10-7-2015

The Effects of Fair Trade on Coffee Growers

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AGRICULTURAL ECONOMICS
Institute of Agriculture and Natural Resources

October 7, 2015

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Cornhusker Economics

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Market Report	Year Ago	4 Wks Ago	10-7-15
Livestock and Products, Weekly Average			
Nebraska Slaughter Steers, 35-65% Choice, Live Weight.	160.50	*	117.28
Nebraska Feeder Steers, Med. & Large Frame, 550-600 lb.	286.59	248.96	213.50
Nebraska Feeder Steers, Med. & Large Frame 750-800 lb.	236.51	218.29	192.97
Choice Boxed Beef, 600-750 lb. Carcass.	238.19	241.06	208.44
Western Corn Belt Base Hog Price Carcass, Negotiated.	108.32	68.43	71.24
Pork Carcass Cutout, 185 lb. Carcass 51-52% Lean.	121.45	85.09	84.59
Slaughter Lambs, wooled and shorn, 135-165 lb. National.	164.00	155.64	155.04
National Carcass Lamb Cutout FOB.	374.30	359.79	359.40
Crops, Daily Spot Prices			
Wheat, No. 1, H.W. Imperial, bu.	4.90	3.95	4.27
Corn, No. 2, Yellow Nebraska City, bu.	2.75	3.36	3.54
Soybeans, No. 1, Yellow Nebraska City, bu.	8.42	8.62	8.07
Grain Sorghum, No.2, Yellow Dorchester, cwt.	4.95	5.54	6.00
Oats, No. 2, Heavy Minneapolis, Mn, bu.	3.62	2.78	2.45
Feed			
Alfalfa, Large Square Bales, Good to Premium, RFV 160-185 Northeast Nebraska, ton.	195.00	177.00	180.00
Alfalfa, Large Rounds, Good Platte Valley, ton.	90.00	85.00	75.00
Grass Hay, Large Rounds, Good Nebraska, ton.	87.50	87.50	80.00
Dried Distillers Grains, 10% Moisture Nebraska Average.	115.00	137.50	125.00
Wet Distillers Grains, 65-70% Moisture Nebraska Average.	40.00	45.75	50.00
* No Market			

Two and a half billion cups of coffee are consumed in the world annually making coffee the second-most traded commodity after oil and the caffeine contained in it the most widely consumed psychoactive drug. Coffee is produced in more than 60 countries and provides a livelihood for some 25 million coffee-growing families around the world. Coffee consumption has been increasing over the past 50 years, but this increase has, for the most part, not been accompanied by increases in raw coffee prices and improvements of coffee growers' lives. After the International Coffee Association (ICA) dissolved in 1989, coffee production increased substantially (mainly due to mass production by Brazil and the entry of new coffee producers in Asia and Africa), and the world coffee prices fell by 50%. While farm-gate prices have been declining during most of the past 25 years, the prices in consuming countries have been soaring, and so have the profits of middlemen – i.e., intermediaries, processors, exporters, and large international corporations – who have been retaining the lion's share of the economic surplus generated in the coffee supply channels. These trends have reduced producer welfare and have pushed many coffee growers into poverty.

The Fair Trade Organization recognized this price imbalance and tried to provide an alternative method of trading aimed at increasing the prices received by coffee growers. This new method creates cooperatives and establishes a a guaranteed minimum price which is greater than the world price of coffee. The Fair Trade Organization hoped that this initiative would increase grower welfare since coffee growers are supposed to be the main beneficiaries of the regime. Despite their noble objectives, Fair Trade movements have had limited success in improving coffee growers' welfare – while some coffee growers did benefit from the increased prices of Fair Trade coffee, others have suffered losses and some have even been driven out of coffee production. A study completed in the UNL Department of Agricultural Economics and published in *Agricultural Economics*[1] recently seeks to provide insights on (and understanding of) the market and welfare impacts of the Fair Trade regime when important idiosyncrasies of the Fair Trade production and marketing are included in the analysis.

The research shows that the premium enjoyed by Fair Trade coffee induced a number of relatively more efficient growers to switch to the production of this coffee, and for these producers, the benefits from increased prices outweighed the increased costs resulting from the requirements of the regime. As long as the Fair Trade cooperatives are able to market the entire produce of their members at Fair Trade prices, the regime results in welfare gains given by the increased producer surplus of coffee growers who find it optimal to join the Fair Trade movement. The greater the price premium and/or the lower the extra costs associated with Fair Trade production, the greater the number of coffee growers switching to Fair Trading and the greater the welfare benefits associated with this regime.

The story is different, however, when (as is often the case) the cooperative is unable to market the entire production of its members at Fair Trade prices due to either grower over-production or the cooperative's limitations. In such a case, when coffee growers are responsible for marketing their excess Fair Trade coffee production, these producers lose as they have to sell their Fair Trade coffee at conventional coffee prices. In addition to making some Fair Trade coffee growers worse off, the marketing of Fair Trade coffee as conventional can reduce conventional coffee prices which, in turn, decreases conventional coffee growers' welfare and drives many of them out of coffee production.

These welfare losses to growers of conventional and Fair Trade coffee can be mitigated by having the cooperatives market the entire Fair Trade coffee quantity and offer their members an average price from the sale of Fair Trade coffee to different (Fair Trade and conventional) coffee markets. The reduction in the price of Fair Trade coffee offered by the cooperatives would reduce Fair Trade production as well as the amount that would need to be sold to the conventional coffee market. While the marketing of the entire Fair Trade quantity by the cooperatives would eliminate welfare losses to Fair Trade growers and would reduce the losses to conventional coffee growers, it would also reduce the benefits accruing to Fair Trade production and the number of participating coffee growers, which can be viewed as inconsistent with the fundamental goals of the Fair Trade movement.

Ways to address these unintended adverse impacts of the Fair Trade regime on coffee growers could include (a) increasing the guaranteed price to coffee growers, (b) enhancing the efficiency of Fair Trade cooperatives, and (c) bolstering the demand for Fair Trade coffee. The latter, and perhaps most critical step in this effort, could be achieved through an improved, more aggressive promotion of fair trading and perhaps, a limit on the, currently exorbitant, profit margins of middlemen in the Fair Trade supply channel. A message of this research is that, in the absence of strategies and policies targeting the demand for Fair Trade coffee and the price received by coffee growers, the regime will keep falling short in achieving its noble objectives.

Before concluding this article, it should be noted that, in addition to providing an understanding of the effects of the Fair Trade regime on coffee growers and the main reasons the regime has fallen short in achieving its goals, our analysis could provide a valuable theoretical grounding and a basis for empirical studies of this important producer welfare-enhancing initiative. Such research endeavors could then guide the development of properly designed mechanisms that could effectively address the inherent idiosyncrasies of different areas and grower populations and lead to coffee grower welfare improvement around the world.

Note: This article is based on the first essay of Omidvar's Ph.D. dissertation at the University of Nebraska-Lincoln. The citation for the published journal article is:

[1] Omidvar V., K. Giannakas. "The Effects of Fair Trade on Coffee Growers: A Framework and Analysis." *Agricultural Economics* 46(2015): 1-11.

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