Social sustainability labels: promises and reality in the example of Fairtrade-coffee

By Pio Baake, Jana Friedrichsen, and Helene Naegele

- Fairtrade labels inform consumers that coffee producers are remunerated above market prices
- Consumers are willing to pay more to increase revenue and improve the living conditions of producers
- Roasters and retailers can use Fairtrade labeling to further segment the coffee market
- In the absence of barriers to entry, too many cooperatives get certified and each can sell only a small portion of its production as Fairtrade coffee
- Empirical studies find almost no positive effect on producers’ revenue and some effects on social indicators

**The coffee value chain: from the cooperative to the coffee cup**

Source: Authors’ own depiction

**FROM THE AUTHORS**

“The problem is that an increasing number of cooperatives are getting certified so that at some point, there will be so many certified cooperatives in the system that each one of them can only market a small part of its production under the Fairtrade label.”

— Helene Naegele, study author —
FAIRTRADE LABELS

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ABSTRACT

Fairtrade certification is intended to improve both the income and living conditions of producers, thereby creating more fairness in international trade. However, theoretical considerations and empirical studies show that this goal is only achieved to a limited extent, at least for coffee: Fairtrade certification leads at best to small increases in income for coffee farmers. The results on the reduction of income volatility, payments used to implement social projects, and improved access to credit are also mixed. Fairtrade is a means of market segmentation for roasters and retailers.

The basic idea of Fairtrade as implemented by the Fairtrade Labeling Organization International (FLO) is simple: a guaranteed minimum price and a social premium, combined with social standards, raise and stabilize the income of producers in developing and emerging countries, thereby improving their economic and social situations. An independent company monitors compliance with the requirements and issues the appropriate certifications, thus ensuring consumers of the credibility of Fairtrade certification.1 Other labels, such as Utz Certified and Rainforest Alliance, advertise using social and environmental sustainability standards (Box). While social sustainability labels now exist for many different products, this study focuses on the coffee market. Coffee, along with cocoa, was one of the first goods to be Fairtrade-certified. Today, it is the Fairtrade product with the highest sales volume, accounting for a share of more than 30 percent of total Fairtrade sales at consumer prices.2

After briefly discussing research approaches on the willingness of consumers to pay for Fairtrade products, theoretical considerations and empirical evidence will be presented which show that Fairtrade labels achieve the advertised redistribution and income effects to the benefit of coffee farmers to a limited extent.

Consumers pay more for Fairtrade-certified products

Demand for Fairtrade goods: preferences for redistribution

Compared to conventional products, Fairtrade products combine the purchase of the actual goods with a donation for the producers.3 If consumers perceive such a donation positively

1 For details on the principles and conditions of Fairtrade, see the box as well as http://www.fairtrade.de/index.php/mID/11/lan/de (in German).
2 This applies not only to the Fairtrade system but also to figures provided by Forum Fairer Handel e.V., which contains information from recognized fair trade import organizations such as Naturland Zeichen GmbH, Ecocert IMOswiss AG, and TransFair e.V.: Forum Fairer Handel e.V., Aktuelle Entwicklungen im Fairen Handel (2018) (in German; available online; accessed November 20, 2018; this applies to all other online sources in this report unless stated otherwise).
Box

**Fairtrade labels and other sustainability labels explained**

The most important sustainability labels in the coffee market are Fairtrade, Utz Certified, and Rainforest Alliance (RA). Today’s Fairtrade label has its roots in the Dutch organization Stichting Max Havelaar Netherlands, founded in 1988. Based on their example, other national Fairtrade organizations were founded, such as TransFair in Germany. The national organizations joined together under the umbrella organization Fairtrade Labeling Organization International (FLO) in 1997 and have used a common label since 2003.

In January 2018, Utz and RA joined forces to form a single organization. They set standards for social sustainability and eco-friendliness which are audited by independent certification companies. Farmers who pass this audit may sell their coffee with the respective label.

The FLO defines a similar standard catalogue but adds a minimum price and a social premium: if the world market price is below the minimum price, Fairtrade-certified farmers receive the minimum price plus the premium; if the world market price is above the minimum price, they receive the world market price plus the premium (Figure). The premium is meant to be invested in social projects and development. Utz and RA argue that farmers also earn a price premium with their label, but this is not guaranteed.

For the three labels, the farm certification is carried out by an organization other than the one setting the production standards. While the standards are set by NGOs, the certifiers are typically companies. FLO works exclusively with FLO-Cert GmbH, which also offers Utz and RA certification. A further unique selling point of Fairtrade is that the organization in the coffee sector only works with democratically organized cooperatives of small-scale farmers—coffee plantations with employees are excluded from the Fairtrade label. None of the label organizations sell coffee themselves or offer purchase guarantees.

Currently, the FLO minimum price for conventional, washed Arabica coffee is 1.40 USD per pound. The premium is 0.20 USD per pound, part of which is invested in measures to increase productivity and quality. The figure shows that until 2007, the Fairtrade minimum price was mostly higher than the world market price and led to a large price difference between conventional and Fairtrade-certified coffee. Since 2007, the world market price has only occasionally been below the Fairtrade minimum price. This can be understood above all as an insurance for farmers against low market prices.

The rise of the Fairtrade label should be viewed in the context of the end of the Cold War. The International Coffee Agreement (ICA), which had stabilized coffee prices at a high level, ended with the war. Without the ICA, prices fell dramatically. Gradually, information about coffee producers, whose incomes were often below the subsistence level, became public. In addition, the Fairtrade labels began to work not only with Fairtrade and “world shops,” but also with large roasters and supermarkets. Although coffee prices have recovered to ICA levels since 2006/2007, sales of Fairtrade products continue to grow at double-digit annual rates. The market share of Fairtrade coffee in German supermarkets was 1.5 percent in 2010.1

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due to views on fairness or prosocial attitudes, they are also prepared to pay higher prices than for conventional products. A further explanation for the success of Fairtrade products is that they allow consumers to send a positive signal about their interest in the well-being of coffee farmers and thus their prosocial attitude; such a signal lends the product additional symbolic value.5

Even if consumers are on average willing to pay a higher price for Fairtrade goods, the willingness of the population to support Fairtrade through higher prices varies greatly. This could be due to differences in prosocial preferences, the need to distinguish oneself by a purchase, or financial situations. Moreover, consumers have differing views on the necessity and effectiveness of the Fairtrade system.

Sustainability labels as a means of market segmentation

The Fairtrade label enables companies (in the case of coffee, roasters and retailers) to differentiate products in an ethical dimension. Products associated with higher incomes for farmers in developing and emerging countries are generally seen as superior. Fairtrade coffee is therefore a premium product which can be used by companies to benefit from prosocial consumers’ willingness to pay higher prices. If strongly prosocial consumers react less to price increases for Fairtrade products, there is an incentive for companies to charge high surcharges for these products. The price difference between conventional and Fairtrade-certified coffee is generally much greater for the end consumer than the income difference for coffee farmers.

Additionally, such certification leads to market segmentation as well as a reduction in competition intensity, which can lead to various product line constellations. If competition between brands is intense, Fairtrade certification can lead to a partitioning of the market, with only one or very few roasters offering Fairtrade coffee. With less intense competition, it is worthwhile for more roasters to offer Fairtrade coffee. Such a product line constellation exists on the German coffee market: almost all large roasters offer conventional (non-certified) as well as Fairtrade coffee. In such an oligopolistic market, the expected price difference between conventional and Fairtrade products for consumers is generally larger than the premium paid to farmers, because ethical differentiation reduces competitive pressure between products and increases profit margins.

Small impact on farmer incomes

The number of cooperatives which can become Fairtrade-certified is unlimited in theory. The decision to become Fairtrade-certified lies with the individual cooperative. Acquiring certification is worthwhile as long as the cooperative’s expected additional income exceeds the certification costs. However, the larger the number of Fairtrade-certified cooperatives, the greater the supply of potentially certified coffee and the smaller the quantity that each individual cooperative can sell at Fairtrade prices. With every new certified cooperative, the expected additional income from the sale of Fairtrade-certified coffee sinks. In the end, it is not worthwhile for any cooperatives not previously certified to become certified: the expected Fairtrade income is lower than the certification costs. Therefore, if the cooperatives are similar in terms of their expected additional revenues, none of them will benefit from the Fairtrade label and certification. Only cooperatives that sell an above-average proportion of their production under the Fairtrade label can profit from certification. Other cooperatives will continue to gain little or nothing from certification or perform even worse in case of unfavorable harvest results or other shocks.

This result remains valid even if requirements are taken into account that oblige traders to establish long-term relationships with the cooperatives. If long-term contracts reduce the risk of income fluctuations, the number of certified coffee can only be marketed as Fairtrade to end consumers if all players in the trade chain are certified in the Fairtrade system. In 2012, approximately 30 percent of certified cooperatives’ production with the Fairtrade label was sold worldwide. A large part of certified coffee is sold as conventional coffee. See Jason Potts et al., “The state of sustainable soybeans review 2014: Standards and the green economy” (Winnipeg, MB: International Institute for Sustainable Development) 2014.


9 The certification costs primarily depend on the number of cooperative members. In 2015, for example, a small cooperative (fewer than 50 coffee farmers) initially paid €466 euros for the certification and then 1,199 euros annually; FLOCERT, Fairtrade System small producer organisation. Version 26 (2015).

10 Coffee can only be marketed as Fairtrade to end consumers if all players in the trade chain are certified in the Fairtrade system. In 2012, approximately 30 percent of certified cooperatives’ production with the Fairtrade label was sold worldwide. A large part of certified coffee is sold as conventional coffee. See Jason Potts et al., “The state of sustainable soybeans review 2014: Standards and the green economy” (Winnipeg, MB: International Institute for Sustainable Development) 2014.


7 Hisco, Hammannüller, and Sequeira, “Consumer Demand for Fair Trade.”

8 For a detailed discussion see Po Paule and Helena Haagel, “Competition between For-Profit and Industry Labels: The case of Social Labels in the Coffee Market,” DIW Discussion Paper No. 1686 (available online).

cooperatives increases in equilibrium and the share of their production that they can sell under the Fairtrade label decreases. The previous result still holds so that no other cooperative can perform better by becoming Fairtrade-certified. Analogous considerations apply to implementing social projects. If cooperatives profit from these projects, they can be interpreted as additional revenue. In theory, there is no change in the decision to become certified.

### Empirical evidence

Numerous empirical studies assess the impact of Fairtrade on small farmers. Aside from the effects on income, additional aspects, such as productivity, education, or credit access, are analyzed. Table 1 provides an overview of the effects of Fairtrade certification on the income of coffee farmers. The results are mixed, but they often do not find an overall positive effect on income.

Certification costs are not considered in most studies, whereas Alain de Janvry, Craig McIntosch, and Elisabeth Sadoulet attach central importance to this aspect. They test the following hypotheses: a) the benefit of participating in the Fairtrade system is negative in periods when the world market price is higher than the price guaranteed by Fairtrade, and b) the long-term benefit of participating in Fairtrade is zero because the certification costs offset the additional profits. Their empirical study on Central American coffee cooperatives between 1997 and 2009 confirms both hypotheses. In their sample, certified coffee farmers sell an average of 22 percent of their production with the Fairtrade label. This share correlates positively with world market prices.

In addition to increased income, price stability is a central argument in favor of the Fairtrade system. As the price cannot fall below the Fairtrade minimum price, price volatility is automatically limited. However, the authors argue that volume volatility destroys part of this price stability: in years with low world market prices, Fairtrade coffee is relatively expensive and sales volumes are lower.

Unlike organic certification, Fairtrade certification hardly has any effect on the specific production conditions. As a consequence, even members of certified cooperatives often do not know that they are selling Fairtrade coffee or how the Fairtrade system functions.

The mixed results on aspects other than income are summarized in Table 2. Among other things, certification should enable coffee farmers to take over a larger part of the value chain within the cooperative and thus increase profits. This effect is underlined by several theoretical studies on Fairtrade, but is not always empirically verifiable.

### Conclusion: Fairtrade labels do not have the desired effects, other models should be considered

Theoretical considerations and empirical evidence make it clear: the simple idea that minimum prices lead to higher income for coffee farmers does not readily work. Without limiting access to the Fairtrade system, potential income gains are eliminated by the oversupply of Fairtrade-certifiable production. Higher revenues in times when the minimum price is above the market price are offset by certification costs and associated losses in times of high market prices. The positive effects of the Fairtrade system do not result from the minimum price but rather from regulations that lead to the implementation of social projects, the long-term development of supply relationships, and improved access to credit.

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**Table 1: Studies on income effects of coffee Fairtrade certification**

<table>
<thead>
<tr>
<th>Authors</th>
<th>Country, year</th>
<th>Criterion</th>
<th>Effect</th>
<th>Note</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chiputwe et al. (2010)</td>
<td>Uganda, 2012</td>
<td>Income</td>
<td>Significantly positive</td>
<td>Higher part of the value added in the cooperative via further processing of own products as explanation</td>
</tr>
<tr>
<td>Ruben and Fort (2010)</td>
<td>Peru, 2007/2008</td>
<td>Income</td>
<td>Not significant</td>
<td>Market price higher than minimum price, small quantities sold as Fairtrade</td>
</tr>
<tr>
<td>Beuchelt, Zeller (2010)</td>
<td>Nicaragua, 1997 vs. 2007</td>
<td>Poverty line</td>
<td>Increased poverty among certified farmers</td>
<td></td>
</tr>
<tr>
<td>Van Roybergen et al. (2016)</td>
<td>Central Kenya, 2009–2013</td>
<td>Overall income (coffee and other income sources)</td>
<td>Significantly negative</td>
<td>Little diversification among certified farmers</td>
</tr>
</tbody>
</table>


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13 The earmarking of the social premium can be efficient, as it can help to overcome coordination and free rider problems when financing public infrastructure, schools, or other social projects.
15 van de Janvry, McIntosh, and Sadoulet, “Fair Trade and Free Entry.”
FAIRTRADE LABELS

Here too, however, the results of empirical studies are not entirely positive.

The proposed exemption of Fairtrade-certified coffee from the coffee tax—which is roughly two euros per kilo in Germany—would possibly increase demand without solving the fundamental problems of the current Fairtrade system.

The design of more effective alternatives to the Fairtrade system cannot be conclusively answered here. Access restrictions, such as those that exist in direct trade systems with direct negotiations between farmers and roasters/retailers, can improve the situation of the farmers and cooperatives involved but have a discriminatory effect on those who are still dependent on conventional distribution channels. Sustainable structural changes are more likely to be achieved through technical support and changes in the value chain. Research19 shows that quality improvements achieved through technical assistance can lead to higher premiums than under the Fairtrade label. The importance of the value chain becomes clear in other studies. By processing their own products, cooperatives in developing and emerging countries can also secure a larger share of the total value added.20

### Table 2

<table>
<thead>
<tr>
<th>Authors</th>
<th>Country</th>
<th>Criterion</th>
<th>Effect</th>
<th>Note</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dragusanu and Nunn (2018)1</td>
<td>Costa Rica</td>
<td>Education</td>
<td>Positive</td>
<td>Effect not only limited to the children of certified farmers</td>
</tr>
<tr>
<td>Gitter et al. (2012)2</td>
<td>Mexico</td>
<td>Education</td>
<td>Positive for girls</td>
<td></td>
</tr>
<tr>
<td>Minten et al. (2018)3</td>
<td>Ethiopia</td>
<td>Child labor</td>
<td>No effect</td>
<td>Ca. 30 percent use child labor</td>
</tr>
<tr>
<td>Van Rijnsbergen et al. (2016)</td>
<td>Kenya</td>
<td>Further processing of own products</td>
<td>No effect</td>
<td></td>
</tr>
<tr>
<td>Ruben and Fort (2013)</td>
<td>Peru</td>
<td>Credit</td>
<td>Improved access</td>
<td></td>
</tr>
<tr>
<td>Van Rijnsbergen et al. (2016)</td>
<td>Kenya</td>
<td>Credit</td>
<td>No effect</td>
<td></td>
</tr>
<tr>
<td>Valkila and Nygren (2010)</td>
<td>Nicaragua</td>
<td>Credit</td>
<td>Worse interest rate on average</td>
<td>Fairtrade cooperatives between 18 and 22 percent, others average at 11 percent</td>
</tr>
</tbody>
</table>

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Source: Own compilation.

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20 Chiapusa, Spielman, and Qaim, “Food Standards, Certification, and Poverty.”

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