

# The Impact of the Alternative Trading System to Small Producers

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ADLINI SJAH, AUG 20 2016

### Is “Fairtrade” Fair? The Impact of the Alternative Trading System to Small Producers

In response to the detrimental effects of the increasing liberalisation of coffee trade in 1989, various alternative trading systems have been established with the aim to provide better livelihoods for small farmers. Of these alternative trading systems, arguably the most successful in terms of providing social justice standards has been the Fairtrade scheme (Fridell 2014; Valkila & Nygren 2010). The Fairtrade Scheme is a certification system which promises certified smallholders fair prices for their products and appropriate farming conditions. However, does Fairtrade actually fulfil their promises? This essay argues that the Fairtrade Scheme, while offering slightly better conditions than Free Trade, in the end does not provide truly fair pricing and farming conditions for small producers. In addition, the increasing corporatisation of the Fairtrade Scheme into its current label certification system in the mainstream market has taken Fairtrade even further from its goal. To show this, a case study of Indonesian coffee producers will be used throughout the essay as an empirical example. This essay will begin by briefly describing the key concepts and background of Fairtrade. This is followed by an analysis of Fairtrade’s impact on prices, conditions, and the results of Fairtrade’s corporatisation.

#### Overview of Key Concepts and Case Study

Before discussing Fairtrade’s effectiveness, it is necessary to understand the key concepts of Fair Trade and global value chains, and the background of Fairtrade’s establishment.

Fairtrade, in its current form, is a certification system run by the Fairtrade Labelling Organisations International (FLO) and the World Fairtrade Organisation, mainly to source from producers in the South to alternative traders and consumers in the North (Bacon 2010). For this reason, the remainder of this essay will use the term ‘Fairtrade’ instead of ‘Fair Trade’ to signify that it is an assessment of the Fairtrade scheme in its current certification form, rather than the concept of Fair Trade. The scheme rose in response to the often unfair conditions that small producers must face in international trade. In the case of coffee, 50% of the world’s supply of green beans is concentrated in 5 roasters (Fridell 2014, p.97). As a result of this market concentration, several mid-sized traders have been forced into bankruptcy or buyouts because they were unable to compete (Hartatri 2014).

In contrast, Fairtrade runs as a “bottom-up” process, with objectives to support producer empowerment, transparency, and sustainable community development (Brown 1993). Fairtrade achieves this through connecting smaller farmer organisations to other actors in the global value chain who are also Fairtrade-certified (Dragusanu, Giovannucci & Nunn 2014). The global value chain itself is the “international structure of production, trade, and consumption of commodities as disaggregated into stages that are embedded in a network of activities controlled by firms” (Bacon 2010, p.116). These stages are producer → collector → processing firm → collector → big collector → exporter → purchaser (Werkander & Wondollek 2009, p.20). Bacon (2010) argues that there are three identifiable categories in the continuum of global value chains: alternative trade value chain, corporate value chain, and the hybrid “Fairtrade” value chain – which represents a mix of alternative and corporate principles in its operation.

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In order to be Fairtrade-certified, farmers must be small-scale and organised into democratic associations – typically in the form of cooperatives. They should also fulfill fair conditions of employment. When certified, farmers will receive a guaranteed minimum price for their coffee and a social premium for development, as well as farming support such as credit loans (Valkila & Nygren 2010). It is these promises that will be used as a baseline in evaluating whether or not Fairtrade system actually offers a fair price and conditions for small producers.

Out of all the Fairtrade products, coffee has been acknowledged as the best established item (Valkila & Nygren 2010). For this reason, this essay will focus on coffee cooperatives under the Fairtrade system in Indonesia to see the empirical impacts of Fairtrade certification. Indonesia is one of the top 4 coffee producers; and the majority of its coffee is exported and produced by smallholder farmers (Arifin 2010; Hartatri 2014). There are two Fairtrade-certified cooperatives in Indonesia – both located in Central Aceh – the Kooperasi Baitul Qiradh Baburrayan (KBQB) and Permata Gayo Cooperative (PGC); KBQB has been Fairtrade-certified since 2007, and currently has 8000 active members; while PGC was certified in 2008 and had 3089 members in 2013 (Fairtrade USA n.d.; Peace Coffee n.d.). Having established the key concepts and background, the next section will begin discussing the impact of the Fairtrade scheme towards Indonesian coffee smallholders.

## Discussion 1: Fairtrade's Effect on Coffee Prices

Fairtrade's primary advantage – compared to both conventional market systems and to other alternative trading schemes[1] – is their guarantee for a minimum price (Bacon 2010; Saragih 2013). As a result, Fairtrade improves farmers' resilience to adverse price shocks (Valkila & Nygren 2010). However, resilience and price stability is only as beneficial as the price amount, and whether or not that price amount covers farmers' basic needs.

In reality, the prices that Fairtrade-certified small producers receive are not consistently fair. Fairtrade farmers in Indonesia were paid 2.47 USD per 1 kg of unprocessed coffee beans by cooperatives, while cooperatives were paid 2.47-2.51 USD per kg by trading firms. This was when Fairtrade regulation actually guaranteed a minimum price of 3.31 USD per kg (inclusive of a 0.22 USD social premium) (Werkander & Wondollek 2009, pp.27–28). Not only did this price not fulfil Fairtrade's requirements, it was at times lower than what collectors in the conventional market offered at 2.37-2.65 USD per kg (Werkander & Wondollek 2009, p.39). There are multiple reasons for this lack of fair pricing and implementation.

Firstly, the prices that Fairtrade offers are not calculated fairly. Fridell (2014, p.109) states that the prices offered by Fairtrade are still below the production cost. This is because rather than being formulated on production cost, the prices are determined by a board of directors based on what's feasible in the market. This is visible in how FLO did not change their guaranteed minimum price from 1988-2008 – not even to adjust for inflation – essentially making coffee prices lose 41% of its real value (Bacon 2010). While prices did increase by 7-11% (for Fairtrade and Fairtrade organic prices respectively) in 2007-2008 after receiving pressure from cooperatives, these were also not in line with the needs of the farmers (Bacon 2010). Due to these pricing systems, Fairtrade-certified farmers in Indonesia cannot solely rely on their coffee cultivation to sustain their living (Werkander & Wondollek 2009).

Secondly, smallholder farmers do not have sufficient bargaining position in the supply chain, which causes inconsistent prices. Instead, larger corporations such as exporting firms have more power to determine prices and benefit from those prices. Even though cooperatives were aware that exporting firms receive a higher price for the coffee that they collected, they do not have much control over it as these exporting firms determine whether or not their products will be bought. PGC in Indonesia has argued that MGMI, an exporting firm, would place a high margin on the coffee sold or buy coffee in advance during low prices and wait until prices rise before selling, effectively holding payment to the PGC hostage. (Werkander & Wondollek 2009). Arifin (2010) adds that coffee farmers often have to rely on collector traders for loans, and are thus reluctant to demand fairer treatment in terms of pricing from these actors.

Due to these conditions, some scholars even go so far as to claim that specialty coffee trading systems – which includes Fairtrade – have actually decreased farmers' value share in the global value chain, compared to the conventional coffee market (Daviron & Ponte 2005). In support of Daviron & Ponte's claim, Jaya et al (2013) also

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argue that exporters and buyers are actually the ones who benefit the most in the supply chain of Acehese coffee, even under certification systems. While Jaya et al's study does not specifically analyse the Fairtrade certification system, their conclusions reflect the previously discussed dynamics in the Fairtrade process.

Thirdly, there is limited access to the "better" price that Fairtrade offers. Even if farmers choose to opt into the Fairtrade certification system they cannot sell all their products, and some may not be able to sell at all. For example, Bacon (2010), Fridell (2014), Valkila and Nygren (2010) argue that although some cooperatives can sell almost all of their coffee through Fairtrade channels, others can only sell 30-60% of their first-grade coffee through Fairtrade schemes, and have to sell the rest in conventional markets at a lower price. For this reason, members of cooperatives in Indonesia receive varied effects from the scheme. While some farmers received a higher price for their beans after they joined the Fairtrade-certified cooperative, other farmers state that they did not experience any changes (Werkander & Wondollek 2009).

Ironically, the increasing surplus of the global supply of Fairtrade coffee essentially threaten the availability of price premiums, therefore decreasing the impact of Fairtrade certification (Bacon 2010; Mutersbaugh 2005). This practice is visible in Indonesia, where cooperatives often sell both Fairtrade and 'regular' coffee due to the limited demand and over supply. In fact, in conditions where conventional market prices are as high as Fairtrade prices, some coffee producers in Central Aceh actually prefer selling to regular collectors, as they have more freedom to find the collectors who will give them the highest price (Werkander & Wondollek 2009). Similarly, some coffee collectors in the area are also less willing to buy Fairtrade coffee if it means that they would receive less volume of coffee (Werkander & Wondollek 2009).

Due to the above three conditions, Fridell's (2014) conclusion that Fairtrade still leaves farmers relatively poor can certainly be understood.

## Discussion 2: Fairtrade's Impact on Farmers' Livelihoods

The second main promise of Fairtrade systems is that farmers will have improved livelihoods, through the existence of working standards and a social premium which would help farmers to increase productivity, implement community programs, and protect labour. Conceptually, Fairtrade has a higher labour rights emphasis compared to other standards, with outlines for (1) fair conditions of employment, (2) right to association and collective bargaining, (3) no forced or child labour, and (4) right to occupational health and safety (Valkila & Nygren 2010, p.324). Valkila & Nygren (2010) notes that this labour rights emphasis is especially important as coffee production is a labour-intensive activity, typically with low wages and unstable working contracts. These three main aspects of farmers' livelihoods will be discussed in this section

### *Improving Farmers' Productivity*

Fairtrade provides farmers easier access to loans, which could significantly boost their productivity. Valkila & Nygren (2010) notes that the main advantage that Fairtrade cooperatives offers in providing loans is less requirement of collateral and no interest for the first few years. However, cooperatives actually charge a higher interest rate at 18-22%, over other companies' average 11%. For example, one of the supporting projects that KBQB runs in Indonesia is a microfinance bank, where farmers will not have to pay interest for the first 3 years, but will then have to repay the full amount with interest (9%) in the subsequent 3 years. Even so, the interest from loans are given back to farmers as it is used for the development of the cooperatives' infrastructure (Fairtrade Proof n.d.).

In addition to loans, farmers' productivity is also boosted by the cooperatives' support for members' improvement. Cooperatives have been known to provide training in coffee production, such as through improving fertilisation, pest control, and processing techniques (Valkila & Nygren 2010). Fridell (2014) also argues that Fairtrade has successfully provided Southern farmers with enhanced access to credit, technology and economic infrastructure. This support is visible in KBQB, which runs rehabilitation projects for land and provides weed-wackers and other equipment for farmers. Being the only certification scheme that started from indigenous smallholder cooperatives (Bacon 2010), it is clear why Fairtrade places a higher emphasis on cooperatives' productivity. However, it is not

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evident that this extra support to farmers' productivity is an exclusive benefit of Fairtrade schemes. Instead, Hartatri (2014) argues that as more international trading companies aim to be more sustainable do to changing international norms, they have also provided training and drying technology for Indonesian small farmers.

On the other hand, there are also negative aspects of the Fairtrade system which are detrimental to farmers. Most notably is the Fairtrade system of delayed payment to producers of cooperatives. This is especially harmful to the day-to-day life of small producers, especially those who don't have the ability or savings to wait for a delayed payment. Both Bacon (2010) and Valkila & Nygren (2010) notes that cooperatives were often paid in stages – sometimes Southern producers will have to wait months or years to receive full payment after they have provided the products. In contrast, farmers in the conventional market are more likely to receive immediate payment. This limited capacity of Fairtrade to provide their promised prices in a timely manner so that farmers can sustain their daily lives is a key situation that undermines Fairtrade's claim of better conditions. It is an especially detrimental situation for small farmers, who may not have the savings to sustain them until their next scheduled payment.

Precisely in this context, Hartatri (2014, p.168) notes that Indonesian coffee farmers fall under this category of poor small farmers who "require fast cash flow to fulfil their basic needs", and therefore will be significantly harmed by a system of delayed payment. Unfortunately, Fairtrade-certified cooperatives in Indonesia such as PGC have to experience both prepayment and delayed payment, depending on the volume of coffee given. For this reason, some coffee producers in Indonesia have chosen not to join the FreeTrade scheme so that they could receive direct payment in cash from any collectors they choose (Werkander & Wondollek 2009). Therefore, it is clear that while farmers may receive support for equipment and loans, these are not exclusive under Fairtrade and may be accompanied by other detrimental schemes that could harm farmers' productivity and livelihoods.

## *Community Programs*

In terms of community programs, there are clear benefits of Fairtrade schemes from Fairtrade's social premium. The generated funds have been used for education programs, scholarships for vocational education, construction of public infrastructure (roads, community buildings), and improvement in healthcare services (Valkila & Nygren 2010). However, many Fairtrade members in Indonesia say that the Fairtrade social premium was not distributed among members and members could not see effects to the community, possibly because it was instead used for certification (Werkander & Wondollek 2009). There is a clear lack of consistent transparency throughout Fairtrade cooperatives, as not all farmers and collectors are aware of decision-making processes in the cooperative (Werkander & Wondollek 2009).

## *Labor Conditions*

Finally, Valkila & Nygren (2010) also note that there is not always better protection for labour under Fairtrade. While the criteria for minimum wages are usually fulfilled, there has been limited improvement for fair conditions of employment and elimination of child labour – the latter being a tricky matter when it comes to family farms. There is a visible lack of fulfilment of Fairtrade standards in Indonesia. Hand pickers for the PGC received around 1.32-3.96 USD per day, based on their productivity. Even with the assumption that these workers worked a full month – amounting to 39.6-118.8 USD – this means that not all hand pickers will receive the guaranteed minimum national wage of 89 USD per month, let alone the higher Fairtrade standards (Werkander & Wondollek 2009, p.29).

The reason for this lack of improvement in conditions of employment is largely the lack of awareness about the higher labour rights standards. According to Valkila & Nygren (2010), there is low awareness due to confusion about the system. This may also be partly caused by the fact that the application of certification schemes, such as Fairtrade in Indonesia, are more often driven by coffee exporting firms rather than the farmers or cooperatives, therefore causing less awareness about the need to improve such standards (Hartatri 2014).

## **Discussion 3: Impact of Incorporation into Conventional Supply Chains**

In order to understand Fairtrade's limited capacity to improve farmers' livelihood and provide fair prices, it is

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necessary to analyse the impacts of Fairtrade's incorporation into conventional supply chains. Fairtrade initially operated as a separate niche market with direct trade between cooperatives in the South and roasting companies in the North (Milford 2004). However, with the certification scheme, the presence of an intermediary trading company or exporter is allowed, as long as they are Fairtrade certified (Fairtrade 2016). Along with this certification scheme, Fairtrade changed their focus on governments regulations towards consumer behaviour (Fridell 2014).

An often cited benefit of the mainstreaming of Fairtrade into conventional market systems is that its products are more readily accessible by a wider range of customers. There are many reports that global Fairtrade sales have increased exponentially since Fairtrade became a label for conventional markets (O'Donoghue 2014; Smithers 2014; 'Fairly traded products market in the U.S. – statistics & facts' 2014). However, Bacon notes that this rapid increase is not only occurring in the corporate and hybrid value chains, but also occurring in alternative value chains (Bacon 2010). This indicates that rather than being an effect of incorporating Fairtrade into conventional markets, the rising sales of Fairtrade coffee is a result of more global awareness about ethical sources of coffee and coffee production. Furthermore, as Thompson (2008) rightly argues, the true measurement of Fairtrade's success should be if producers can proportionally benefit from the mainstreaming of Fairtrade schemes, rather than simply being able to access a wider market. As shown by the previous discussion on prices, this has not been the case.

Moreover, there are various detrimental impacts of the conventionalisation of Fairtrade. Firstly, it forces the scheme to operate in a limited market space under pressures from other larger companies who set low competitive prices. Valkila & Nygren (2010, p.324) state that the market share of Fairtrade coffee was only 1% of international coffee trade in 2003-2004. Although this number grew 40% in 2004-2005, this only made it into 1.4% of international coffee trade, which is still a significantly low amount. As long as cheaper prices remain in the market, there will be limited market space for Fairtrade's higher price (regardless of how truly reflective those prices are of sustainable farming practices) and a limit to how high prices can go.

As a result of this limited market share, there are only limited benefits of the Fairtrade scheme. As more farmers enter Fairtrade, there is a higher competition between the farmers to obtain these benefits. Out of these farmers, early entrants to the Fairtrade markets control the market, and will therefore more likely be benefited by Fairtrade (Valkila & Nygren 2010). As Fairtrade's certification costs farmers money it is likely that earlier entrants were those with a higher capacity than their peers, as they could organise into a cooperative sooner and follow Fairtrade's certification process (Arifin 2010). Therefore, the coffee organisations that are actually more vulnerable and more in need of protection may not be getting it through the Fairtrade scheme. For example, the coffee cooperative in Indonesia actually had to borrow money from exporting firms to cover the Fairtrade certification cost – showing how vulnerable coffee stakeholders actually struggle to get into Fairtrade schemes (Werkander & Wondollek 2009).

Furthermore, the new emphasis of Fairtrade on consumer-driven approaches rather than government regulations also hampers Fairtrade's ability to create meaningful benefits. As long as Fairtrade relies on consumers and do not seek to change the structure of the – such as through establishing a minimum price – this problem of limited market space will always continue. For this reason, scholars have stated that the Fairtrade scheme is a downgrade from the era of the International Coffee Agreement (ICA), where guaranteed minimum prices could reach all coffee farmers in the world (Bacon 2010; Fridell 2014). In addition, the corporatization of Fairtrade schemes, instead of helping to improve democratic processes, may actually hamper democratic regulation as they do not engage with local government structures – elected by the community – and allows a bigger role for the private sector rather than smallholder farmers (Neilson 2008). Certainly, in Indonesia's case, the demise of the ICA has weakened government protection, and have made both local producers and local exporters more vulnerable to the power of international trading houses (Ponte 2002).

The problem with consumer-driven approaches is also that consumers often lack information and are subject to corporate propaganda (Fridell 2014). While consumers may be led to believe that Fairtrade provides a fair situation to small producers, Fairtrade's limitations and sometimes unfair results for producers are not well known by society. Dragusanu, Giovannucci & Nunn (2014) argue that Fairtrade's significance is that it is a credible source of information to the consumer. However, as there are no requirements for companies to source all their products through Fairtrade schemes (Fairtrade 2016), this allows companies to gain the advantage of the Fairtrade brand but

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only minimally committing to the scheme. Starbucks, for example, uses the Fairtrade label but in fact only source 8.6% of their coffee through Fairtrade (Starbucks 2014). In the end, Fairtrade's schemes still cannot counter the dominance of large corporations in voluntarily choosing the extent of their adherence to ethical standards (Fridell 2014). This was not an issue in the early forms of Fairtrade, as corporations were still regulated by government legislations (Schmelzer 2010). Therefore, it is clear that the incorporation of Fairtrade into conventional market schemes, along with an increased reliance on consumers rather than governments, have partly hampered Fairtrade's ability to achieve its objectives.

Having said the above, it is important to note that the whole Fair Trade movement contains multiple processes with differing approaches – and some actors still pushing for a completely alternative trading system. Although the FLO labelling scheme has been dominant – as shown throughout this essay – it will be unfair to deem the whole Fairtrade system as nothing more than a neoliberal capitalist project (Bacon 2010). Some scholars also argue that it is necessary for Fair Trade schemes to be in conventional markets, but in a way that doesn't make it succumb to capitalist market forces which would harm smallholder farmers (Taylor 2005).

## Conclusion

In conclusion, Fairtrade is a well-intentioned scheme for improving smallholder farmers' livelihood; however, it is impaired by ineffective implementation, problematic practices and an unwillingness to fight the limitations of the conventional market system through stronger measures. This essay has shown that firstly, Fairtrade has not been able to provide farmers with consistently fair prices that truly reflect their production costs. Secondly, it has shown that Fairtrade schemes in Indonesia have only marginally improved farmers' conditions – whether in terms of farm productivity, community development or labour conditions – as the use of social premiums and implementation of programs vary. Finally, the incorporation of Fairtrade into conventional supply chains have significantly hampered Fairtrade's ability to achieve better prices and conditions – as it constrains Fairtrade projects into a limited market space and distracts Fairtrade activists from engaging with government stakeholders. If Fairtrade wishes to make more meaningful contributions, there needs to be some significant changes within its system.

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## **Endnotes**

[1] Alternative certified channels include Utz Certified, Rainforest Alliance, C.A.F.E. Practices, and Bird-Friendly Coffee.

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Date written: May 2016*