷ An explanation of how market imperfections, such as lack of access to market, lack of information about the market and lack of access to financial markets, can be fixed with FT will be presented in chapter 5.2, and a discussion of whether or not this help is recognised by South African producers will be examined in chapter 6.5.

¹⁷Nicholls & Opal 2006 p. 32f

3 Fairtrade in South Africa

As of October 2006, 43 of the world's 586 FT producers were located in South Africa. After Mexico and India, South Africa possesses the highest number of producers, making it a main producer of FT commodities¹⁸. The FT production in South Africa includes wine, fresh fruits, juice, tea and dried fruits. Most producers are involved in wine making or fresh fruits production and are located in the Western Cape¹⁹.

Table:1 **Growth in sales volume of FT products**

PRODUCT	SALES VOLUME	SALES VOLUME	GROWTH IN %
	2004	2005	
WINE**	617.74	1.129.508	83
FRESH FRUIT*	5.16	8.29	61
TEA*	1.96	2.62	33
JUICES*	4.54	5.9	30
DRIED FRUIT*	238	306	29

* METRIC TONS || ** LITRES Source:FLO

In table 1 above we can see how the total consumption of these products increased in 2005 (The figures include sales of products from all FT producing countries)²⁰. In South Africa there are many local organisations with similar goals to FT. WIETA (Wine Industry Ethical Trade Association) is an organisation which audits and certifies producers like FT, but only in the wine industry and without using a floor price²¹. Normally producers only belong to one certification organisation as both organisations charge fees²². There are also other initiatives working towards ethical trade, which include other commodities such as handicraft.

The structure of FT producers in South Africa is not similar to the rest of the world, as the majority of FT producers are small farm organisations, whereas in South Africa the majority of FT producers are HL-producers. Only 3 out of the 43 producers in South Africa are considered as small farm organisations. About a handful are a hybrid functioning as an HL

¹⁸Fairtrade.net 2006

¹⁹www.flo-cert.net 2007

²⁰FLO international 2006 p. 11

²¹www.wieta.org

²²Interview; Flaaten 2007

producer but owned by the workers²³. In July 2004 a special document of FT labelling standards for South Africa was introduced by FLO which clarifies one particular standard for the South African context. It had become obvious that a document that clarifies the logic of FLO's generic standards was urgently needed for South Africa, particularly for HL situations.²⁴

Here follows the particular standards requirement and how it should be interpreted in SA.

Standards requirement

1. Social Development

1.1 Fairtrade adds Development Potential

Fairtrade should make a difference in development for certified producers

1.1.1 Minimum Requirement

1.1.1.1 The producer organisation (employer in case of hired labour situations) can demonstrate that Fairtrade revenues will promote social and economical development of small farmers (of workers in the context of hired labour situations).

1.1.2 Progress Requirement

1.1.2.1 A monitored plan should be developed under which the benefits of Fairtrade (including the Fairtrade premium) are shared based on a democratic decision taken by the beneficiaries.

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In the South African context, Standard 1.1 should be understood to mean an agricultural enterprise, which is either:

- A smallholder group engaged in commercial agriculture which complies with the generic FT standards for small farmers, or
- A plantation, which complies with the generic FT standards for hired labour, and where the employees have legally protected interests in a substantial part (i.e. 25%+) of the farming business, which has engaged in an auditable program of skills transfer and capacity building, and where the employees have a significant input in the operational management of the

²³Interview; Law 2007

²⁴Paulsen 2004 p. 1

²⁵Paulsen 2004 p. 2

enterprise.²⁶

The requirement of a 25%+ of equity or quasi-equity comes from two sources. First, the South African *Companies Act* 61 of 1973 specifies 25%+ as the shareholding level at which minority shareholder protection is activated, granting the shareholder certain rights, including representation at Board level. Secondly, the Black Economic Empowerment Act of the South African government, established in 2003, which sets this as the benchmark at which an enterprise is "empowered". Certified producers who do not comply with these standards have three years to adjust to the requirement.²⁷

3.1 Working standards in South Africa

Although South Africa is a richer land than many other FT producing countries (in GDP), poverty and unjust working standards are very much present. South Africa has a dark history of racial classes, beginning with slavery and later the Apartheid system that exploited black and coloured workers. Since the first democratic elections in 1994 South Africa has been trying to develop a country where everyone matters, a so-called "rainbow country"²⁸. Apartheid structures are still present, especially when looking at economical statistics. As shown in the *Human development report* in 2005, income distribution according to the GINI coefficient is among the largest in the world²⁹; an uneven distribution based on the Apartheid history of forced evictions and labour. Working conditions have improved since the end of Apartheid, but violations still exist. The *American Bureau of Democracy of Human Rights and Labor* describes this in their South African country report from March 2006:

"Labor conditions for mostly black farm workers were harsh. Many mostly white farmers did not accurately measure working hours and often required their laborers to work 11 hours per day and 6 days per week. Twelve-hour days were common during harvest time, and few farmers provided overtime benefits. HRW reported low wages, a lack of basic services in farm workers' housing, and inadequate education for workers' dependents (see section 5). Some white farmers still gave the predominantly black farm workers cheap alcohol (a system of payment known as "tot") in addition to wages. Mostly white farmers continued to evict workers legally and illegally; however, unlike in previous years, there were no reports that farmers set their dogs on employees (see section 1.f.). There was lack of compliance with labor legislation, lack of information on HIV/AIDS, and unacceptable

²⁶Paulsen 2004 p. 2

²⁷Paulsen 2004 p. 2

²⁸www.wikipedia.org 2007

²⁹Human development report 2005 p. 55

levels of violence and crime against farm workers and farm owners. Health and safety regulations often were not observed during the use of chemicals in agricultural work.”³⁰

According to reports shown in “*The Rotten Fruit*”, a paper by Action aid, a Non-Governmental Organisation (NGO), wages can be below minimum and there are violations against acceptable working conditions in SA.

“I get 378 Rand pay every two weeks, which is not the minimum wage. I can’t afford school fees for my daughter or go to school functions or buy school uniforms.... They spray pesticides while the women are working in the orchards. We have no gloves or protective clothing...we have to pick pears from the trees while they’re still wet from pesticides.” Tawana Fraser (name changed)³¹

Obviously the above description is an example of how bad conditions *can* be and not representative of the average South African producer.

³⁰ www.state.gov

³¹Wijeratna 2005 p. 2

4 Method

This thesis focuses on the arguments in favour of and against FT. The analysis of the arguments is divided into a theoretical part as well as a more practical part. First, the theoretical section evaluates the arguments based on economic theory. Different trade theory models are used to evaluate the validity of the arguments from a theoretical viewpoint. The models used are taken from different sources and some models are modified to be more relevant in a FT context. Secondly, the arguments are discussed from a South African perspective, in which interviews with people involved in FT in South Africa are used as the main source of information. The interviewed people, all interviewed during the field study in South Africa, represent a diversity of FT certified producers and people with other specific knowledge and experience of FT in South Africa. Those interviewed on farms were mainly managers on the farms, as they handle most of the market contacts etc. At one producer, Heiveld Co-operative Ltd., both management and farm workers were interviewed. The farm workers were interviewed with help from a manager who interpreted Afrikaans to English, and vice versa.

4.1 Limitations

As this thesis covers a broad topic with a number of questions, which all deserve a thesis of their own, time has been a major limiting factor. The interviews were not recorded on tape nor were they transcribed, as that would have required too much time. Only four FT producers were interviewed, which could be considered as a small case study. However, these producers represent both HL structured producers and co-operatives and are of different sizes and from both the Western Cape and Northern Cape province in South Africa.

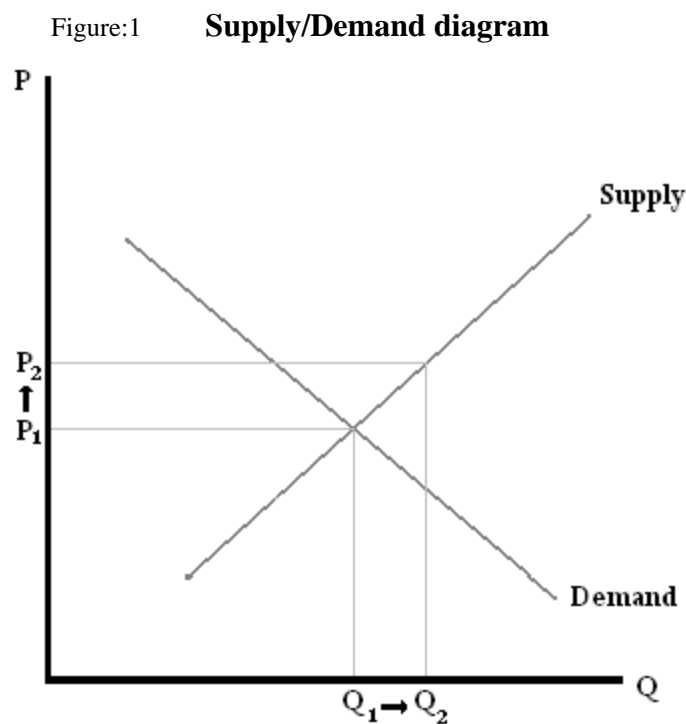
5 Theory

The arguments presented in *The Economist* will be theoretically analysed and discussed one by one in the chapter below as will economic theories that have significant information for and against the arguments. At the end of this chapter, the supporters' reasoning will be more thoroughly described. This will help to more easily understand and evaluate the comments by South African producers in the next chapter.

5.1 Fairtrade as a violation of the free market:

5.1.1 Lowering the world market prices

The Economist's article argues that an effective floor price (above market price) gives a higher price and payoff to the producer, thus increasing the incentive to produce more. This can be shown in a standard supply/demand diagram.



We see that at the market price P_1 producers supply quantity Q_1 . As the price increases from

P1 to the floor price P2 producers are prepared to produce Q2. The higher floor price paid covers the cost of more production and generates a profit until the supply curve reaches the higher price.

That a floor price leads to more production is only partly true. A higher price, which is a reason to produce more, will result in a lower demand and less products sold. An excess supply does not give incentives to produce more but to produce with higher quality to be able to sell products in a smaller and more competitive market. If we imagine a floor price that is so high that no consumer is prepared to buy any products, no production would take place. For FT producers there is no guarantee that their products will be sold at a FT price. The average FT producer sells the bulk of his/her produce to non-FT buyers³². When the producer has sold as much as possible at the FT price, he/she turns to the normal market to sell whatever is left. What determines the producer's incentives to produce more or not is the last sold item. A producer does not decide that he/she will try to double production if the cost of producing the second half is not covered by how much income the second half generates.

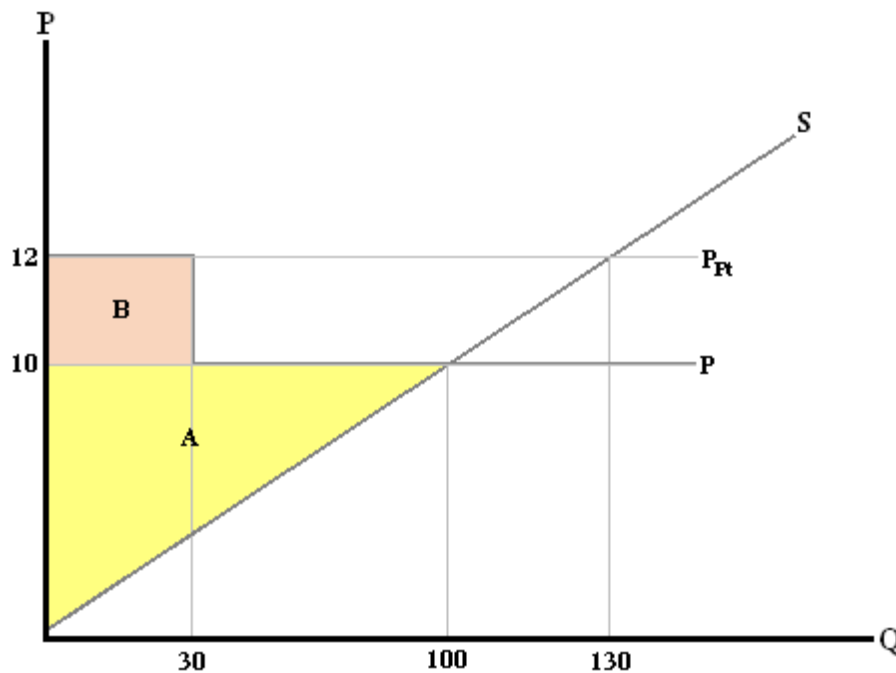
In the model below we see a FT certified producer. The producer is a price taker and affects neither the world market nor the FT market price³³. Before certification, the producer produced 100 units at a price of 10. As the producer acquires FT status, he/she is able to sell the products on the FT market at a 20% higher price. The FT market is small and, like most FT producers, this producer still has to sell the bulk of production on the normal market. To show this in the model, a quota of 30 units is used representing the limited demand on the FT market.

The price (P) equals the marginal revenue earned on every product additionally sold. Supply (S) indicates the marginal costs of producing one more product. The producer always wants to sell at the highest price, in this case the FT price 12 (Pft). However, the demand is limited to 30 units, so after 30 units sold, the producer faces the same marginal revenue as before certification on the normal market. Marginal revenue (P) and marginal cost (S) intersect at the same output as before certification. Therefore, the producer will continue producing 100 units and not more. The output is not changed by a fixed quota that is smaller than what was already produced.

³²Nicholls & Opal 2006 p. 7

³³Schotter 2001 p. 145

Figure:2 FT quota diagram



If the quota were larger than 100 units, say 130, then there would be an increase in output, as the last product produced is affected by the higher FT price. Before certification, the producer gained area A in surplus which increased to area A and B with certification. Figure 2 shows that FT does not have to lead to a higher output, even if it increases the surplus of the FT producer. As for entries of new firms and producers to the market, the higher average price is a motivation to try to take part in the FT market. But at the same time the excess supply is an incentive to stay out.

If the FT producers were able to sell all their products on the FT-market, non FT producers would be more affected. Below are two models; the first figure, figure 3.1, shows an example where the demand for FT is relatively low compared to FT supply, and the second figure, figure 3.2, shows where demand is relatively high.

The two figures represent a market where FT labelling is introduced. It is assumed that there is a single homogeneous product which can be produced by two methods: one that fulfils the FT requirements, F, and the other which does not, N. There are two consumer groups: one is concerned about producer conditions and prefers to buy FT products, even if the prices of the labelled products are higher, and the other is unconcerned and buys whatever good is cheaper. Before an introduction of FT the market equilibrium is where total supply, S total, and

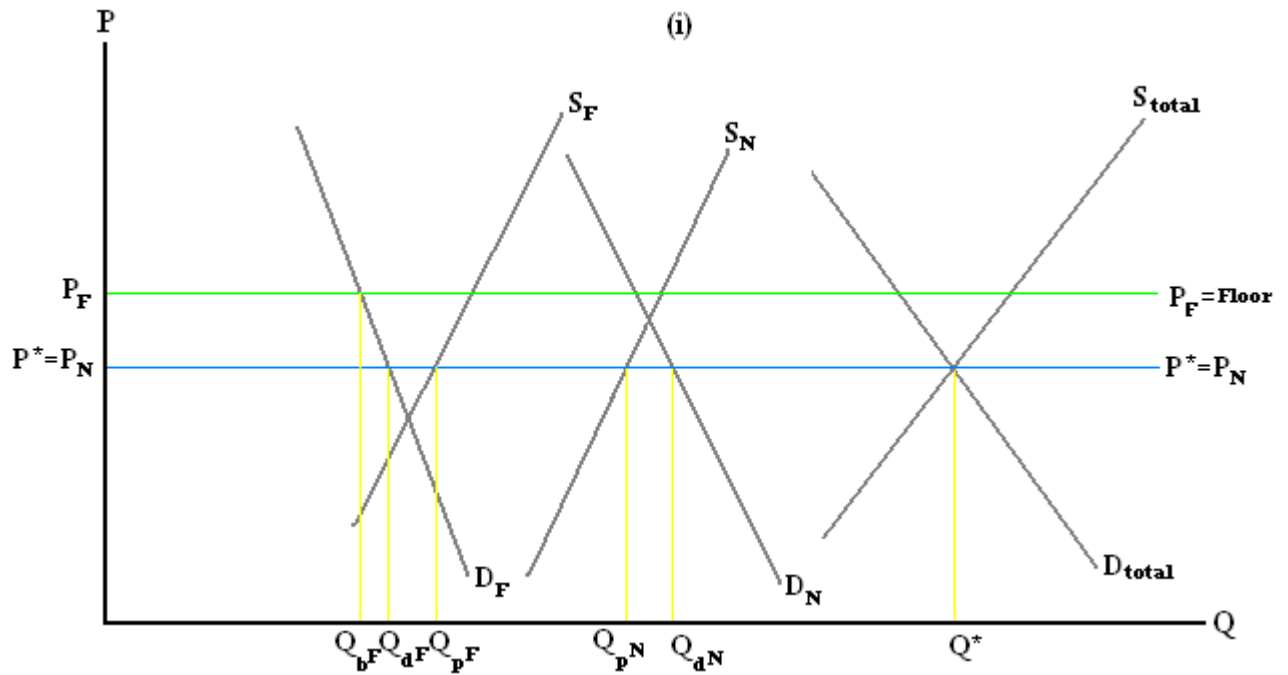
demand, D total intersect, giving price P^* and quantity Q^* . D total is the sum of demand by both concerned and unconcerned consumers, and S total is the sum of supply by producers that fulfil the FT standards and producers who do not. As FT certification is established, the consumers that are concerned about producer conditions will demand D_f products supplied by FT producers, S_f . The supply produced by non FT producers is represented by S_n , and demand by consumers who are unconcerned is shown by D_n . The supply and demand functions are continuous monotonic functions of the market price. It is assumed that all the conditions necessary for the existence, uniqueness and stability of equilibrium in each of the following situations are satisfied.

Labelling alters the market conditions, making it possible now for the two categories of the product to have different equilibrium prices, the FT price P_f and ordinary price P_n . As FT uses a price floor to secure acceptable working conditions and a minimum wage, the FT price may be higher than the equilibrium. P_n can never be higher than P_f because then the unconcerned consumers will perform arbitrage between the two categories until prices are equalised. The concerned consumer group is expected to buy the same quantity of commodities as before the labelling was introduced although the FT price is higher. As the FT price becomes relatively higher, some price-sensitive concerned consumers will buy the cheaper non FT alternative. An example of how concerned consumers are only concerned at a certain price is presented in a survey from the United States that discusses ecological choices. The survey shows that two thirds would pay more for a 'green product' than a not 'green product', but if the price difference was as high as 6% only half the population would be willing to pay, and if the 'green product' were 10% more expensive only one-fifth would choose the environment friendly alternative.³⁴

³⁴Matto & Shingh 1994 p. 57

Figur:3.1

Altering of market with a low demand for FT products

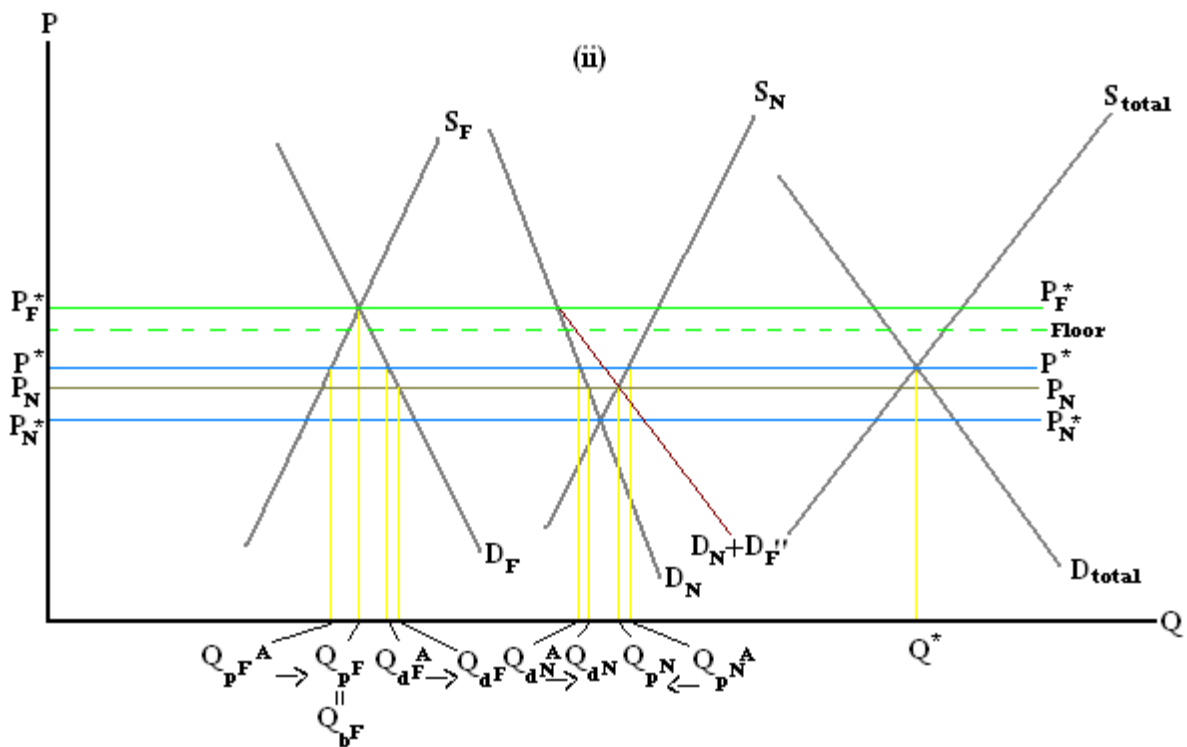


Help Box (i)	
P^* = Equilibrium price on the total market	Q_{pF} = Quantity produced by FT producers
P_N = Price on non FT market	Q_{dN} = Quantity demanded by unconcerned non FT consumers
P_F = Price on FT market	Q_{bF} = Quantity bought on the FT market

In figure 3.1 the demand for FT, D_F , is relatively low compared to the supply, S_F . Before an introduction of labelling in the market, FT concerned consumers represented Q_{dF} of the total demand and the unconcerned consumers accounted for Q_{dN} , at the equilibrium price P^* . Potential FT producers produced Q_{pF} and non-FT producers produced Q_{pN} adding up to Q^* , with both selling at price P^* . As the market alters through labelling, concerned consumers can now be sure to buy a FT product by paying an added premium given by the organisation FLO. FLO determines what price is fair enough and creates a price floor which no FT label product can be sold under. At the FT price P_F , in this case the floor price, concerned consumers are prepared to consume the quantity Q_{bF} . There are still concerned consumers demanding products but not prepared to pay the FT price. They will get their commodities outside the FT market, paying the non-FT price P_N . If FT producers were able to sell all their products at a FT floor price they would increase their output, but as there is a lack of demand at the FT price they will keep on producing at Q_{pF} . The FT producers will sell Q_{bF} at the FT floor price and their remaining products ($Q_{pF} - Q_{bF}$) at the non-FT market. The non-FT market will shrink as most concerned consumers choose FT products, and most FT produced products will be sold as FT. What remains is a slightly smaller non-FT market which still has the same price and the quantity of $Q^* - Q_{bF}$. Everything will be the same as it was before the altering of the market,

besides the fact that some of the consumption will be at a higher price that the concerned consumer is willing to pay. In this model, FT producers are better off as they are able to perform price discrimination, selling a part of their output at a higher price. Non-FT producers will neither gain nor lose as they sell the same quantity at the same price as before. The average price for the commodity will be higher and total output the same. According to this model with its assumptions, non-FT producers will not be worse off with an introduction of FT if the demand for FT is relatively lower than the FT supplied. The consumers must be as well or better off as they now have more variety and are free to buy what they prefer.

Figure:3.2 **Altering of market with a high demand for FT product**



Help Box (ii)
 P_N^* = market equilibrium price of non FT producers and non FT consumers
 D_N+D_F'' = Demand by unconcerned and concerned consumers on the non FT market
 Q_{pNA} = Quantity produced by non FT producers before altering of the market
 Q_{dFA} = Quantity demanded by concerned consumers before altering of the market
 Q_{dF} = Quantity demanded by concerned consumers both on FT and non FT market

In figure 3.2 the demand for FT is relatively high compared to the supply. Before an introduction of labelling in the market, FT concerned consumers represented Q_{dFA} and the unconcerned Q_{dNA} , of the total demand Q^* at the equilibrium price P^* . Potential FT producers produced Q_{pFA} and non-FT producers Q_{pNA} . As the market alters, the high demand for FT products will raise the FT price to P_{F^*} , a level that is over the FLO determined floor price. FT producers will sell all their products to the FT market and will therefore increase their production from Q_{pFA} to Q_{pF} . Some concerned consumers will not be prepared to pay P_{F^*} and will therefore buy in the non-FT market. In the non-FT market the demand is relatively low. As some concerned consumers will also consume at a lower non-FT price, the demand increases from D_N to $D_N + D_{F^*}$, which crosses the supply line on the non-FT market at the quantity Q_{pN} and price P_N . Non-FT producers will face a lower price P_N and will produce less, Q_{pN} than before the altering of the market. As the price is lower, total consumption will increase by $Q_{dF} - Q_{dFA}$ plus $Q_{dN} - Q_{dNA}$. FT producers will be better off as they are able to increase their production and gain a higher price for all products sold. Non-FT producers will be worse off as they receive a lower price and sell fewer products. All consumers will be better off as they have more variety and can buy at a lower price.

For a deeper analysis of these models turn to the article *Eco-Labelling: Policy Considerations* by Aaditya Mattoo and Harsha V. Singh³⁵. Their article discusses the altering of the timber market in an ecological and a non-ecological part, using similar models explaining how labelling affects the output of timber (though without using a floor price).

The models are built upon assumptions which more or less reflect the real world. The assumption that a FT consumer will continue consuming the same quantity although the price is higher might be more true for some commodities (e.g. coffee) than others (e.g. bananas). Historically, coffee consumer consumption has not been affected by price changes³⁶. If the consumer has a “banana budget” and is supposed to spend e.g. £10 on bananas, obviously the quantity of bananas consumed would be less. There is also a possibility that as FT is introduced, more bananas would be sold, as FT adds an advertising value. The total demand for bananas may grow as the variety of bananas increases.

The models also build upon more classical economic assumptions, for example the possibility to easily switch product produced. For many producers, market models are not the main force

³⁵Mattoo & Shingh 1994 p. 53ff

³⁶Durevall 2006 p. 22

of how to act as a player on the market; e.g. if the tea price were to go up quickly, the ability of the producer to change to that crop is not very high in the real world. If the price of citrus fruits goes down, the model tells us that fewer citrus fruits will be produced. For the small citrus farmer the incentive may be the opposite. If your margins were already small before the price fall, instead of changing your crop to tea, you may be forced to produce even more of the citrus fruits just to stay alive.

“In a perfect functioning market, economic actors can switch easily from one income-generating activity to another in response to price information. This is clearly not the case for the world's poor. Even if isolated producers had access to price information, their ability to change their source of income is limited. The 1.2 billion people who live on less than \$1 a day are extremely risk-averse. Switching from growing a crop that your grandfather grew to a higher-priced crop that no one in your village has ever grown before is an extremely risky activity. For families with no slack in their income and little by saving, risk-taking is not an option. A lack of access to credits or education about other income sources contributes to this inability to diversify income sources.”³⁷

Examples of how lower price does not lead to less production, but to the opposite, are found in Oxfam's report *Rigged Rules and Double Standards* from 2002:

“In 2001, prices for cotton were less than half of those prevailing in 1990, but production was 10 per cent higher. In the case of coffee, production levels were one-quarter higher at the end of 2000 than in 1990, despite the protracted decline in prices. In a market where prices are falling, the only way to maintain income is to increase the volume of output. This is precisely what many commodity exporters have been doing. The problem is that this closes the vicious circle: producers export more, which pushes down prices, and then seek to increase exports again, which produces a similar outcome. In other words, primary- commodity exporters have to run, simply to stand still”³⁸

As FT uses a minimum price which reduces the need for diversification of production, it is accused of keeping non-effective production alive through mouth to mouth resuscitation³⁹. If FT were to cease to exist, producers would be powerless as they grow dependent on a FT price. Diversification is difficult to achieve, not only because of a lack of know-how and

³⁷Nicholls & Opal 2006 p. 19.

³⁸Watkins 2002 p. 159

³⁹The Economist 2006

tradition, but also because there is a lack of resources and possibilities. Considering that e.g. coffee and vanilla like most crops take 3-5 years to grow before you see any return you need a, normally non-existing, buffer to change yield. As financial markets often are non, or close to non-existent, this dilemma is hard to crack. According to TransFairUSA, one of the twenty members of FLO and a FT certifying organisation, FT is a solution for diversification.

*“While in theory, higher Fair Trade prices might incent farmers to increase production, in practice we have often seen the opposite. Fair Trade farmers invest Fair Trade revenues into improving their homes, sending their children to school, and on farming methods and equipment that improve crop quality -- rather than on increasing production. In fact, many Fair Trade farmer groups have successfully implemented crop diversification and income generation projects in order to reduce their dependence on a single crop as their primary source of income. Fair Trade revenues provide a safety net that allows farmers to explore alternative income generation projects such as beekeeping, ecotourism, and handicraft production.”*⁴⁰

Whether FT leads to more or less diversification needs a deeper examination. In this chapter and the above models we see that the reasoning by *The Economist* might be true. If the FT producers are able to sell all of their production at a higher FT price they clearly have an incentive to increase their output. However, FT does not need to lead to overproduction and does not have to be bad for non-FT producers, as a limited demand is no motive to raise production. Considering that the FT producers usually sell their bulk of production to the non-FT market⁴¹ the risk of overproduction for the majority of the FT producers is limited. As for consumers FT is something they can choose to buy or not, making it as good as or better than before the introduction of the FT-market.

5.1.2 Reducing the incentive to raise quality

The Economist's article argues that the price floor is an incentive to lower the quality of commodities, meaning that the minimum prices are harmful for producers as they take away an incentive to improve quality. When the price is already set, there seems to be no danger in falling behind in quality as long as the quantity is reached.⁴²

⁴⁰www.transfairusa.org

⁴¹Nicholls & Opal 2006 p. 7.

⁴²The Economist 2006

Theoretically and practically, the FT market works like any other in the sense that if there is no demand for the products, nothing will be sold. If the quality is too low, the producer will not get any orders. As shown in the chapter above, the price floor might even increase initiatives to increase the quality as there is an excess supply on the FT market. The price floor blocks the possibility of competing with the price under a certain level, giving quality and marketing etc. increased importance. The reasoning by *The Economist* would be true if the producers were to be guaranteed a minimum price for their production for years to come. As there is no such guarantee the argument used by *The Economist* is incorrect. One form of a limited non-compulsory pre-finance does exist, but only on a one year basis and a maximum amount of 60% of the production value⁴³.

5.1.3 Hired Labour producers vs Small co-operatives

The Economist article discusses the fact that FT certification is available only to co-operatives of small producers of particular commodities, for instance, coffee. It quotes Mr Wille of the Rainforest Alliance, a rival/alternative certification organisation for ethically produced goods who does not deny bigger plantations. Mr Wille says that limiting certification to co-operatives means “*missing out on helping the vast majority of farm workers, who work on plantations*”⁴⁴. What explanations are there for FLO not accepting bigger producers to a full scale?

As quoted in chapter 2, FT's objective is to “*contribute to sustainable development by offering better trading conditions to, and securing the rights of, marginalized producers and workers...*”⁴⁵

Using economic theory, it is possible to find reasons that explain why small producer co-operatives may be preferred to bigger plantations in order to reach these goals. By generalising about small producer organisations and bigger plantations, certain differences can be assumed, making small producers a better alternative for sustainable development and helping

⁴³Nicholls & Opal 2006 p. 37.

⁴⁴The Economist 2006

⁴⁵de Ferran & Grunert 2007 p. 219

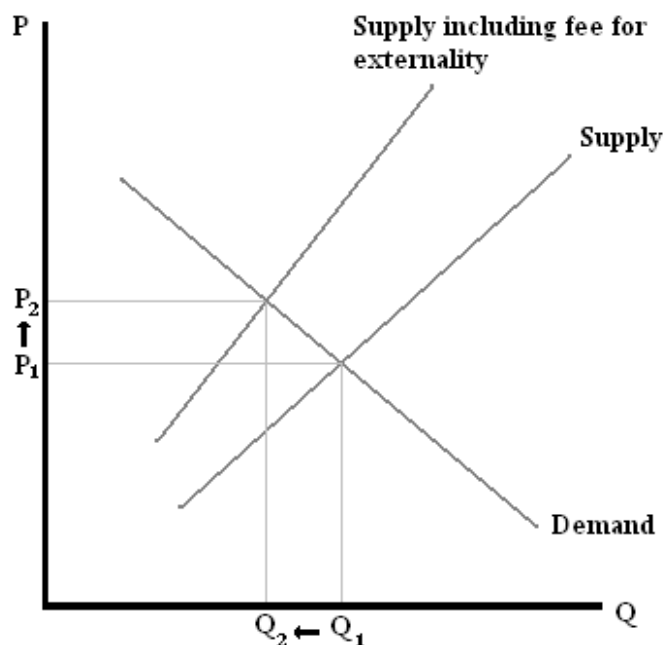
disadvantaged producers. The two economic models below show how commonly owned small farm organisations may act differently to more capital based HL structured farms.

5.1.3.1 Sustainable development

A small scale producer owns the land he/she ploughs and has typically a very long-term relationship with the land, having it passed on from one generation to the next. A hired labour producer owns the farm and pays workers to work for him/her; assumably these farms are more likely to change owners as well as workers. If this is true, the small scale producer is expected to have a long term relationship with his/her land, and not be able to concentrate on short term profits or ignore negative externality that will appear over time. Examples of negative externalities are deteriorating groundwater, land erosion and unhealthy working conditions. For a buyer of e.g. an apple, it is almost impossible to investigate if there are pesticides used in the production process that may lead to an early death for the apple picker.

If an externality is not included in the calculation of a product, the equilibrium of supply and demand will be ineffectively allocated, as externalities should also be included in the calculation.

Figure:4 **External effects model**



46

⁴⁶Eklund 2001 p. 103

The market price in the model is P_1 and quantity Q_1 , where no consideration is taken of the negative externality. If the true cost of production were to be respected, the price would be higher, P_2 . The higher price can compensate for the negative external effect, e.g. detoxicate the ground water. As the real price is higher the consumption will be lower, Q_2 .

One example of when negative externalities were ignored occurred in the Swedish wood industry and received a lot of attention in early 2000. As the value of timber was high and the cost of woodland was low, short-term investors found it very profitable to buy the forest, cut it down for a direct profit, and sell the clear cut area to the highest bidder, already making a profit on the one time felling. A clear cut forest has a much longer recovering process which is both harmful for the environment and damaging to the landscape. In practising sustainable forestry, clear cutting a forest is avoided since it will not generate any profits for a long time, making it an unfavourable option in the long run. A forester who lives and owns his/her wood, would include the externalities of a cut down forest. His/her children might also want to practise forestry and until then they will likely want to play in the wood, instead of a clear cut area, incentives an owner living far away in a city does not include in his/her consideration.⁴⁷

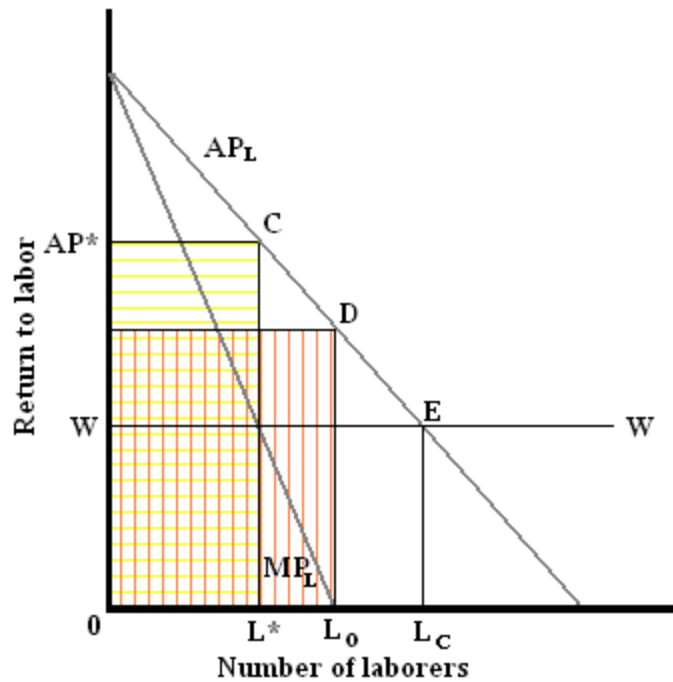
As quoted in chapter 3.1 there have been cases where fruit pickers at commercial farms have picked fruit that was still wet from pesticides without gloves or protective clothing. Since unskilled labour is easy to replace, a farm owner does not have as big incentives to invest in protective gear as owner working the field herself.

5.1.3.2 Disadvantaged workers

As shown in the Common property resources model below, it is assumed that a privately owned farm with hired labour operates more efficiently than a common owned farm that does not hire labour. HL producers aim to employ the number of workers that gives the maximum profit, while commonly owned farms tend to engage too many. In the model below we see the allocation of number of labourers. The original model was made to show the difference between privately held land and commonly owned land, where the farmers of the commonly owned land are not organised. In this model an alternative are added where commonly owned farmers are organised.

⁴⁷www.dn.se 2003

Figure:5 **Common property resources model**



48

In figure 5 above we see return to labour on one axis and number of labourers on the other. It is assumed that the MPL (marginal profit per labour) is declining for an extra worker as there is a decreasing return to labour with a limited amount of land. W represents wage which in this case (as in South Africa) is a minimum wage. A HL producer hires labour as long as the wage is covered by the marginal production of the last employed to maximise the owner's profit. If he/she employs one more worker the cost of that worker will be higher than the marginal production he/she generates; although his/her individual production is above the wage, the marginal production will be lower as every other worker's production falls due to the decreasing returns to labour. For a maximising HL producer in this model, L^* will be the amount of labour employed and AP^* (average production) minus W (wage) are the profits made by the producer. A common property producer functions differently. Generally, if land is commonly owned, the number of labourers will increase further as each worker is able to appropriate the entire revenue of his/her work (both profits and wage), which is equal to the average product of all workers. If the profit is not divided among the workers, through e.g. a co-operative, the number of workers will be so high that the marginal production of the last engaged worker will be negative. The allocation would end up where AP_L (average production per labourer) crosses W , instead of where MP_L crosses W . In this model it is at point

⁴⁸Todaro & Smith 2003 p. 477

E where there is no profit made but a greater number of workers earning a wage.⁴⁹

If the workers on a commonly owned property organised themselves by sharing the profit, the amount of labour would not be so high that the marginal production turned negative. The “organisation” would benefit from having fewer workers on the farm even if the workers who did not work were to share the income in the organisation. An organisation that maximises the value of the land would use as many workers as possible until the marginal production becomes negative. In this model the allocation is shown by point D, giving a profit of the area between D and W. Total income including both profit and wage will be larger for the organisation scenario than for the privately owned farm, although the average production per worker is smaller. Whether the relatively inefficient organisation can be seen as a better or worse alternative than a privately owned farm from a disadvantaged worker's perspective, depends to a large extent on what other possibilities there are for the workers.

It is normally assumed, in neoclassical models, that all workers could be employed elsewhere with productivity equal to or greater than W. With this assumption, the social welfare must fall when MPL falls below W. In this case, a privately owned farm would be more efficient than a commonly owned and organised farm.⁵⁰ If it is assumed that the workers could not be employed elsewhere, the commonly owned and organised farm could generate the most social/total welfare (profit plus wage). Focusing on which type of producer favours equity, it is clearly the commonly owned producer, where more workers earn a wage and where also the profit is divided amongst the workers. If unemployment is very high in a region, it can be assumed that assisting only small organisations that employ more workers may be more beneficial for the average disadvantaged worker (unemployment in South Africa was officially 25.5% in September 2006⁵¹).

Bigger plantations may be just as good as small organisations in terms of environmental standards and working conditions while also being more effective. However, it is not a guarantee that the higher price paid for a FT good is used only to credit the disadvantaged workers and for long-term sustainable production. On the other hand, other economical arguments exist as to why privately owned businesses might be more developing for a region in the long run. An important engine for economical growth is inventions, and inventions

⁴⁹Todaro & Smith 2003 p. 476f

⁵⁰Todaro & Smith 2003 p. 476f

⁵¹www.statssa.gov.za 2006

require investments.⁵² HL producers who maximise their profits are able to invest more money in research and development. As HL producers normally are bigger players with a higher turnover than small co-operatives they can also benefit from increasing returns to scale as e.g. the administrative cost per hectare farmland is smaller on a larger farm⁵³.

In chapter 6.3 this will be discussed from a South African perspective.

5.1.4 Inefficient help

The article in *The Economist* claimed that FT is a very inefficient way to transfer money from the rich to the poor since most money disappears before reaching the FT producers.

The FT label should give you a fivefold guarantee

- a fair and stable price to farmers
- extra income for farmers and estate workers
- a greater respect for the environment
- a stronger position for small farmers in world markets
- a closer link between consumers and producers

54

If the extra money spent by a consumer on a premium to benefit disadvantaged producers does not reach the producers, the consumer has been deceived. To make an efficient purchase, the consumer needs to have full information about the commodities, and full information is practically impossible to get. When you buy a FT product you know that the producer who works at the bottom of the ladder gets something more out of it than she would if the product were not a FT product. What you do not know is how much of the extra price you pay actually reaches the producers.

Arthur M. Okun, former professor of Economics at Yale University, compares the transfers of money from rich to poor to a leaky bucket. There is no costless transfer of money from rich to poor since some of the money will always disappear in transit. The leakage basically represents inefficiency and the question is how much inefficiency the donor is prepared to

⁵²Jones 2001 p. 195

⁵³Schotter 2001 p. 172

⁵⁴Litvinoff & Madeley 2007 p. 16

tolerate⁵⁵.

Consider a situation where water needs to be transported from one place to another place in a leaky bucket. Some water would always leak out. If all water leaked out, it is obvious that no one will want to carry any water. The decision to carry the water or not will depend on how leaky the bucket is and on how big the will is to carry the water to the destination. If bringing a little water to the other end can save a life the carrier might accept that, say, 99 % of the water leaks out. If the water is used to quench one's thirst, say, a 50% leakage will be accepted. If the water is needed to water a thirsty flower there might not be anyone prepared to carry the water no matter the amount of leakage.

This reasoning can also be used for FT. If the FT consumer knows that all the extra money spent will be used to improve lives then he/she may be willing to go without something else to finance the FT purchase. If the consumer thinks that the bucket is leaking heavily and 90% of the extra money spent goes to middlemen, as in Harford's study, it is less likely that he/she will pay extra for that good.

The problem is that it is very hard to know where the money goes, and how working conditions are during production when you buy any commodity, FT or not. The FT supporters, Nicholls and Opal, recognise that far from every extra coin spent on FT reaches the FT producers.

“it is indisputable that £1 given to a development charity generates more immediate revenue for relieving poverty than £1 spent on a Fair Trade product.”⁵⁶

“a typical Fair Trade chocolate bar only returns about 4 per cent of its final price to the producer, this can be twice as much as would conventionally go back down the supply chain”⁵⁷

Although FT gives less direct money to poverty relief than aid, Nicholls and Opal still anticipate that FT has more to give than pure aid, meaning that aid alone often fails to offer a developmental path out of poverty and leads to dependence on outside support. Meanwhile, FT does not only create economical resources but also develops social capital at the FT

⁵⁵Kakwani & Son 2005 p. 1

⁵⁶Nicholls & Opal 2006 p. 30

⁵⁷Nicholls & Opal 2006 p. 29

farms⁵⁸. The inefficiency of FT transfers will be further discussed in chapter 6.4.

5.2 Fairtrade as market imperfection fixer

In the book *Fair trade Market-driven ethical consumption* authors Alex Nicholls and Charlotte Opal discuss a wide range of aspects concerning FT. Contrary to *The Economist* Nicholls and Opal see FT commodities as goods functioning as any other commodity in the market, with the difference that it actually helps the market to function better.

*“Fair trade is entirely a consumer choice model, it operates within the larger free trade model of unregulated international commerce. Fair Trade is not controlled or enforced by any government agency; rather it can be seen as just another product feature, like colour or size, albeit a very powerful one.”*⁵⁹

As a FT product is something you buy out of choice, it is a product like any other. If you wish, you can pay extra for FT coffee where you have a guarantee that the worker who picked the beans is better off. If you do not want to, you do not have to buy FT and can save the extra money for, maybe, a pink cellphone case. You are free to buy a pink phone case if that makes you happy, and you are free to buy FT coffee if you prefer to buy FT. If your intention is to help disadvantaged workers, your choice is obvious, although it becomes more complicated when the workers who get their income by making pink cellphone cases are included in the equation.

According to Nicholls and Opal, the free market does not function for producers in the developing world. The producers are disadvantaged and easily exploited as they face obstacles to operate as an equal part in the market. Basic conditions for the free market to work as perfect information, access to credits and ability to shift crops, are not a reality for the producers. Nicholls and Opal explain that FT is a solution to this shortcoming, as FT works to organise the small-scale producers into larger co-operatives with bigger possibilities. Here follows their reasoning as to how a co-operative structure helps disadvantaged producers.

⁵⁸Nicholls & Opal 2006 p. 30

⁵⁹Nicholls & Opal 2006 p. 31

5.2.1 Lack of access to market

As farmers in developing countries often live in isolated rural areas, with few or no roads, and without trucks or mules to take their product to the market, they are often reliant on middlemen to come to their farms and buy their product. The farmer is normally subjected to monopsony situations; they often only get one price offer, since middlemen (or, coyotes, as they are called in Central America) agree to not compete with each other on price. Forming a co-operative where farm members own shares in an umbrella business organisation allows the co-operative to pool resources to own or rent a truck. As the co-operative is owned by the farmers themselves and all profits are shared democratically according to the wishes of the farm members, there is no incentive for exploitation.⁶⁰

5.2.2 Lack of information about the market

As remote farmers have few channels to market information, such as knowledge about prices, quality and industry requirements, their market perception is poor. Without telephones, internet, newspapers etc. the middleman becomes the only source of information on customer feedback regarding quality and prices, making it impossible to have up to date information. By creating a larger co-operative, farmers can pool their income to purchase a phone, fax etc. and even afford the services of an English speaking sales manager to better market their products.⁶¹

5.2.3 Lack of access to financial market and credits

Accessing income-smoothing market solutions, such as futures and options that give the farmer a predictable price is practically impossible for small farmers. Also, the usage of loans to smooth income flows is difficult as there is normally a lack of competition in the credit markets with excessively high interest rates as a result. Many small farmers depend on financing from the middleman, who might contract out a farmer's crop for the next year. Rates can be as high as 100 percent per annum⁶². Through creating a co-operative, members can benefit from these financial markets and reduce their exposure to risk from price fluctuations. As a FT co-operative, it is possible to demand that the importer provides up to 60 percent of the contract amount if asked by the co-operative, as it is a FT standard, which will give the

⁶⁰Nicholls & Opal 2006 p. 34f

⁶¹Nicholls & Opal 2006 p. 35f

⁶²Nicholls & Opal 2006 p. 36

producer a more smooth and predictable income. However, sometimes co-operative leaders are afraid to ask FT importers for credits for fear that the buyer will go to a less-demanding co-operative and they end up losing the sale.⁶³

There are devastating examples of how disadvantaged farmers lose everything to the middle-man as a result of vulnerability. For example, in Andhra Pradesh province, India, many farmers committed suicide since escalating debts to middlemen left them no hope⁶⁴.

The sum of this reasoning is that the lack of market access makes the farmer exploitable, and by creating a co-operative, the strength of the producers will increase. A co-operative shares fixed costs and by collaboration and pooling resources market access and market information can be gained. FT obviously does not have to be involved to create a Co-operative and obtain the above benefits. Nevertheless, FT can be the engine for formation of co-operatives as it brings skills and adds an extra economical value for the farmers engaged. The premium paid is used to invest in common interest, such as transportation and information channels etc., which strengthen the farmers in the co-operative.

⁶³Nicholls & Opal 2006 p. 36f

⁶⁴Litvinoff & Madeley 2007 p. 105f

6 The views at South African farms.

In this chapter the opinions of persons involved in FT in South Africa will be presented. I used the arguments from the article in *The Economist* as well as the points by Nicholls and Opal to investigate if the problems and/or solutions are recognised by the players involved. Four FT certified producers were interviewed in which three are HL structured producers and one is structured as a co-operative. The four producers were unlike each other in both size and structure.

Table:2.1 **Interviewed South African producers**

Producer	Structure	Product	FT certified
Citrusdal cellers	HL	Wine	2003
Heiveld co-operative ltd	Co-op	Tea	2001
Thandi	HL	Wine	2003
Vuki	HL	Fruits	2004

65

Five other persons were also interviewed, representing FT exporters, a farm manager seeking FT status, an NGO director concerned with the FT market and a representative from Fair Trade South Africa.

The viewpoints from these interviews will be used to comment on the theoretical arguments from a South African context.

6.1 Lowering the world market prices

Since FT is a very small part of the world market today, the producers thought that the question was odd. The output of FT is so small that it is far fetched to talk about any world market price changes. On the question of whether the FT minimum price can increase or limit output, Winemaker Ian Nieuwoudt at Citrusdal responded: “*minimum price will not be a life*

⁶⁵Interviews; Nieuwoudt, Skippers, Tshapile & Visser 2007

buoy for inefficient producers” as the competition is also hard on the FT market⁶⁶. At Heiveld, on the contrary, they are highly dependent on the FT market. Heiveld, which has been a FT producer of the unique South African tea rooibos since the co-operative started in 2001, sells 100% of its production on the FT market. For Heiveld, the FT market is absolutely necessary; “*when FLO came in, development could take place*” says Barry Koopman, tea maker in the Heiveld co-operative⁶⁷. The producers of Heiveld fear that big HL structured producers will earn FT certification which could lead to more competition than Heiveld can handle (this will be discussed further in chapter 6.3). As Heiveld produces 100% of the rooibos to the FT market, it is likely that they would not have produced as much if it had not been for FT.

In table 2.2 we see how much of the production of the interviewed producers is sold as FT.

Table:2.2 **Percent sold as FT at interviewed produces**

Producer	% sold as FT in 2007
Citrusdal cellers	35
Heiveld co-operative ltd	100
Thandi	60
Vuki	6

68

One reason why HL producers sell less of their total production to the FT market is that they in general have a much higher output. Angard Flaaten, a FT wine trader with an overview of the wine market confirms that supply is higher than demand on the FT market⁶⁹. For the Vuki farm which sells fruits, the FT floor price is higher than the world market price. Although the FT price is higher, they only sold 6% of their production on the FT market⁷⁰. This proves that being a FT producer does not ensure that you will sell all your products at a higher price.

In *The Economist* article there was also an argument that the higher price leads to less diversification. Heiveld, the only producer that clearly has an incentive to produce more and therefore should be less stimulated to diversify, seems to do the opposite. With the premium money Heiveld is working on research to create a new organic seed tea plant to diversify

⁶⁶Interview; Nieuwoudt 2007
⁶⁷Interview; Koopman, B. 2007
⁶⁸Interviews; Nieuwoudt, Skippers, Tshapile & Visser 2007
⁶⁹Interview; Flaaten 2007
⁷⁰Interview; Tshapile 2007

production and also enter the seed selling market. Heiveld has also ventured into packaging as partners in Fair Packers, a Cape Town based packaging company. This involves Heiveld in more steps of the market chain, which enables the company to gain more revenues from their products. This would not be possible without FT, according to Petricia Visser, Marketing Manager at Heiveld⁷¹. *The Economist* suggests that FT leads to overproduction and a lower world market price. Out of the four producers investigated in this case study, only one is likely to increase output using the models presented in chapter 5.1.1.

6.2 Reducing the incentive to raise quality

The Economist suggests that FT leads to lower quality products due to the floor price. This is theoretically possible if producers are guaranteed both a minimum price and a minimum quantity for a long time to come. Such guarantees do not exist according to the producers in this case study.⁷² FT producers are also exposed to competition, and there is no quantity that can be safely sold to the buyers. A possibility for the producers to demand pre-finance of a value up to 60% of the products exists, but Sandra Kruger, who is Fair Trade's representative in South Africa, does not know any pre-financed example in South Africa⁷³. This can be a result of, as mentioned in chapter 5.2.3. fear that importers will turn to the least demanding producers.

6.3 Hired Labour producers vs Small co-operatives

The demand for FT is growing rapidly. So is the interest for South African producers to gain a part in the FT market. For example, in the wine market there were two FT wine producers in 2006, four in 2007 and probably seven in 2008 according to winemaker Ian Nieuwoudt. As new producers enter the FT markets old producers get competition. Three out of four interviewed producers, who all represented HL producers, welcome competition from other South African producers, as it may make the South African FT market more well known. The small co-operative, on the other hand, is very upset over the entering of a large HL Rooibos plantation to the FT market, which brings much new competition for them.

FT farmer co-operatives are estimated to earn between 25 and 60 percent more than they

⁷¹Interview; Visser 2007

⁷²Interviews; Nieuwoudt, Skippers, Tshapile & Visser 2007

⁷³Interview; Kruger 2007

would have done without FT⁷⁴. A farmer in Heiveld Co-operative Ltd earns about 85 percent more than a farmer at a commercial company according to Barry Koopman, a tea maker at Heiveld Co-operativ Ltd⁷⁵. Recently, Rooibos Limited, the biggest producer of rooibos in South Africa, and in the world, with approximately 70% of the world market, gained FT certification⁷⁶. The small scale co-operative Heiveld is no longer sure of survival as the big plantations who enter the market are able to lower the FT price to less than half. According to Patricia Visser, Marketing manager at the Heiveld co-operative, the price of FT rooibos was reduced by 50% on the American market when Rooibos Limited entered, from 45 R/kg to 22R/kg. Heiveld is no longer able to compete as its production costs are higher.⁷⁷

“It is very important to keep out the commercial farmers... One commercial farmer has the capacity to taking out 52 farmers. Do you want one to develop very quickly, or 52 to develop sustainably?” says tea maker Barry Koopman.⁷⁸

The article in *The Economist* suspects that the FT certification builds on a political assumption that small producers are favourable towards fair production. In some commodities it is not possible to gain a certification if you are not a co-operative of small producers. This is seen as a problem as the majority of farm workers work on bigger plantations⁷⁹. In South Africa, FT is mainly criticised for the opposite reason, when they do let bigger producers enter the market. In the case of wine, fresh fruits and tea, bigger plantations are welcomed to get FT certification.

Stephen Law, director of the NGO Environmental Monitoring Group (EMG), a NGO working to raise awareness of trade debates, particularly in FT, food security and water, sees FT as a victim of its own success. As FT becomes more popular, bigger plantations take part in FT and take over market shares from the small farm co-operative. He sees FT as a way of protecting the small farm organisations and small farming as a way of life. As Hired Labour producers enter the FT market, traditional small scale producers can no longer compete. Law thinks that one of the reasons that small scale producers can not compete is due to the fact that larger companies are able to ignore externalities, while small scale farmers are more obliged to farm

⁷⁴Litvinoff & Madeley 2007 p. 13

⁷⁵Interview; Koopman, B. 2007

⁷⁶www.rooibosltd.co.za

⁷⁷Interview; Visser 2007

⁷⁸Interview; Koopman, B. 2007

⁷⁹The Economist 2006

the soil sustainably as they have less mobility.⁸⁰

Rydal Jeftha, who is the general manager at Kootmanskloof, a wine producer undergoing a FT certification process, and former brand manager in wine at Thandi, says that “*Big business hijacks the fair trade concept*”. He means that FT is failing in its support to the exploitable small scale producer when bigger producers as well as companies with a bad reputation (such as Nestle and Lidl) enter FT. When the small scale producer can be outcompeted by a bigger producer FT has lost its prime objective. Jeftha says “*When everyone becomes Fair trade producers, we are back to the starting point for small farmers.*”⁸¹

Many are also critical against how the FT-premium is used at the HL producers. The premium may only be used to benefit the workers on the farm, investments for improvements are democratically decided by the joint body. The money is often used on housing. Examples from the three HL producers interviewed are community hall renovation, air-conditioning, TVs and playing fields.⁸² Although these improvements have been democratically decided and benefit the workers, they are criticised as they also benefit the farm owner. The farm owner possesses the land which the houses stand upon, and accordingly owns the houses where the improvements add extra value. Although the improvements are in line with the workers' wishes they only benefit the farm owner if the worker has to move.

*“FLO premium on commercial farms are used to build houses; is it not the farmers obligation to build a good house for the worker? Profit will go to the farmer. The value of the farm will go up, not the money of the workers.”*⁸³

At the HL producers interviewed, there are also examples of using the premium for: paying for workers' children's school fees, day care for kids, and courses to uplift workers (e.g. gender equity and decision making courses, which clearly benefit the workers).⁸⁴

Another problem is to benefit the seasonal labour as it is hard to get the seasonal labour to profit from the development as they are not living on the farm during most of the year⁸⁵. Additionally, workers in the wine cellars, who work on similar pay and also live under bad

⁸⁰Interview; Law 2007

⁸¹Interview; Jeftha 2007

⁸²Interviews; Nieuwoudt, Skippers & Tshapile 2007

⁸³Interviews; Koopman, B. 2007

⁸⁴Interviews; Nieuwoudt, Skippers & Tshapile 2007

⁸⁵Interview; Keteldas & Tshapile 2007

conditions but normally in the townships and not on the farm, are not included in the FT premium although working within FT wine.⁸⁶

For a co-operative worker to have an 85% higher wage than the average “normal” worker, does not sound like a possible long term solution. Non-FT workers should see the huge wage gap and try to join the FT market, which would level out the differences between the two markets. If the objective of FT is to affect as many workers' life situations as possible, then including HL producers is essential, but if the objective is to secure small farming as a way of living, and to achieve a bigger impact on fewer farm workers, supporting small co-operatives is the obvious choice. *The Economist* criticises FT for excluding bigger plantations on the “political assumption” that small co-operatives are a better way of organising labour. In the case of FT commodities produced in South Africa there is no exclusion of HL structured producers. On the contrary, there are critical arguments against FT for *not* excluding HL producers.

6.4 Inefficient help?

The Economist writes that FT is an inefficient way of transferring money to the poor. The interviewed producers claim, on the other hand, that FT is a good way to make sure that money reaches rural disadvantaged areas and that the method of giving pure unconditional aid is not as stimulating for development.⁸⁷

“They have made a difference for the farm workers so they can be motivated and realize their dreams.” says Elliot at Vuki about the FT organization.⁸⁸

Koos Paulse, a tea maker who used to work for a white conventional farmer says that he was born on the farm without any rights. Now that he has joined the FT co-operative, he has finally received rights which give him a “human boost”. *“Before there was just work, now there is pride.”*⁸⁹

To think that producers of FT products would openly say that to buy FT is an inefficient way to support disadvantaged communities would be naive. There are, however, critics involved in

⁸⁶Interview; Jeftha 2007

⁸⁷Interview; Jeftha, Nieuwoudt, Skippers, Tshapile & Visser 2007

⁸⁸Interview; Tshapile 2007

⁸⁹Interview; Paulse 2007

FT that definitely share *The Economist's* viewpoint.

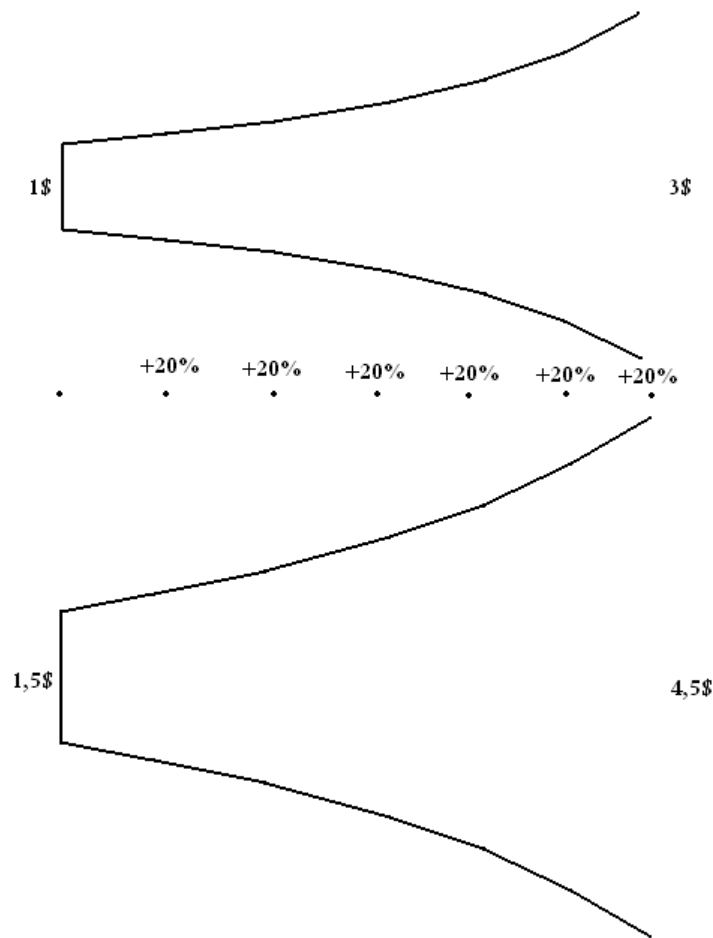
Johan Hamman, who used to work with land reforms in South Africa and is also interested in FT issues, looks very critically at the market chain between the FT producer and the FT consumer. He says that “*The system adds cost, not value*”, as mark-ups follow the commodities along traders on the trading line.⁹⁰

What Hamman explains can be shown in the following way. Figure 6 below shows how the price increases for two identical commodities when passing six middlemen to reach the market. One product is sold at the conventional market at 3\$, of which the initial producer gains 1\$ and the remaining 2\$ is earned by the six middlemen. Each of the middlemen adds 20% to the value to cover their costs and to make a profit. At the FT market, the same product is produced but it has an initial price 1.5\$ as the minimum price set by FLO, which is 0.5\$ higher than the world market price. Each of the six middlemen adds, as for the non-FT good, 20% of the value of the product, ending up at a price of 4.5\$ ($1.5 * 1.2^6$). The middlemen together earn 3\$ of the final price 4.5\$, and of the 1.5\$ extra spent by the concerned consumer only 1/3 becomes revenue for the initial producer. There are extra costs for the FT middlemen because they also need to pay a fee for certification, and there might be an extra risk since FT is a small market. But according to Hamman, middlemen in the FT market clearly earn a lot of money at the moment, money the consumers intended for the rural farm workers⁹¹.

⁹⁰Interview; Hamman 2007

⁹¹Interview; Hamman 2007

Figure:6 **Added costs**



FT citrus exporter Stiaan Engelbrecht is so far disappointed with FT. He says that “*it is the clever people making money at the moment, not the workers*”⁹². Engelbrecht exports about a half percent of his citrus fruits which does not cover the annual R23000 fee to become a certified exporter. He sold his FT citrus fruits for R50 thinking he made a good deal, until he saw that they were sold for R150 in the shops. In a perfectly functioning market this extra revenue made by the middlemen should diminish with competition, but as middlemen possess more power and knowledge than rural producers, they are able to make big profits. In Engelbrecht's case, one of the big supermarkets in the UK is now in direct contact with him to skip a few middlemen. Engelbrecht says that nothing has changed so far in the way products are exported, but he hopes that FT will help to make the transits from seller to buyer more transparent in the future.⁹³

Besides the “fair” price, FT is also about guaranteeing fair working conditions and respect for

⁹²Interview; Engelbrecht 2007

⁹³Interview; Engelbrecht 2007

the environment. All interviewed producers already fulfilled the FT requirements for housing standards etc. when they applied for certification⁹⁴. There are producers that heavily violate working condition standards, such as the case mentioned in chapter 3.1 where a fruit picker picked fruits still wet from pesticides without any protection. Nieuwoudt, who sells FT wine, suggests that “*supermarkets should give more information when the product is sold, like a TV on the shelf in the supermarket.*” so the difference in working conditions becomes obvious for the consumers.⁹⁵

6.5 Fairtrade as market imperfection fixer

As mentioned in chapter 5.2 Alex Nicholls and Charlotte Opal describe in the book “*Fair Trade Market-Driven Ethical Consumption*” how FT can act as a market fixer for disadvantaged producers. Their reasoning is mainly based on the benefits for small scale farmers if they create co-operatives which FT can assist and sponsor⁹⁶. As only three out of 43 producers in South Africa are classified as co-operatives⁹⁷, the benefits of creating a co-operative are not as significant to a majority of the South African FT producers.

6.4.1 Improved access?

The interviewed producers responded to questions regarding how FT could adjust market errors such as lack of market access, lack of market information and lack of access to financial market.

All of the four interviewed producers recognised that FT improves the market access. For the HL producers, the increase in market access is not the effect of cutting out middlemen as Nicholls and Opal point out, but of gaining a new consumer group.⁹⁸ Gaining market information was not recognised as an effect of FT. Nieuwoudt says “*it isn't FT that informs us about the prices on the market, it is the buyers*”⁹⁹. No producer has used the social premium to invest in a telephone etc. Heiveld, the only co-operative interviewed, has gained access to credits as they have received loans from the FT organisation AlterEco¹⁰⁰. The HL producers

⁹⁴Interviews; Nieuwoudt, Skippers, Tshapile & Visser 2007

⁹⁵Interview; Nieuwoudt 2007

⁹⁶Nicholls & Opal 2006 p. 33ff

⁹⁷Interview; Law 2007

⁹⁸Interviews; Nieuwoudt, Skippers & Tshapile 2007

⁹⁹Interview; Nieuwoudt 2007

¹⁰⁰Interview; Visser 2007

have not received any “FT loans” although Jan Skippers, assistant manager at Thandi Farm, says that FT has helped Thandi to become more established, which indirectly leads to being more trustworthy for loans.¹⁰¹

¹⁰¹Interview; Skippers 2007

7 Conclusions

Many questions regarding how FT affects the market have been discussed in this thesis. The arguments used for and against FT are *more* or *less* accurate although all important to examine in order to erase a few question marks regarding FT.

- FT might lead to an increased production which eventually has a lowering effect on the world market price. The theoretical models in chapter 5.1.1 show that the decision for farmers to increase output depends on the size of demand the producer faces relative to the output produced before certification. In the South African case study, one out of four producers interviewed sold 100% of their production as FT, and for this reason, only one producer clearly had an incentive to produce more output as the last product sold will be sold at the higher FT price. The remaining three producers faced a low demand relative to their supply and had therefore no incentive to increase their output.
- *The Economist's* argument that FT would lead to a lower quality of products as a result of the floor price could be true if the producers were guaranteed long-term purchase from consumers. As there is no such guarantee, FT does not lead to a lower quality of products.
- FLO is criticised for both excluding and including bigger HL plantations. For the FT products that are produced in South Africa: wine, fresh fruits, dried fruits, juices and tea, HL producers are not excluded. Farmers at the small South African rooibos co-operative, Heiveld, are very critical of the fact that FT supports bigger HL plantations as they think that the premium paid mainly reaches the owner and not the workers' pockets on the HL farms.¹⁰²
- FT can definitely be seen as an inefficient way of transferring money to the disadvantaged workers. Sadly, probably any kind of aid can be seen as inefficient with various weaknesses. A problem for FT is that only a part of the extra amount paid for a FT product reaches the producer.

¹⁰²Interview; Koopman, B. 2007

- The discussion around how FT can function as a “fixer” of the market for disadvantaged farmers is mainly built upon the benefits for small scale farmers to create co-operatives. FT can be an engine for small scale farmers to create co-operatives to gain market power and share investment costs. A great majority of the FT producers in South Africa are HL structured producers and therefore do not create small farm co-operatives. The arguments presenting FT as a market fixer are not very significant in the South African context.

FT probably gives the Western consumers that buy FT a good conscience. Although all the extra money spent does not reach the initial producers, FT still brings good effects to disadvantaged producers. FT guarantees that at least a minimum wage is paid and adequate housing standards are met. Every interviewed producer fulfilled the requirements to be FT certified, including working conditions and environment standards. The inefficiency of FT is a problem which needs to be addressed in a transparent way to keep the confidence of FT consumers. More transparent transits and more market information is a keystone for both FT and the conventional market to reach greater fairness. In a perfectly functioning market, perfect information is necessary and, in my opinion, the lack of information is the greatest obstacle to fairer trade.

Including HL structured plantations has both advantages (reaching more workers) and disadvantages (small scale producers lose market shares). A possible solution could be to divide FT into two similar labels: one label for small scale farmers which concerned consumers, who want to protect small scale traditional farming as a way of life, can choose, and one for bigger plantations that also fulfil the FT requirements of housing and working conditions etc.

Future questions:

How leaky is the FT bucket? A bigger investigation of how much of the extra money spent on FT reaches the producers would be very interesting. How can trade become more efficient and transparent? As FT supporters Nicholls and Opal put great emphasis on the benefits for small farmers to create co-operatives, an interesting future question would be to investigate how important FT's role is in creating co-operatives.

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