



Fair Trade Coffee: The Mainstream Debate

Richard M. Locke, Cate Reavis, Diane Cameron

In November 2008, Shaw's supermarkets sold a 10-ounce bag of Green Mountain Fair Trade certified coffee for \$8.49. The bag which was adorned with the Fair Trade certified logo, did not explain the meaning of Fair Trade. Consumers were directed to a website or a phone number to get more information. However, the bag did say the following:

A good cup of coffee can change your day. A great cup of coffee can help change the world. By supporting farming communities, promoting sound environmental practices and sourcing only the highest quality beans we work to ensure that everyone who comes in contact with our coffee benefits. So while you appreciate the results in your cup, you can also rest assured that this coffee has had a positive impact on every person it has touched which to us makes these little beans a pretty big deal.

The main premise of Fair Trade was that farmers were given a guaranteed "fair price" for their coffee, a guarantee that became particularly appealing to farmers in the late 1990s and early 2000s when the price of coffee fell below the cost of production. For knowledgeable consumers, this was a positive reinforcement knowing that they were helping a social cause even though it was not clear on any bag of Fair Trade coffee just how much farmers were being paid and how much they were profiting.

The organization responsible for certifying food products (including coffee) as Fair Trade was the Fairtrade Labeling Organization (FLO). Based in Bonn, Germany, FLO was an umbrella organization that united 20 labeling initiatives in 21 countries and producer networks. But with a market share of

This note was prepared by Cate Reavis under the supervision of Richard M. Locke, the Alvin J. Siteman Professor of Entrepreneurship and Political Science. It is based largely on thesis work completed by Diane Cameron, MIT Master of Science, ESD, 2007.

Copyright © 2010, Richard M. Locke and Diane Cameron. This work is licensed under the Creative Commons Attribution-Noncommercial-No Derivative Works 3.0 Unported License. To view a copy of this license visit <http://creativecommons.org/licenses/by-nc-nd/3.0/> or send a letter to Creative Commons, 171 Second Street, Suite 300, San Francisco, California, 94105, USA.

less than 3.8% of the coffee market and 6.1% of the specialty coffee market,¹ and a growth rate that had plunged from 97% in 2003 to 2% in 2007 (**Exhibit 1**), the leadership of FLO found itself at a crossroads. Pressures were mounting inside and outside the organization to grow market share for Fair Trade certified coffee, and stakeholders were divided on how best to do this.

One potential growth strategy under discussion was mainstreaming Fair Trade coffee into non-specialty brands like Folgers and Maxwell House that were sold in large supermarkets. In 2003, Procter & Gamble-owned Millstone Coffee made a first step in this direction when it began offering Mountain Moonlight, an organic Fair Trade certified coffee for purchase online or by mail order. A 10-ounce bag cost \$8.99. Many in the industry believed that scaling up by mainstreaming was the most important strategy for the future of Fair Trade and promised the greatest welfare gains. In addition to growth through access to larger markets, mainstreaming had the potential to increase efficiencies with scale economies.

But there were many skeptics who questioned the whole idea of mainstreaming. Could Fair Trade be scaled up without compromising the economic and social standards that were at the heart of the Fair Trade movement? Would the involvement of transnational corporations like Nestlé, Procter & Gamble and Kraft undermine the integrity of the Fair Trade movement, particularly the value captured by producers? Would Fair Trade coffee ever be more than a successful niche market and should it? As one leader at Oxfam pointed out, “If too many producers try to move into this segment of the market, it would cease to be a niche capable of commanding high prices.”²

In addition to the mainstreaming skeptics were those who shrugged off the whole notion of Fair Trade, believing that it was not the role of big business to eradicate poverty, and that Fair Trade and free trade were not compatible.

Coffee Industry

Coffee was the world’s second most valuably traded commodity, second only to oil. More than 2 billion cups of coffee were consumed every day. According to the International Coffee Organization (ICO), the size of the retail market for coffee was over \$70 billion in sales per year. An estimated 17-20 million families in more than 50 developing countries produced and sold coffee.³ More than 80% of all coffee was produced by smallholder farmers, those who farmed on 2 hectares or less of land which yielded between 15 and 30 bags.⁴ In many producing countries, coffee accounted for over 75% of total export revenue. In 2007, production was about 117 million bags and world consumption was 123 million bags.⁵

¹ *Almanac 2007*, TransFair USA.

² Tim Harford, “Fair Trade Coffee Has a Commercial Blend,” *Financial Times*, September 12, 2003.

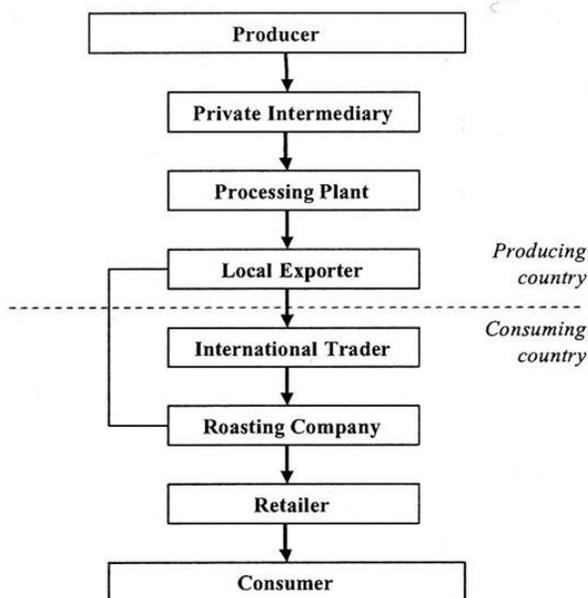
³ Bryan Lewin, Daniele Giovannucci and Panos Varangis, *Coffee Markets: New Paradigms in Global Supply and Demand, Agriculture and Rural Development*, The World Bank, 2004.

⁴ Niraj Dawar and Jordan Mitchell, “Nestlé’s Nescafe Partners’ Blend: The Fairtrade Decision,” *Richard Ivey School of Business*, Case Study No. 9B06A020.

⁵ International Coffee Organization.

By some reports, a coffee bean could change hands as many as 150 times along the commodity chain between the producer and the consumer.⁶ (See **Figure 1** for a simplified diagram of the major parties in the coffee commodity chain.) In the simplified chain, producers sold unprocessed coffee to private intermediaries who then transported the product to processing plants in the producing country. Local exporters purchased green beans from the processing plants and sold green beans on the international markets. International traders linked consuming countries with producing countries and sold green beans to roasters in consuming countries. Roasting companies were responsible for roasting and other industrial processes to produce decaffeinated and soluble coffee products, which were sold to retailers such as supermarkets and restaurants. Consumers purchased coffee products from retailers. Four multinationals—Kraft, Nestlé, Procter & Gamble, and Sara Lee—accounted for more than 40% of the global coffee trade.⁷

Figure 1 Commodity Coffee Chain



Source: Anna Milford, *Coffee, Co-operatives and Competition: The Impact of Fair Trade*, Chr. Michelsen Institute, 2004.

The majority of green bean coffee was traded as a commodity on the London International Financial Futures Exchange (LIFFE) and the New York Board of Trade. Up until 1989, coffee prices were regulated and fell within a set band providing farmers with some financial stability. This all unraveled leading to what has become known as the coffee crisis.

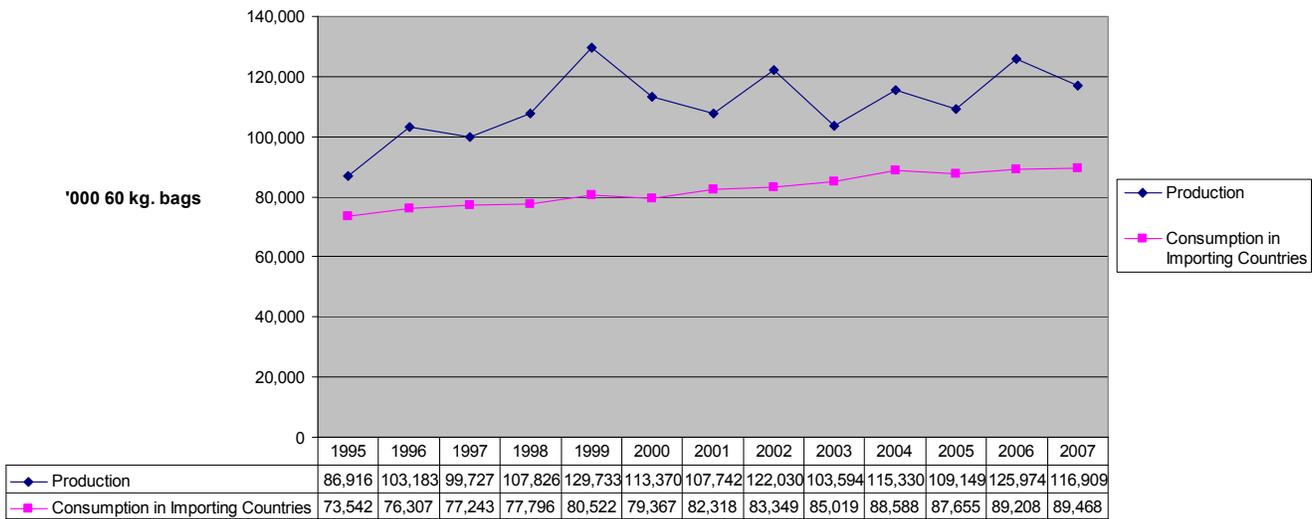
⁶ Anna Milford, *Coffee, Co-operatives and Competition: The Impact of Fair Trade*, Chr. Michelsen Institute, 2004

⁷ <http://www.pbs.org/frontlineworld/stories/guatemala.mexico/facts.html#03>, accessed August 1, 2010.

Coffee Crisis

The coffee crisis referred to a four-year period between 2001 and 2005 when the price of coffee fell below the cost of production, a time when supply far outweighed demand.⁸ See **Figure 2**. The cumulative effect of low prices over these years was crippling to farmers. Consider the fact that the price of \$.55/lb in 2002 was the equivalent of receiving \$.19/lb in 1977. However, when calculating in inflation, the actual price of coffee in 1977 was \$2.18/lb, which translated to \$6.47/lb in 2002.⁹

Figure 2 Coffee Production and Consumption, 1995-2007



Source: International Coffee Organization.

The makings for the crisis, which began in the early 1990s, could be called a perfect storm of sorts: deregulation which ushered in new producers, namely Vietnam, new technology and adverse climatic events together created a volatile industry where the price for a pound of coffee went from \$.53/lb in 1993 to \$1.19 in 1994 to \$1.26 in 1995 before deflating back to \$.82 in 1996. (See **Exhibit 2** for prices.) As one industry observer noted, “On the consumer’s side historically coffee has benefited when prices have been over \$1.00 a pound based on current inflationary factors. If coffee is over that amount, farmers get good remuneration and use good agricultural practices. The only problem is they must not increase their production beyond what can be sold to the consuming nation.”¹⁰

The deregulation of the coffee industry came as a result of the collapse of the 1989 International Coffee Agreements (ICAs) between producing and consuming countries when the quota and supply

⁸ Ted. R. Lingle, “State of the Specialty Coffee Industry,” *Tea & Coffee Trade Journal*, July 1, 2007.

⁹ Ibid.

¹⁰ Ibid.

control provisions of the 1983 ICA were suspended. (See **Exhibit 3** for a timeline history of the ICA.) Prior to the collapse of the ICA many coffee-producing nations regulated the production and supply of coffee through state-owned or parastatal coffee institutions (also known as Coffee Boards). (**Figure 3**) The marketing boards regulated production systems, and acted as intermediaries between producers and global traders.¹¹ They were responsible for maintaining coffee quality, promoting coffee production and ensuring that producers had the resources with which to meet the volume of exports allocated by the ICA. In contrast, global traders and roasters tended to operate at an arms-length from the rest of the value chain.¹²

Figure 3 Commodity Coffee Production Chain pre-Deregulation



Source: Diane Cameron.

The collapse of quotas ushered in new producers starting in the early 1990s. Vietnam, with help from international aid agencies, began a subsidized coffee growing program. The international market was flooded by cheap Robusta beans putting further downward pressure on prices.¹³ In 1990, Vietnam was the 17th largest coffee producer with 1 million 60kg sacks. In 2001, it had become the world's second largest supplier after Brazil producing over 12 million 60 kg sacks.¹⁴

¹¹ R. Kaplinsky, "Competitions Policy and the Global Coffee and Cocoa Value Chains," Paper prepared for United Nations Conference for Trade and Development (UNCTAD), May 2004.

¹² Ibid.

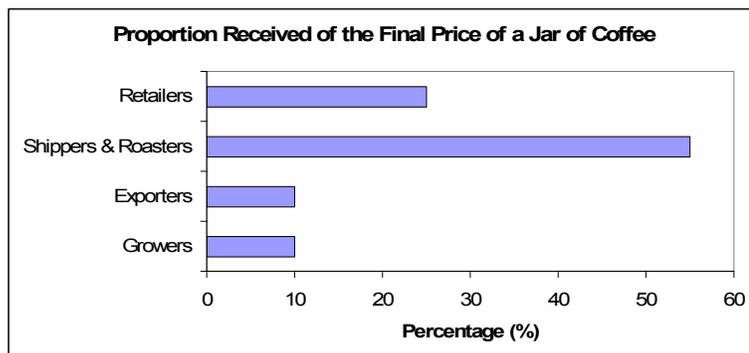
¹³ Lawrence Solomon, "Bitter Brew," *The National Post*, April 8, 2004.

¹⁴ Hallie Eakin, "Responding to the Coffee Crisis," *The Geographical Journal*, June 1, 2006.

Alongside deregulation, climatic events and new technologies contributed to the industry's increasing price volatility. Brazil experienced a frost in 1994 and a drought in 1997 which pushed up the price of coffee as production levels fell (**Exhibit 4**). It was around this time that new coffee processing techniques had improved the quality of Robusta beans to the point where it was being used as a substitute for higher quality Arabica beans in certain blends.¹⁵ This created a scale advantage for global traders who could now source coffee from more countries.¹⁶

These combined market forces had resulted in a growing asymmetry of power within commodity coffee chains, characterized by fragmentation on the producer side and a concentration of economic power on the consumer side. While prices were known to traders and roasters, small producers in developing countries had limited knowledge of coffee prices on the international market. In the documentary *Black Gold*, Ethiopian coffee farmers were asked how much a cup of coffee cost in the United States. After a prolonged and awkward silence, they were surprised to learn that a cup of coffee at Starbucks (\$1.70) cost almost five times what they earned for an entire kilo of beans (\$.35) on the commodity market. As **Figure 4** indicates, 10% of the final price of a can of coffee went to growers. Furthermore, since quality was determined by purchasers after processing, farmers who sold unprocessed coffee lacked information about the quality of the product they were selling.¹⁷

Figure 4 Coffee Value Chain Revenue Breakdown



- 10% paid to growers
- 10% paid to exporters
- 55% paid to shippers and roasters
- 25% paid to retailers

Source: David Ransom, *The No-Nonsense Guide to Fair Trade* (Rotherham: New Internationalist, 2006), p. 20.

By the early 2000s, the International Coffee Agreement's goal of developing a sustainable coffee economy had met a brick wall in the guise of plummeting prices. In the early 1990s, earnings by coffee producing countries were about \$10-\$12 billion and retail sales were \$30 billion. In 2002,

¹⁵ Hallie Eakin, "Responding to the Coffee Crisis," *The Geographical Journal*, June 1, 2006.

¹⁶ R. Kaplinsky, "Competitions Policy and the Global Coffee and Cocoa Value Chains," Paper prepared for United Nations Conference for Trade and Development (UNCTAD), May 2004.

¹⁷ Anna Milford, *Coffee, Co-operatives and Competition: The Impact of Fair Trade*, Chr. Michelsen Institute, 2004.

earnings were about \$5.5 billion and the value of retail sales was \$70 billion.¹⁸ In 2003, with world prices at historic lows, Mexican coffee producers in Oaxaca's Pluma region were fertilizing less, growing less and picking less. Farms in Costa Rica were switching to other crops. With producers in Vietnam and Brazil pushing prices lower, Guatemalans had taken to burning their unprofitable coffee fields.¹⁹ Between 1998 and 2001, poverty rates in Nicaragua increased by 2% among coffee farmers, while poverty rates fell by 6% in the overall rural population. School enrollment fell by 5% among coffee farming families, while school enrollment rose by 10% in the overall rural population.²⁰

Alongside price, the quality of coffee beans had also suffered. The coffee crisis had been fueled by an overflow of cheap, sun-loving, easy-to-grow Robusta beans from chemically fertilized plantations in Brazil and Vietnam.²¹ Brazil replaced some of its high quality, mountain-grown, hand-farmed Arabica coffee for cheaper, less flavorful Robusta that could be harvested by machines.²² Meanwhile, good coffee was becoming a rare commodity due to the hit that farmers' incomes were taking. Part of what allowed the quality to deteriorate was the fact that U.S. import guidelines stated that only 75% of raw, imported coffee consisted of beans. In other words, up to 25% could be triage—spoiled beans, sticks and rocks usually filtered out during the roasting process.²³

Fair Trade Movement

Definition

According to FLO's website, the most widely recognized definition of Fair Trade was created by FINE, an informal association of the four main Fair Trade networks (Fairtrade Labelling Organizations International, International Fair Trade Association, Network of European Worldshops, and European Fair Trade Association):

Fairtrade is a trading partnership, based on dialogue, transparency and respect that 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. Fairtrade organizations (backed by consumers) are engaged actively in supporting producers, awareness raising and in campaigning for changes in the rules and practice of conventional international trade.

Based on its definition, Fair Trade had three strategic intents:

1. to work with marginalized producers and workers in order to help them move from a position of vulnerability to security and economic self-sufficiency;

¹⁸ Nestor Osorio, "The Global Coffee Crisis: A Threat to Sustainable Development," *International Coffee Organization*, August 21, 2002.

¹⁹ Sara Silver, "Coffee's Crisis Stirs Traders to Take Action," *Financial Times*, May 14, 2003.

²⁰ Bryan Lewin, Daniele Giovannucci and Panos Varangis, *Coffee Markets: New Paradigms in Global Supply and Demand, Agriculture and Rural Development*, The World Bank, 2004.

²¹ Katherine Ellison, "Can Great Coffee Save the Jungle?" *Smithsonian*, June 1, 2004.

²² John Otis, "Left Behind," *Houston Chronicle*, July 13, 2003.

²³ *Ibid.*

2. to empower producers and workers as stakeholders in their own organizations;
3. to actively play a wider role in the global arena to achieve greater equity in international trade.²⁴

History

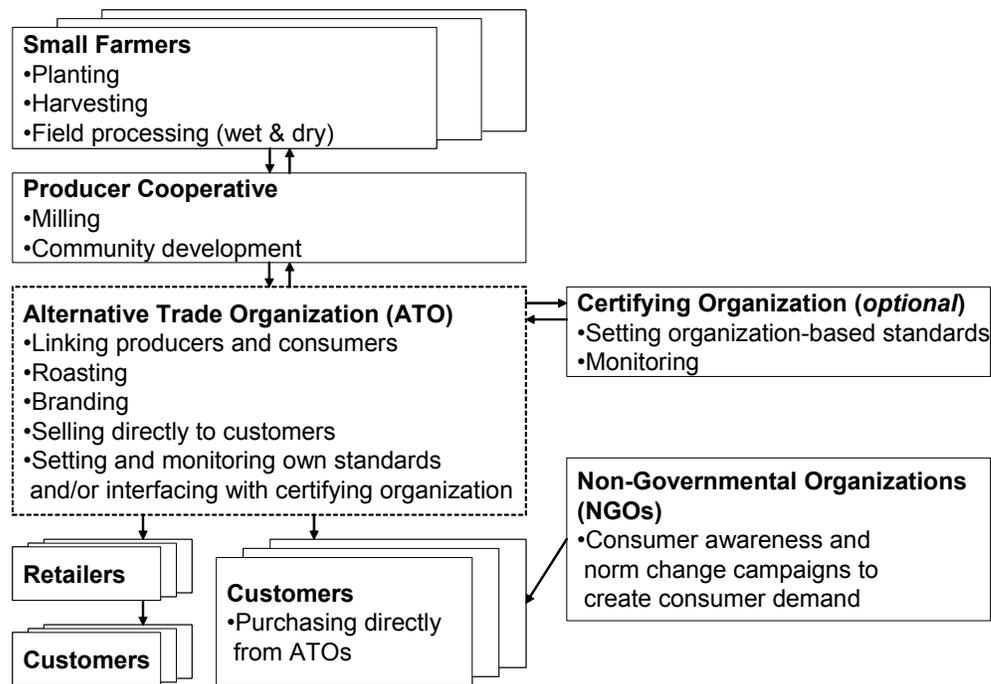
The concept behind the Fair Trade movement could be traced back to a mid-19th century novel by Max Havelaar, which portrays the protagonist fighting against the colonial government of Dutch Indonesia and its unjust policies toward coffee producers.²⁵ In practice, however, Fair Trade began as a response to poverty after World War II. In the late 1940s, churches and religious groups in the United States organized to sell handicrafts made by refugees from Europe as a way to give small-scale producers in developing countries access to Western markets.

Fair Trade, which started with handicrafts, expanded to coffee in 1973, and later to other foods, such as tea, cocoa, and sugar. In the 1970s, fairly traded foods, including coffee, were distributed exclusively through Alternative Trade Organizations (ATOs). ATOs, which established long-standing relationships with the democratic producer cooperatives from which they purchased coffee, linked producers directly with consumers and typically sold products in specialty shops. The ATO created a new value chain structure by reducing the number of hand-offs in the chain, creating shorter social distances between consumers and producers. The ATOs also facilitated information flows in both directions along the chain. ATO campaigns informed consumers about the production and trade conditions, and also transferred knowledge about world prices, market conditions, and consumer preferences to producers. **(Figure 5)**

²⁴ http://www.fairtrade.net/faq_links.html?&no_cache=1 (accessed October 9, 2008).

²⁵ Terrence H. Witkowski, "Fair Trade Marketing," *Journal of Marketing Theory and Practice*, October 1, 2005.

Figure 5 Organization-based Fair Trade Value Chain



Source: Diane Cameron.

Many ATOs operated without independent certification of their Fair Trade standards. Instead, they set and monitored their own standards. The ATO model was based on the notion that trust and respect naturally encouraged adherence to higher standards and that the presence of a third-party certifying organization destabilized trust and undermined actual standards. In 2004, the International Fair Trade Association established the Fair Trade Organization Mark, the first organization-based certification. It was expected that some ATOs would begin to apply the independent IFTA certification in addition to, or instead of, their own standards.

While ATOs continued to market Fair Trade handicrafts, standards-based certification eventually replaced organization-based certification in Fair Trade coffee.

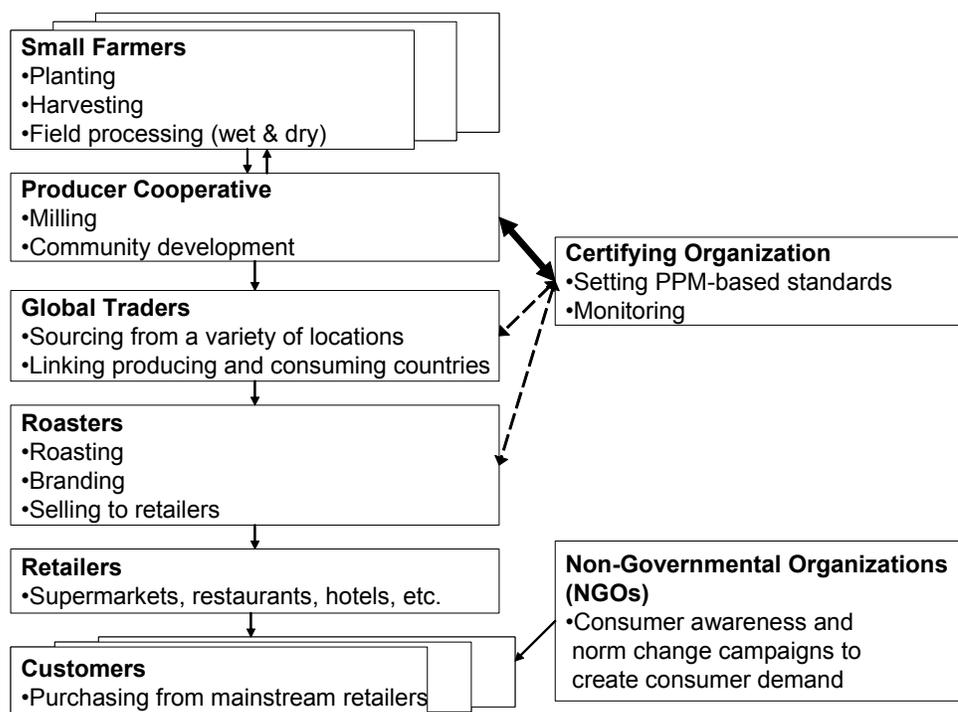
Fair Trade Certified Coffee

The idea of standards-based certification and labeling of foods, such as coffee, emerged in the 1980s. Unlike the commodity coffee chain, the standards-based Fair Trade value chain eliminated several middle layers, including the local buyer, miller, exporter, shipper and importer and allowed farmers to deal directly with wholesalers.²⁶ Unlike the ATO Fair Trade model, in the standards-based model, the

²⁶ Jennifer Alsever, "Fair Prices for Farmers," *The New York Times*, March 19, 2006.

certification organization operated independently from the distribution channels and Fair Trade interests. See **Figure 6**. The certification organization established standards based on process and production methods (PPMs). Fair Trade labels were applied to final products with information about the PPMs used to produce the coffee. In principle, PPM-based certification made it possible for any coffee company to purchase Fair Trade coffee from producing countries, and sell it in consuming countries with a Fair Trade label recognized by consumers.

Figure 6 Standards Based Fair Trade Value Chain



Source: Diane Cameron.

The most widely recognized standards-based certifying organization involved in Fair Trade coffee was the Fairtrade Labeling Organization (FLO), formerly the Fairtrade Labeling Initiative. FLO was founded in 1997 as an association of 20 labeling initiatives that promoted and marketed the Fairtrade Certification Mark in their respective countries. (Transfair USA was FLO's U.S. arm.) Its three-fold mandate was to set and monitor Fair Trade standards, connect Fair Trade buyers with suppliers, and promote Fair Trade market share. FLO provided a Fair Trade mark for organizations that were registered members of the International Federation of Alternative Trade. The mark signaled that standards pertaining to working conditions, wages, child labor, and the environment were being

met.²⁷ FLO's standards included a guaranteed minimum price as well as a Fair Trade premium. The price guarantee was intended to create stability while the price premium was intended to alleviate poverty and was often invested in community development projects dedicated to improving health care and education. FLO was funded by charitable contributions and from member and producer organizations that paid a certification fee.²⁸

Standards

FLO's certification processes were based on two sets of standards: those that applied to small farmer organizations and those for hired labor. The coffee industry fell under the former. Within this category there were two sub-sets of standards: generic and those relating specifically to coffee. The set of generic Fair Trade standards applied to all small farmers and workers including those who worked in the coffee industry. Generic standards were divided into three groups: social, economic and environmental development. **Exhibit 5** provides a broad summary of the standards. Each standard included guidelines of what the minimum requirements were and progress requirements.

The coffee-specific standards related mainly to price. Fair Trade certified growers were guaranteed a minimum price for their coffee. If the world market price rose above the minimum price, the Fair Trade minimum price was set at \$.05 above the world market price. As **Figure 7** indicates, prices were valid as of June 1, 2008 and applied to all coffee producing regions. For example, a grower would receive \$1.55 for one-pound bag of washed organic Arabica of which \$.10 was to be reinvested in the community. **Figure 8** provides a pricing history for Fair Trade Certified, Robusta and Arabica coffee.

Figure 7 **Prices for Fair Trade Coffee for All Regions, Valid June 1, 2008**

| Type of Coffee | Fair Trade Minimum Price (for conventional coffee) | Organic Differential | Fair Trade Premium |
|--------------------|-------------------------------------------------------|----------------------|--------------------|
| Washed Arabica | \$1.25 | \$.20 | \$.10 |
| Non-washed Arabica | \$1.20 | \$.20 | \$.10 |
| Washed Robusta | \$1.05 | \$.20 | \$.10 |
| Non-washed Robusta | \$1.01 | \$.20 | \$.10 |

Source: Fairtrade Labeling Organization.

²⁷ Rebecca McQuillan, "Ethics on the high street," *The Herald*, February 19, 2008.

²⁸ Ibid.

Figure 8a Robusta vs. Fair Trade Certified Coffee Prices

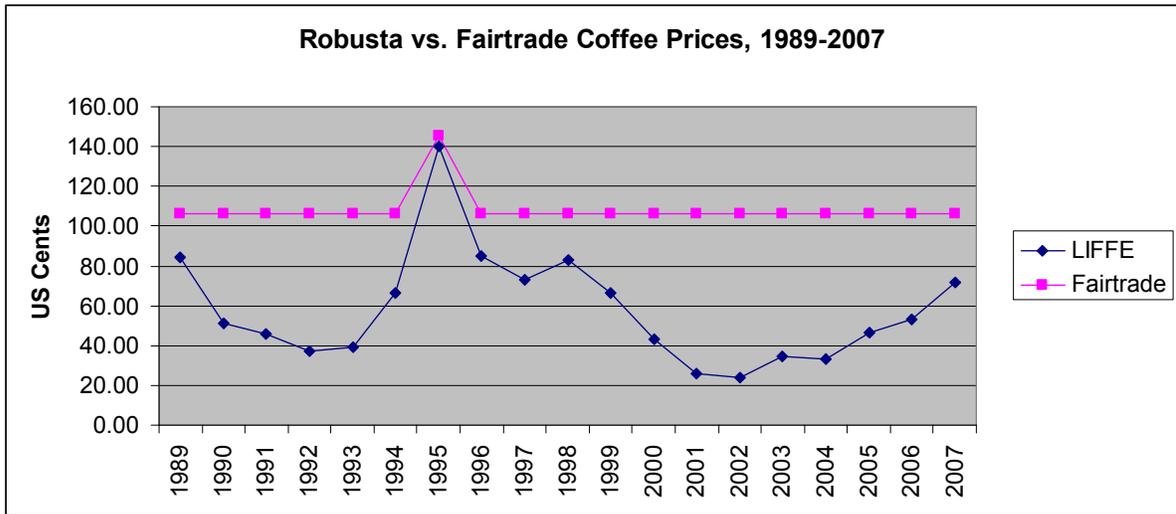
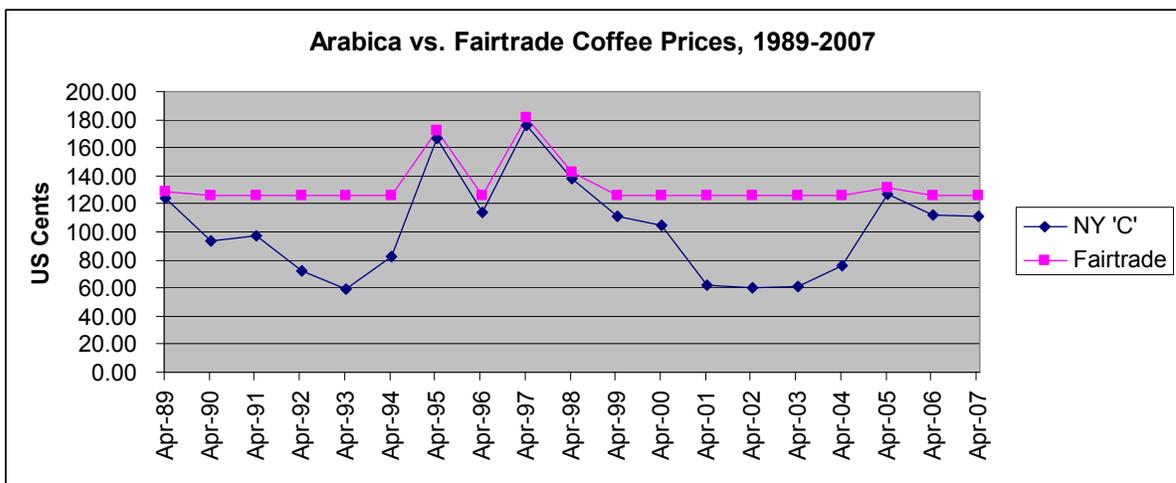


Figure 8b Arabica vs. Fair Trade Certified Coffee Prices



Source: Fairtrade Labeling Organization.

Certification Process

In order to qualify for Fair Trade certification, coffee growers had to be part of a small family farm that was a part of a larger cooperative, also known as smallholder rule.²⁹ Smallholder farms organized into cooperatives represented about 2% to 3% of the world's coffee farmers.³⁰

²⁹ Sam Komell, "The Pros and Cons of Fair-Trade Coffee," *The Santa Barbara Independent*, April 5, 2007.

³⁰ Ibid.

For many coffee cooperatives, getting certified as a Fair Trade producer was a significant investment. FLO charged small farmer organizations a flat fee of €500³¹ for the application service. The initial certification fee varied depending on the number of members, products and processing installations. For example, a legally formed small farmer organization with 200 members applying for coffee certification that also ran a wet processing plant with 45 workers would pay €2,600. Every two years, organizations that had successfully met the standards requirements could renew their certification and, depending on their performance, the renewal inspection fee fell somewhere between €1,050 and €1,750.³² Though they may follow the Fair Trade model, some cooperatives did not have the infrastructure needed to undergo the time-consuming and often financially toiling certification process.³³

Economics

Understanding the economics of Fair Trade was not easy. While it was clear how much certified producers were paid, it was not clear how much they ended up profiting. As the Fair Trade coffee cost analysis in **Figure 9** shows, growers who sold beans to wholesale roaster Dean’s Beans received nearly 17% of the retail price of a can of coffee. One detail missing, however, was growers’ production costs.

Figure 9 Fair Trade Coffee Cost Analysis

What Fair Trade Coffee Costs Wholesale Roaster Dean’s Beans
 (prices for 1 lb. bulk bags of organic coffee)

| | |
|----------------|---------------------------------------------------------------|
| \$1.41 | Price paid to grower, include \$.05 fair-trade premium |
| +\$.39 | Administrative costs and shipping |
| +.36 | Shrinkage during roasting |
| +\$2.50 | Operating and maintenance costs at wholesale roaster |
| +.14 | Packaging and misc. costs |
| = \$4.80 | Wholesale roaster cost |
| \$5.00 | Price at which wholesale roaster sells to stores |
| -\$4.80 | Total wholesale roaster cost |
| =\$.20 | Wholesale roaster profit |
| \$8.49 | Grocery-store price |
| -\$5.00 | Price store paid |
| =\$3.49 | Store profit before expenses |

Source: Steve Stecklow and Erin White, “What Price Virtue?” *The Wall Street Journal*, June 8, 2004.

There was yet a further complication to analyzing what farmers earned. It was not clear how much growers really earned since cooperatives’ directors decided how much to pass on to the farmers. One

³¹ €1 = \$1.26 (11/18/08)

³² FLO-CERT Producer Certification Initial Fees, www.flo-cert.net.

³³ Alyssa Urish, “Playing Fair,” *Daily Camera*, December 10, 2007.

coffee buyer recalled, “We did a breakdown and saw that sometimes, what they’re paying farmers is only \$.70 to \$.80 a pound” instead of the entire Fair Trade price of \$1.26.³⁴ Assuming that growers were indeed given the full Fair Trade price and that it cost them about \$.80 to produce a pound of coffee they would pocket \$.75 per pound of washed organic Arabica coffee (Fair Trade minimum price + organic differential + Fair Trade premium – cost of production.).

Critics of Fair Trade

The Fair Trade movement had its critics. For some, Fair Trade represented a marketing ploy. Smaller coffee roasters complained that the large firms such as Starbucks and Dunkin’ Donuts were buying only a small percentage of Fair Trade beans and were turning their minimal purchases into a marketing scheme. TransFair did not make a distinction between the smaller 100% Fair Trade roasters like Larry’s Beans in North Carolina from massive operations like Starbucks, which carried only 3.7% Fair Trade coffee.³⁵ As the CEO of TransFair USA put it, “If a corporate giant roasts a million pounds of Fair Trade coffee in one year, they are still doing far more than some of the smaller 100-percent roasters will in their entire history.”³⁶

Some critics argued that Fair Trade was not really free trade. After all, the World Trade Organization (WTO) banned discrimination on the grounds of production methods which would mean that if Fair Trade ever threatened the interests of dominant producers in the market then the WTO would be able to step in. There were those that believed that Fair Trade could be a disadvantage to those producers who did not engage in Fair Trade.³⁷ As one journalist wrote, “The Fair Trade idea has become a mainstay for ethical shoppers in countries such as Britain. But it was an idea under attack and free-trade bibles such as *The Economist* had recently dismissed the scheme as little more than inefficient Western aid in disguise.”³⁸ Lawrence Solomon, a well-known Canadian environmentalist who was vocal about the concept of Fair Trade, added to that thought: “Although it purports to be a consumer-driven movement that promotes trade over aid, it is funded by government foreign aid agencies and trade unions bent on keeping Third World goods out of Western markets. Although it claims to have the small farmers’ interest at heart, it acts as a gatekeeper that excludes small farmers from the Fair Trade club to ensure the movement’s own self preservation.”³⁹ For advocates of a free market, Fair Trade “is a system spoiling market effectiveness and causing excessive production.”⁴⁰

Some critics argued that Fair Trade was not addressing underlying economic issues plaguing development countries. As one industry observer noted, “Producing more low-priced commodities for

³⁴ Jennifer Alsever, “Fair Prices for Farmers: Simple Idea, Complex Reality,” *The New York Times*, March 19, 2006.

³⁵ Sam Kornell, “The Pros and Cons of Fair Trade Coffee,” *The Santa Barbara Independent*, April 5, 2007.

³⁶ Tim Rogers, “Small Coffee Brewers Try to Redefine Fair Trade,” *The Christian Science Monitor*, April 13, 2004.

³⁷ Geoff Moore, “The Fair Trade Movement,” *Journal of Business Ethics*, 53: 73-86, 2004.

³⁸ “Café Society,” *Belfast Telegraph*, February 12, 2007.

³⁹ Lawrence Solomon, “Boycott Burundi,” *National Post*, May 8, 2004.

⁴⁰ “Villager Touched by ‘Fair Trade’ to Turn Exporter,” *Turkish Daily News*, March 3, 2007.

oversupplied markets postpones what is really needed for development: diversifying exports and adding value, rather than depending on commodities and crafts. Or finding new social solutions for upland communities whose economic viability remains in doubt.”⁴¹ Meanwhile, some economists opined that a price guarantee could have the undesirable effect of fostering dependency.⁴²

The Fair Trade price structure was confounding to many. First, the definition of a universal “fair price” was problematic considering that the cost of producing coffee varied dramatically from country to country and even within countries. Second, the premiums charged by supermarkets and coffee houses for certified Fair Trade coffee did not indicate that the wellbeing of coffee farmers was their primary goal. Retailers were known to charge huge markups on Fair Trade goods while promoting themselves as good corporate citizens. In 2006 Britain’s largest chain of coffee shops Costa Coffee increased the price of a cup of cappuccino made from Fair Trade coffee by \$.18, a move that received a lot of criticism from consumers and was eventually rescinded.⁴³ As one FLO manager noted, “[Retailers] are taking advantage of the label to make more profit because they know that consumers are willing to pay a bit more because it’s Fair Trade.”⁴⁴ But according to a World Bank economist, there was no reason why a cup of Fair Trade coffee should cost that much more than non-Fair Trade: “Doubling a producer’s family income should add less than one penny to the price of a cup of coffee.”⁴⁵

A spokeswoman for the U.S. Fair Trade certification organization TransFair believed the inflated prices would subside: “There is no reason why Fair Trade should cost astronomically more than traditional products. We truly believe that the market will work itself out as Fair Trade certified products move from being a niche market to a mainstream option. As the demand and volume of Fair Trade certified products increase, retailers will naturally start to drop their prices to remain competitive.”⁴⁶

Mainstreaming Challenges

While many in the coffee trade believed that Fair Trade coffee should stay within its niche market where the brand would be better protected, others believed that the long-term sustainability of Fair Trade coffee hinged on its ability to access larger markets. As a development economist pointed out, “If you count on everyone to [buy Fair Trade] because of their ideological commitments, you’re going to be stuck in a niche market that doesn’t serve a broad range of people.”⁴⁷ But mainstreaming would mean overcoming some significant challenges.

⁴¹ Peter Hulum, Alexander Kasterine and Stephen Browne, “Fair Trade,” *International Trade Forum*, April 1, 2006.

⁴² Geoff Moore, “The Fair Trade Movement,” *Journal of Business Ethics*, 53: 73-86, 2004.

⁴³ Jennifer Alsever, “Fair Prices for Farmers: Simple Idea, Complex Reality,” *The New York Times*, March 19, 2006.

⁴⁴ Steve Stecklow and Erin White, “What Price Virtue?” *The Wall Street Journal*, June 8, 2004.

⁴⁵ Peter Hulum, Alexander Kasterine and Stephen Browne, “Fair Trade,” *International Trade Forum*, April 1, 2006.

⁴⁶ Jennifer Alsever, “Fair Prices for Farmers: Simple Idea, Complex Reality,” *The New York Times*, March 19, 2006.

⁴⁷ Sam Kornell, “The Pros and Cons of Fair Trade Coffee,” *The Santa Barbara Independent*, April 5, 2007.

One of the biggest challenges in mainstreaming the sale of Fair Trade coffee came down to educating the consumer on the specifics of Fair Trade coffee. The coffee aisle in a typical supermarket was stocked with many different types of niche coffees — Bird Friendly, Shade Grown, Organic, Rain Forest Alliance Certified, Sustainable, Fairly Traded—all of which espoused similar missions and offered few details. Even Starbucks which had sold Fair Trade certified coffee since 2002 was adding to the confusion. As of 2008, the company was no longer selling Fair Trade certified coffee but was marketing all of its coffee as “fairly traded.” When asked what fairly traded meant, a Starbucks employee simply replied: “We pay our growers a fair price.”

But should price be the most important element stressed in trying to mainstream Fair Trade coffee? As industry insider attempting to help farmers improve the quality of their coffee noted,

It isn't just about paying more for coffee. It is looking at the quality of what you're buying, how you're increasing consumption, and how you're increasing excitement about coffee. I don't believe that simply funding programs at origin without taking into consideration promotion to consumers will be the answer. There has to be a considerable effort made to educate consumers at the real retail level about high-quality coffees.⁴⁸

The question remained how best to do this.

Many feared that mainstreaming would put Fair Trade standards at risk of being diluted as a result of large corporations engaging in “image laundering.” As one coffee roaster noted, “You have to question the motivation of some of these big corporations. Sam's Club is doing Fair Trade now, and they're part of Wal-Mart which is notorious for mistreating their workers.”⁴⁹ The increasing presence of multinational corporations (MNCs) led some to worry that small retailers would be forced out of the market, resulting in fewer Fair Trade champions to promote and protect higher standards. As a co-founder of Just Coffee, a small coffee roaster dedicated to the Fair Trade movement feared, “Without people outside the increasingly corporate-friendly TransFair system pushing for the original vision of a better model, [the Fair Trade movement] will be watered down into nothingness.”⁵⁰

Opponents to this line of reasoning argued that it was unlikely that corporations would allow standards to become diluted. As one Fair Trade expert put it: “It is unlikely that any company today would want to face public accusations of greenwashing or inadequate measures of corporate or social responsibility. Too many major brands have been bruised by such battles.”⁵¹

⁴⁸ Laura Everage, “Issues at Source,” *Gourmet Retailer*, February 1, 2004.

⁴⁹ Sam Kornell, “The Pros and Cons of Fair Trade Coffee,” *The Santa Barbara Independent*, April 5, 2007.

⁵⁰ Tim Rogers, “Small Coffee Brewers Try to Redefine Fair Trade,” *The Christian Science Monitor*, April 13, 2004.

⁵¹ D. Giovannucci and F.J. Koekoek, “The State of Sustainable Coffee: A Study of Twelve Major Markets,” United Nations Conference on Trade and Development, Geneva, 2003.

FAIR TRADE COFFEE: THE MAINSTREAM DEBATE

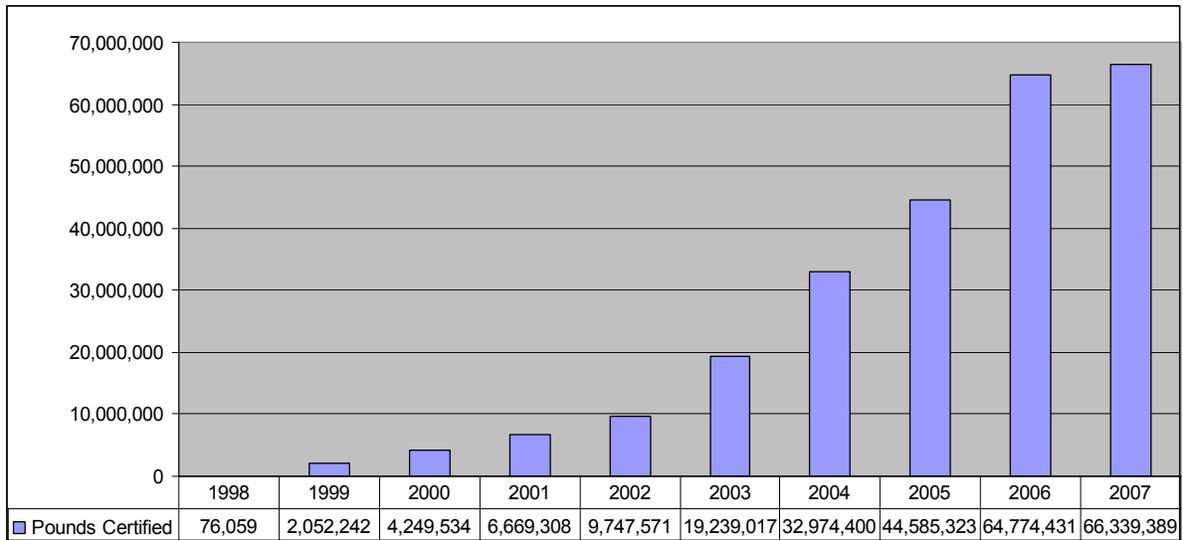
Richard M. Locke, Cate Reavis, Diane Cameron

And then there was the whole issue about price. Continuing to sell Fair Trade coffee at a premium could limit sales among price sensitive customers, making it an issue for retailers like Wal-Mart that stressed everyday low prices.⁵² But would MNCs like Kraft and Nestlé be willing to settle for lower margins on their sales of Fair Trade coffee or would they have to negotiate with FLO to lower the guaranteed minimum prices paid to growers?

In the end it came down to what was more important for producers: access to markets or price premiums?

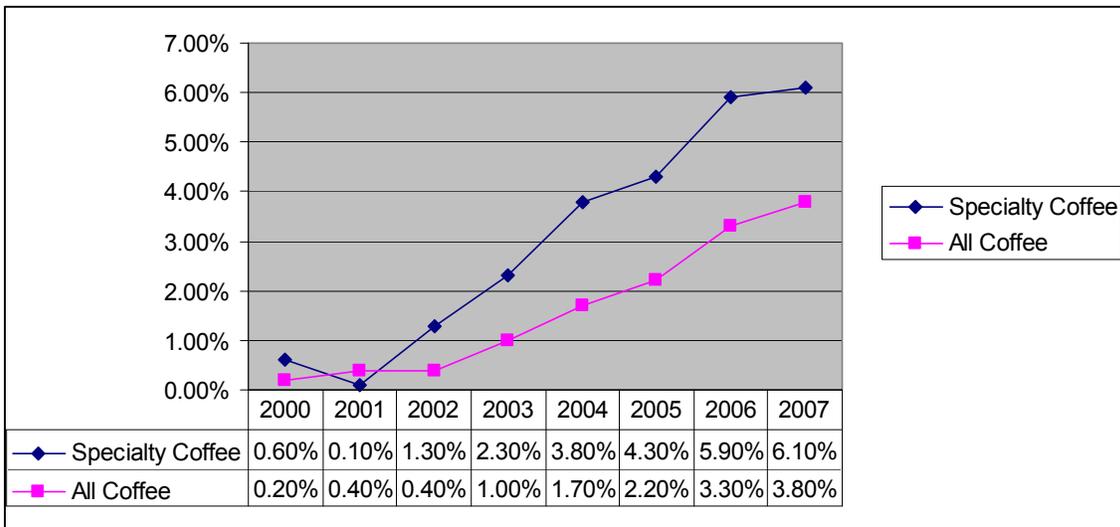
⁵² Terrence H. Witkowski, "Fair Trade Marketing," *Journal of Marketing Theory & Practice*, October 1, 2005.

Exhibit 1a Fair Trade Certified Coffee Imports into the United States



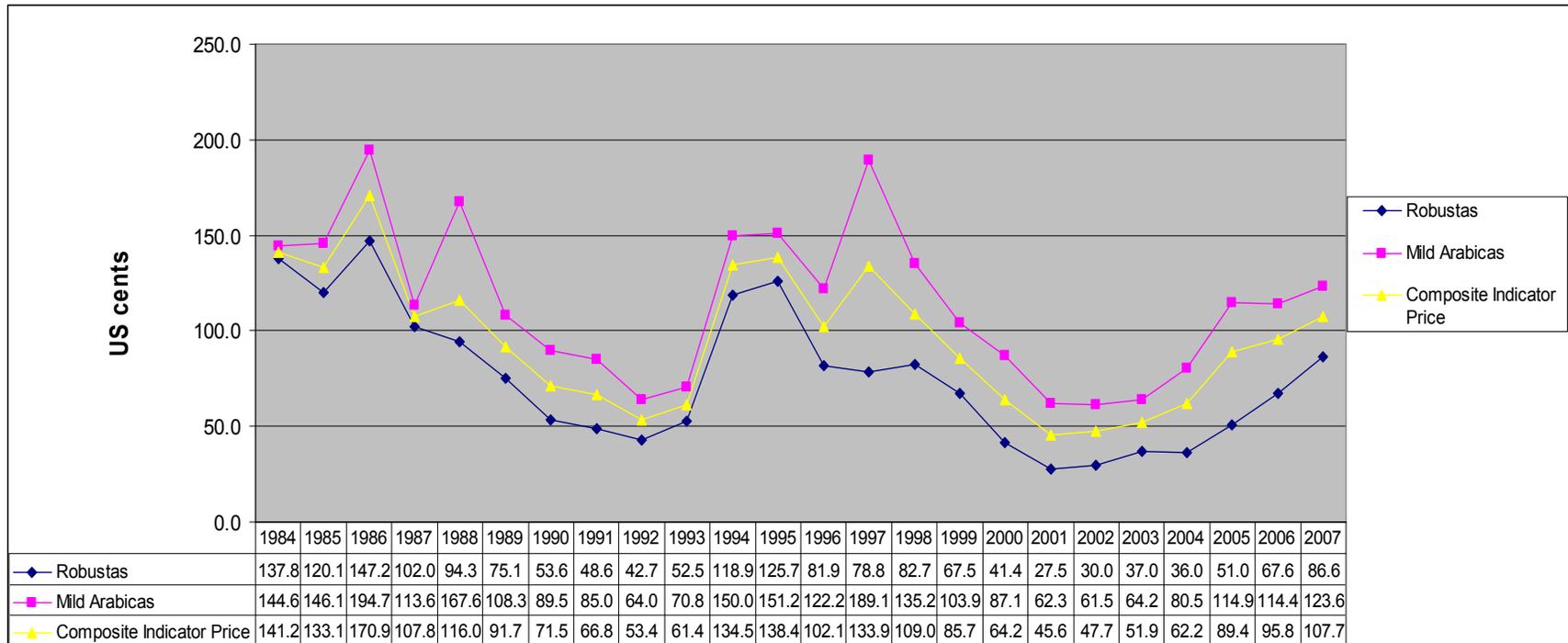
Source: TransFair Fair Trade Almanac, 2007.

Exhibit 1b Fair Trade Certified Coffee Market Share



Source: TransFair Fair Trade Almanac 2007.

Exhibit 2 Coffee Prices for Robusta, Mild Arabicas and Composite Indicator, 1984-2007



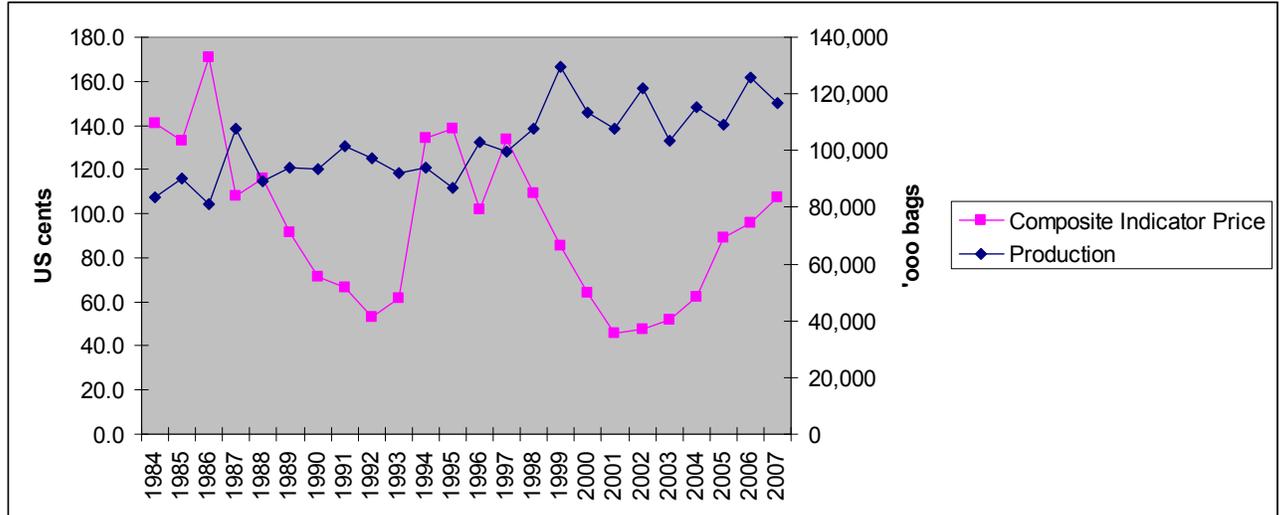
Source: International Coffee Organization.

Exhibit 3 Timeline History of ICA

- 1962 International Coffee Agreement between exporting and importing countries. Attempt to stabilize the market and halt the fall in prices. Provision of a quota system whereby supplies of coffee in excess of consumer requirements were withheld from the market. Production and diversification policies were also initiated to limit supplies of coffee and promotion activities instituted to increase consumption.
- 1968 Original agreement extended. Throughout duration of 1962 and 1968 helped prices to remain stable, production and consumption was balanced.
- 1973 Quota system established via 1962 agreement collapsed as supply was unable to meet demand, causing prices to increase. 1968 agreement was extended, however, all economic provisions were deleted. The ICO acted as a center for collecting and disseminating information and as a forum to negotiate a new agreement.
- 1976 Unlike the environment under which the initial ICA was created, frosts in Brazil (world's largest producer) had caused concerns whether there would be adequate supply to meet demand, pushing prices up. The 1976 agreement allowed for the suspension of quotas if prices were high and their reintroduction if prices became too low.
- 1980 per 1976 agreement, quotas were reintroduced
- 1983 New agreement, quotas in place
- 1986 Quotas suspended due to price increase
- 1987 Quotas reinstated and remained until July 1989
- 1989 1983 agreement extended for 2 years due to failed negotiations; verification of stocks was discontinued in addition to provisions related to production policies
- 1992 Record low prices resulted in another extension of 1983 agreement for 1 year
- 1993 1983 agreement extended 1 year
- 1994 New International Coffee Agreement in place. Coffee prices no longer regulated. New ICA goals included providing a forum to discuss matters pertaining to the coffee industry, making the industry more transparent by compiling and disseminating objective information on the world coffee market, monitoring of coffee development projects, developing programs relevant to the well being of the global coffee industry including topics on marketing and encouraging consumption.
- 1999 1994 agreement extended for 2 years
- 2001 New International Coffee Agreement in place. Objectives included: encouraging members to develop a sustainable coffee economy, promoting coffee consumption, promoting quality of coffee, providing a forum for the private sector, promoting training and information programs designed to assist the transfer of technology relevant to member countries, analyzing and advising on the preparation of projects to the benefit of the world economy.
- 2007 New International Coffee Agreement adopted. Overall objective was to strengthen the global coffee sector and promote its sustainable expansion in a market-based environment for the betterment of all participants in the sector. New objectives included: encouraging members to develop appropriate food safety procedures in the coffee sector, encouraging members to develop strategies to help local communities and small-scale farmers to benefit from coffee production, and facilitating the availability of information on financial tools and services.⁵³

⁵³ International Coffee Organization, <http://www.ico.org/history.asp>, accessed May 6, 2008.

Exhibit 4 Coffee Production and Composite Indicator Price, 1984-2007



Source: International Coffee Organization.

Exhibit 5 Fairtrade Labeling Organization Generic Standards

Social Development

Key Principles

Fairtrade adds Development Potential: Fairtrade should make a difference in development for certified producers.

Members are Small Producers: Small producers are those that are not structurally dependent on permanent hired labor, managing their farm mainly with their own and their family's labor-force.

Democracy, Participation and Transparency: The organization must be an instrument for the social and economic development of the members, and in particular, the benefits of Fairtrade must come to the members. The organization must, therefore, have a democratic structure and transparent administration, which enables effective control by the members and its Board over the management, including decisions about how the benefits are shared. Furthermore, there must be no discrimination regarding membership and participation.

Non-Discrimination: FLO follows ILO Convention 111 on ending discrimination of workers. The Convention rejects "any distinction, exclusion or preference made on the basis of race, color, sex, religion, political opinion, national extraction or social origin, which has the effect of nullifying or impairing equality of opportunity or treatment in employment or occupation." As far as applicable, FLO extends these principles to members of organizations.

Economic Development

Fairtrade Premium: The organization has the commitment and capacity to administer the Fairtrade Premium in a way which is transparent for beneficiaries and FLO. Decisions on the use of the Premium are taken democratically by the members.

Export Ability: The producers must have access to the logistical, administrative and technical means to bring a quality product to the market.

Economic Strengthening of the Organization

Environmental Development

Impact Assessment, Planning and Monitoring: The organization is expected to assess the environmental impacts of its members' operations, to develop plans designed to mitigate those impacts and to monitor the implementation of those plans.

Agrochemicals: Producers are expected to continually reduce the volumes and types of agrochemicals used in production to the maximum possible extent. (The term agrochemicals includes all synthetic inputs directly or indirectly used in the production of agricultural products or in the maintenance of processing equipment. This include pesticides, fertilizers and coadjuvants such as cleansing substances, detergents and mineral oil products.)

Waste: Producers are expected to reduce, reuse, recycle compost waste in a manner that is appropriate to the materials in question.

Soil and Water: Producers are expected to maintain and enhance the fertility and structure of soil. Water resources are managed with the objectives of conservation and non-contamination.

Fire: Producers are expected to prevent the use of fire in ways that adversely affect natural systems.

Genetically Modified Organisms (GMO): Producers do not use GMOs in either the production or processing of products.

Standards on Labor Conditions

Forced Labor and Child Labor: FLO follows ILO Conventions 29, 105, 138, 182 on child labor and forced labor. Forced or bonded labor must not occur. Bonded labor can be the result of forms of indebtedness of workers to the company or middlemen. Children may only work if their education is not jeopardized. If children work, they must not execute tasks, which are especially hazardous for them due to their age.

Freedom of Association and Collective Bargaining: FLO follows ILO Conventions 87 and 98 on freedom of association and collective bargaining. Workers and employers shall have the right to establish and to join organizations of their own choosing, and to draw up their constitutions and rules, to elect their representatives and to formulate their programs. Workers shall enjoy adequate protection against acts of anti-union discrimination in respect of their employment.

FAIR TRADE COFFEE: THE MAINSTREAM DEBATE

Richard M. Locke, Cate Reavis, Diane Cameron

Conditions of Employment: FLO follows ILO Plantation Convention 110, ILO Conventions 100 on equal remuneration and 111 on discrimination. All employees must work under fair conditions of employment. The producer organization must pay wages in line with or exceeding national laws and agreements on minimum wages or the regional average.

Occupational Health and Safety: FLO follows ILO Convention 155 which aims "to prevent accidents and injury to health arising out of, linked with or occurring in the course of work, by minimizing, so far as is reasonably predictable, the causes of hazards inherent in the working environment."

Source: Fairtrade Labeling Organization.