

The dynamics of Fair Trade as a mixed-form market

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Abstract

This article analyzes the Fair Trade sector as a “mixed-form market”, i.e. a market in which different types of players (in this case, nonprofit, co-operative and for-profit organizations) coexist and compete. The purposes of this article are (1) to understand the factors that have led Fair Trade to become a mixed-form market and (2) to propose some trails to understand the market dynamics that result from the interactions between the different types of players. We start by defining briefly Fair Trade, its different dimensions (including the “fair” quality of the products) and its organizational landscape, focusing on the distinction between the pioneer “Alternative Trading Organizations” and the second-mover companies. Then, we recall the theoretical emergence factors for each type of organization (nonprofit, co-operative and for-profit) and apply these emergence factors to the context of Fair Trade. This analysis allows us to capture the specificities of each type of operator with regard to Fair Trade and, thus, to have a better understanding of the competition dynamics in the sector. The latter analysis includes elements on ethical imitation, consumers’ behaviors, effects on welfare and the role of the government, in order to outline some of the major trends in this rapidly evolving sector.

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Introduction

Among the recent trends towards ethical and sustainable consumption, Fair Trade (FT) is probably one of the fastest growing and most promising initiatives. Even though FT sales still do not exceed 0.01% of the total trade in the world, their size¹ and growth rate² make it much more than an anecdotic phenomenon.

Simultaneously to the commercial success of fairly traded products, research on Fair Trade has started to lift off in the last years (Moore, 2004; Nicholls *et al.*, 2005). Until now, economic and business-oriented articles have mainly focused on the description of the chain (Gendron, 2004; Moore, 2004; Poncelet *et al.*, 2004; Renard, 2003), on the concept of “fair price” (Becchetti *et al.*, 2002; Maseland *et al.*, 2002; Yanchus *et al.*, 2003) and on consumer and marketing issues (Becchetti & Rosati, 2005; De Pelsmacker *et al.*, 2005; Moore *et al.*, 2006).

Whereas there has been a lot of work on the two extremes of the FT chain – producers and consumers –, the intermediaries of the chain, mainly the FT operators in the North³, have received less attention. The reason is, probably, that these organizations are supposed to link the demand and the supply-side under precise conditions fixed by the FT label or code they subscribe to. Therefore, it can seem less important to consider the way these intermediary organizations are structured and governed.

However, far from being “black boxes” that conduct FT activities in a homogeneous way, these organizations, on the contrary, can have very diverse structures, objectives and ways of functioning. The pioneers of the movement have mainly been nonprofit (or “not-for-profit”) and co-operative organizations with a strong attention to regulation (the setting up of new rules for conducting trade in a fair way), education (the initiatives aiming to raise the awareness of consumers) and development (a close relationship with the producers in the South). These pioneer fair-traders are often referred to as “Alternative trading organizations” (ATOs).⁴

¹ Fair Trade sales reached 900 million \$ worldwide in 2003 (Nicholls & Opal, 2005), and 660 million \$ in Europe in 2004 (Krier, 2005); market shares range from 1 or 2% for several products up to 20% for coffee in the UK and even 50% for bananas in Switzerland (Krier, 2005).

² 30 to 40% annual growth for FLO-labelled products (FLO, 2005)

³ In the literature on development, the terms “North” and “South” refer to the geopolitical division of the world between, respectively, developed and developing countries. In this article, these terms will be used as synonyms.

⁴ Even though the term “FTO” (“Fair Trade organization”) would be more accurate, we will keep the term “ATO” so as to remain in line with the literature on the issue.

The initial development of FT by ATOs has attracted a growing number of mainstreaming “for-profit” companies in the last years. These companies have emerged mainly in the distribution area (supermarkets selling FT products), but also in the import and the transformation of fairly traded goods (for instance, coffee roasters or chocolate companies). As a parallel to the mainstreaming of FT, ATOs, on their turn, have evolved towards a more commercial profile. Some ATOs have become privately held or limited by shares, while other ATOs have evolved as “Fair Trade groups” gathering a commercial venture and a nonprofit organ in the same structure (examples include Traidcraft in the UK, Dritte Welt Partner in Germany or Oxfam Wereldwinkels in Belgium).

As a result, Fair Trade appears as “mixed-form market” where different types of players coexist. Such a coexistence induces specific market dynamics that deserve a special attention. Thus, the purposes of this article are (1) to understand the factors that have led Fair Trade to become a mixed-form market and (2) to propose some trails to understand the market dynamics that result from the interactions between the different types of players. We start by defining briefly Fair Trade, its different dimensions and its organizational landscape (part 1). Then, we recall the theoretical emergence factors for each type of organization (nonprofit, co-operative and for-profit) and apply these emergence factors to the context of Fair Trade (part 2). This analysis allows us to capture the specificities of each type of operator with regard to Fair Trade and, thus, to have a better understanding of the market dynamics in the sector (part 3).

1. Fair Trade and its diverse players

1.1. The Fair Trade concept

The definition which gathers most agreement and is most widely used by field actors and academics (Moore, 2004) is the FINE⁵ definition:

Fair Trade 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. Fair Trade organisations (backed by consumers) are engaged actively

⁵ FINE is an informal network gathering the four main Fair Trade umbrella organs: EFTA (European Fair Trade Association), NEWS (Network European Worldshops), FLO INTERNATIONAL (Fair Trade Labelling Organizations) and IFAT (International Fair Trade Association).

in supporting producers, awareness raising and in campaigning for changes in the rules and practice of conventional international trade.

It appears from this definition and from the sector's observation that Fair Trade is a highly multidimensional concept. While everyone agrees on the multidimensional character of Fair Trade, these multiple dimensions can be organized in different ways (Becchetti *et al.*, 2002; Nicholls *et al.*, 2005). In our view, the elements that constitute the FT concept can be grouped under four main categories:

- **Trade:**

Albeit “fair”, we are talking about “trade”. FT operators conduct market activities (import, transformation, distribution) similar to any commercial initiative (Nicholls *et al.*, 2005). The positioning of trade within the missions of FT operators, however, can vary, from a mean to produce more development in the South, to a goal on its own. When analyzing the FT product, the “trade” dimension can be assimilated to the material character of the good. Indeed, it is not the product in itself that is “fair”: nothing distinguishes physically a FT banana from a conventional one. Rather, it is the bundle of invisible characteristics linked to the conditions under which the good has been produced and traded (Becchetti *et al.*, forthcoming).

- **Fairness:**

Thus, the “fair” dimension constitutes the specific and powerful – albeit invisible – attribute of FT products, differentiating them from non-FT products (Becchetti & Rosati, 2005; Nicholls *et al.*, 2005). This “fair” characteristic is linked to both the producers and the importers of FT products. While the former must respect a number of organizational criteria (small-scale producers, democratic decision-making, no discrimination,...), the latter are entitled to specific trading conditions (fair price, social premium, pre-financing, provision of market access, long-term relationship,...).

The fair price consists in a “countercyclical mark-up” that can reach more than 100 percent of the market price (see the example of coffee, cocoa and bananas), and that is provided by FT importers to first level producer organizations and, ultimately, to individual producers. Opponents of this price rule say that it is not market clearing, that it creates excess supply and that it constitutes a distortion of market mechanisms. Advocates of it have two main counterarguments: i) the market price is not competitive and reflects the

monopsonistic/oligopsonistic structure of trades between local producers and intermediaries. In these cases a higher minimum price (analogous to the one created by ATOs) is the solution to this specific market failure; ii) fair trade product (e.g. fair trade coffee) is a new and distinct variety of the product and, as such, has its own market price determined by the equilibrium between supply and concerned consumers demand (Becchetti & Adriani, 2002). In this sense fair trade can be truly interpreted as a form of product innovation.

Research on Fair Trade has tried to determine whether the fair price and the other FT tools effectively lead to a better socio-economic development for the producers than in the case of standard trade (i.e., whether Fair Trade leads to less inequality than standard trade by increasing the producers' remunerations). Maseland and De Vaal (2002) argue that this is the case only when product demand is inelastic and consumers have fairness preferences. Hayes (2003), however, argues that their approach is too narrow as it does not take into account non-monetary characteristics of the FT activity (production prefinancing, provision of local public goods, promotion of consumer awareness, etc.).

- **Education:**

Fair Trade can also be seen as a tool for consumers' education. Some FT operators, mainly ATOs, conduct education campaigns directed to the consumers. These campaigns are intended to promote Fair Trade and, more globally, to educate citizens (and governments) toward consumption habits that are more respectful for the environment and the people, especially for the producers in the South. Even if all the FT operators do not conduct educational activities, it can be assumed that FT consumers finance a part of these activities through their purchases.

- **Regulation:**

At the origins of Fair Trade, there is the intent of setting up a new regulation framework for commercial exchanges. This framework is, first, applied within the FT partnerships through a number of specific criteria. Furthermore, the FT regulation framework also aims at influencing the mainstream commercial practices within international exchanges. The design and the control of the specific norms within the FT sector have been progressively carried by specific FTOs that do not conduct trade of commodities but focus on the creation and the control of the FT norms (this is being referred to as the "labeling" process).

How can we characterize these dimensions from an economic point of view?

- The material characteristic of the FT product is a classical **private good**. Similarly to any consumption good, the product in its physical dimension is financed and consumed by Northern consumers and produced by growers or craftsmen in the South.
- The “fair” character of the product, even though involving material elements, is a **trust good**. Indeed, the concrete application of the FT principles by companies is something that cannot be observed directly by the consumer. Because the beneficiaries of the fair characteristic (the producers in the South) are located far from the ones who finance it (the consumers in the North), there is an information asymmetry that requires a certain level of trust from the consumers.⁶
- The dimensions of education and regulation are close to **(quasi-) public or collective goods**. A public good (Milgrom *et al.*, 1992) is defined as non-rival (the consumption by an agent does not diminish the available quantities for other agents) and non-excludable (it is impossible to exclude an agent from the consumption of the good). The education of citizens towards more sustainable consumption habits and the setting up of new rules for commercial exchanges are two elements that cannot be divided into separate consumption units (non-excludability) and for which it is impossible to exclude the consumption through the payment of a price (non-rivalry).

It thus appears that Fair Trade is composed of private, public and trust dimensions. Table 1 summarizes the producers, the beneficiaries and the financers of these different dimensions. The multidimensional character is likely to play an important role for explaining the diversity of organizations participating to Fair Trade. Indeed, the nature of the produced goods constitutes a major explanation for the differences in institutional choices (Anheier, 2005; Ben-Ner, 2002; Ben-Ner *et al.*, 1991; Handy, 1997).

Table n°1: The different dimensions of Fair Trade

	<i>Nature</i>	<i>Producers</i>	<i>Beneficiaries</i>
<i>Trade</i>	Private good	Producers (South)	Consumers (North)
<i>Fairness</i>	Trust good	North and South organizations	Producers (South)
<i>Education</i>	Public good	ATOs (North)	Consumers (North)
<i>Regulation</i>		Labelers ATOs (North)	Producers (South)

⁶ The complexity of the informational asymmetry in fair trade products is that such products are not “experience goods” with regard to their socially responsible dimension. In other terms, while many dimensions of

1.2. The diversity within the Fair Trade landscape

FT operators can be classified according to different criteria. In this article, we propose to focus on (1) the missions pursued and (2) the legal status, two criteria which are partly overlapping and which will appear useful in the forthcoming analysis.

1.2.1. Missions

All the participants to Fair Trade do not necessarily pursue jointly the four dimensions presented above. While “trade” and “fairness” are the minimal requirements for all participants, differences can be observed between the organizations which focus on trade and those which have a wider view of Fair Trade. Thus, two types of FT operators can be distinguished:

- “Alternative trading organizations”, which are totally or principally dedicated to Fair Trade. ATOs have built the foundations of the FT movement and continue to play an essential role in its qualitative (but also quantitative) development.
- The companies which have added the import, transformation and/or distribution of FT products to their pre-existing activities. Thanks to the development of FT labeling, these “*second-mover companies*” have often “*adopted Fair Trade in the face of consumer pressure to meet a market opportunity*” (Nicholls *et al.*, 2005, p. 80). Supermarket channels and multinational food companies are typical examples of second-movers.⁷

Nicholls & Opal (2005) identify three criteria which differentiate ATOs from second-mover companies. Two of them seem particularly adequate to characterize ATOs: (1) a majority of products traded under the FT principles and (2) a commitment to Fair Trade as the main goal (instead of profit maximization).

1.2.2. Legal status

Historically, ATOs have emerged under “non-capitalist” or “Third Sector” statuses such as nonprofit organizations (NPOs) and co-operatives. However, in the last years, ATOs have also

informational asymmetries about product quality may be overcome by purchase and taste, repeated purchase of fair trade products cannot help consumers to verify the truthfulness of the ethical characteristics of the products.

⁷ One of the most interesting examples of “second mover moves” is documented by the BBC press report of October the 7th, 2000 when it is announced that “*Nestle has launched a fair trade instant coffee as it looks to tap into growing demand among consumers.*” The BBC commented the news saying that “*Ethical shopping is an increasing trend in the UK, as consumers pay more to ensure poor farmers get a better deal.*” and reported the comment of Fiona Kendrick, Nestle's UK head of beverages arguing that “*Specifically in terms of coffee, fair trade is 3% of the instant market and has been growing at good double-digit growth and continues to grow.*”

adopted “mainstream” structures such as companies limited by shares or privately owned corporations. Following the economic literature, we will call the latter “for-profit organizations” (as opposed to nonprofits), even though ATOs, according to the second criterion by Nicholls & Opal, do not seek primarily to make profits. ATOs under a “for-profit” status can thus be considered as commercial companies which do not seek profit maximization, which brings them close to Third Sector organizations or “social enterprises”.

As mentioned earlier, a growing number of ATOs are in fact “groups” which gather different types of organizations: a nonprofit and a co-operative (e.g. Oxfam Wereldwinkels in Belgium, IDEAS in Spain, Equal Exchange in the UK,...) or a nonprofit and a commercial company (e.g. Traidcraft in the UK, Dritte Welt Partner in Germany or CONA in Austria).

Concerning mainstream market players which have become interested in Fair Trade, they are mainly for-profit companies, from small ventures to multinational corporations. However, it is also possible to have NPOs and co-operatives act as second-mover companies. The Co-op group in the United Kingdom and the COOP in Italy, for example, have included FT products in their assortment, considering the inclusion of such products coherent to their philosophy⁸.

In spite of these exceptions, for the clarity of our analysis and in order to focus on the dominant characteristics of “pioneers” and second movers, we will consider that ATOs are Third Sector organizations and that second-mover companies have a profit-maximizing goal.

2. Reasons for the presence of different types of players

Focusing on the organizational diversity in terms of legal statuses, let us now try to explain why each of these statuses has been chosen by a number of FT players.

2.1. Nonprofit organizations

Nonprofit organizations are characterized by the “non-distribution constraint”, i.e. the prohibition to distribute net earnings (after taxes and expenses) to any “residual claimant” (Hansmann, 1980). The people in charge of the organization (on the Board of Directors) have the residual control right (the ultimate decision-making power) but cannot sell this right nor claim any right on the assets of the organization. Thus, there is no owner with complete property rights (both the rights on control and on residual income).

⁸ The Fair Trade and the Co-operative movement share a partially common ideology and similar economic mechanisms. For a comparison between the two initiatives, see for example Develtere and Pollet (2005).

The emergence factors of nonprofit organizations have been studied on two different sides: the demand-side and the supply-side (Ben-Ner *et al.*, 2000; Steinberg, 2006).

2.1.1. Supply-side arguments

On the supply-side, the intent is to understand why entrepreneurs have chosen the nonprofit form for their venture instead of the mainstream for-profit form. Several authors (James, 1987; Rose-Ackerman, 1987) observe that idealistic entrepreneurs are likely to prefer the nonprofit status because it is the most coherent with their ideal. In the case of Fair Trade, it is likely that pioneer entrepreneurs with the goal of helping poor producers in the South have not imagined to adopt an organizational form which would have allowed the generation of profits for themselves. Moreover, the choice of the nonprofit status serves as a guarantee to all the stakeholders (and particularly to the consumers) that the goal of the organization is not to make profits but to pursue a social mission (Rose-Ackerman, 1987). In this case, the main goal is the improvement of the living conditions of small-scale producers in the South.

2.1.2. Demand-side arguments

On the demand-side, the emergence factors are linked with the types of goods produced. First, in the presence of trust goods, nonprofit organizations are more likely to overcome the problems of information asymmetry. Indeed, when the “ethical” quality of the good is not easily observable, the nonprofit status, because of its non-distribution constraint, is more likely to overcome the “market failure” as identified by Akerlof (1970). When there is an information asymmetry, for instance when the financier of the good is different from its beneficiary, the former needs guarantees that the firm will not act in an opportunistic way by delivering a product with lower quality than announced.

This argument finds a perfect illustration in the case of the FT purchase: given that the consumer in the North cannot verify immediately whether the Fair principles announced by the FT operator (fair price and premium, prefinancing,...) are fully enforced, he will ask for guarantees from the firm when purchasing the product. In the case where there is no generally recognized labeling system⁹, the non-distribution constraint can precisely fulfil the role of trust signal, at least ensuring to the financier of the good (the Northern consumer) that the additional price he pays for a good with a FT quality will not be appropriated by the shareholders.

⁹ We will include further the apparition of a recognized Fair Trade label.

One could object that the nonprofit firm might still act in an opportunistic way, for example by using the FT price differential for raising the salaries of the managers (this phenomenon is called “implicit distribution”, as opposed to explicit distribution of the surplus to the shareholders). That is why nonprofits generally add other trust guarantees in order to secure their social mission, such as the involvement of different stakeholders, including donors and voluntary workers, in their decision-making structures (Ben-Ner *et al.*, 2000; Enjolras, 2000). The rationale is the following: if these stakeholders, who are close to the organization, are ready to give money (donors) or time (voluntary workers) “for free”, it is highly unlikely that the firm acts in a opportunistic way against the announced goals.

Beside trust goods, a second category of goods that nonprofit organizations traditionally produce is public goods, i.e. non-rival and non-excludable goods (Milgrom *et al.*, 1992). These goods cannot be provided by for-profit companies due to the problem of free-riding. Indeed, consumers can benefit from a public good without paying for it or only at a lower tariff than what they would be ready to pay. Thus, a for-profit firm will be reluctant to produce such a good and the demand will not be met (“sub-optimal provision”).

That is why it is traditionally the government that produces public goods (e.g. defense, education,...). However, governmental action is constrained due to the “median voter” problem. According to Weisbrod (1975), when defining the optimal quantity of public good produced, the State chooses the quantity preferred by the median voter. Thus, two categories of people necessarily remain unsatisfied: those who would prefer less public good and those who would prefer more. For the latter, one solution in order to obtain the additional quantity of desired public good can be the creation of a nonprofit organization.

Nonprofit organizations are said to be better able to overcome the free-riding problem because consumers will be more likely to reveal their preferences to a firm with a lesser likelihood of opportunism, and because the nonprofit will be able to raise other resources than through the sales (e.g. donations, public grants and voluntary work) (Kingma, 1997; Weisbrod, 1975).

The public dimensions of Fair Trade provide, again, an interesting illustration. It can be assumed that the public authorities (in a wide sense, i.e. supranational authorities such as the European Union and the World Trade Organization) have chosen a level of regulation for international trade which leaves a whole portion of the population unsatisfied (i.e., they would prefer more regulation, for instance, minimum prices for producers in the South). One of the solutions for these consumers is to finance a nonprofit which will propose a stronger regulation

framework, through gifts or, more interestingly, through the joint purchase of a product traded under that specific regulation framework. Nonprofit ATOs may not only partially solve the problem of the heterogeneity of North consumers' preferences on public goods, but also the misrepresentation of preferences of individuals (and marginalized producers) in the South due to the imperfections in the mechanisms of representation in international institutions.

2.1.3. "Demand creating supply"

The latter example of unsatisfied consumers has shown that the supply of goods through a nonprofit structure may come from the demand itself. Indeed, when there are demanding stakeholders who do not find an existing provider for the good they expect, a solution can be to become themselves nonprofit entrepreneurs (Ben-Ner *et al.*, 1991). It is likely that a number of pioneer FT entrepreneurs are the ones who were initially interested, as consumers, in buying fairly traded goods but couldn't influence neither the State (because of the median voter problem) nor for-profit companies (because of the risks of opportunism). The creation of a nonprofit organization has allowed these potential consumers to satisfy their demand and to keep the control on the quality of the demanded good (Ben-Ner *et al.*, 1991).

2.2. Co-operatives

2.2.1. In the South

The co-operative form is particularly widespread among producer organizations in the South. The reasons which explain the grouping of producers into co-operatives are to be found in the configuration of local markets. Those markets are characterized by (1) a monopsonistic situation, i.e. a high number of providers for a low number of purchasers, and (2) a situation of information asymmetry.

The monopsonistic situation as a factor of emergence of co-operatives is described by Hansmann (1996) and can be applied to FT co-operatives in the South (Becchetti *et al.*, 2002; Hayes, 2005; Nicholls *et al.*, 2005). Indeed, in local markets of primary goods such as coffee, bananas or cocoa, there are plenty of individual producers for only a few buyers. These buyers have strong incentives to take advantage of their market power in order to abuse the producers. Their market power is reinforced by the information asymmetries concerning the prices and the

quality of the goods: it is easy to cheat on an individual producer who has no information about the market prices and on the quality of his production¹⁰.

In this context, the creation of a co-operative is a solution which allows small-scale producers to control the prices at which they sell their goods and, thus, to avoid the high costs they would assume if conducting their transactions individually on the market (Hansmann, 1999). The inclusion of the co-operative in the FT chain reinforces the appropriation of market power by the producers. Indeed, Fair Trade allows these producers to get access to export markets and to develop organizational capacities (Hayes, 2006). Thus, from an economic point of view, Fair Trade can be justified by its support to local co-operatives as solutions to the market failures faced by small-scale producers (Hayes, 2006; Nicholls *et al.*, 2005).

2.2.2. In the North

The co-operative form is chosen by some import and distribution operators in the North (Develtere *et al.*, 2005). It can be fair-traders having chosen the co-operative status from the beginning, or nonprofits which have evolved as groups including a co-operative structure.

Why has the co-operative form attracted some FT operators? Unlike in the South, the reasons do not lie in the market configuration in the North. When monopolies or oligopolies are observable, for instance in the food distribution sector, the co-operative responses historically take the form of consumers gathering in order to obtain lower prices through joint purchases. In the case of Fair Trade, it is exactly the opposite: consumers want to pay higher prices than market standards in order to contribute to the development of producers in the South. Thus, the factors of emergence of FT co-operatives in the North are different from traditional co-operatives, given that the former aim at providing an advantage to external stakeholder groups (the producers in the South) and not to themselves. FT co-operatives can thus be qualified as “general interest” organizations (as opposed to traditional “mutual interest” co-operatives).

We believe that the factors of emergence of FT co-operatives in the North are very similar to those of nonprofit organizations. Indeed, the differences which can be observed between the two types of structures seem much less important than their common features. First, in terms of their capacity to provide trust goods. For some authors, the limited distribution of profits and the democratic decision-making processes within co-operatives provide trust signals which are

¹⁰ For a description of such information asymmetries and monopsonistic situations faced by small-scale producers, see for example the book written by the founders of the label Max Havelaar (Roosen *et al.*, 2001).

as strong as those enjoyed by nonprofits (Mertens, 2005; Spear, 2000). The guarantee given to the consumers that their FT purchase will benefit to the producers as it is announced¹¹ is reinforced because of the “general interest” nature of FT co-operatives, which is confirmed by the presence of donors and voluntary workers in some of them.

Secondly, co-operatives are also able - although probably to a lower extent - to propose public goods such as education and regulation. Like nonprofits, general interest co-operatives can sometimes raise non-commercial resources (gifts, voluntary work or public grants) in order to provide such public goods (Spear, 2000).

There are, though, differences between nonprofits and co-operatives. While the former are generally restricted in their commercial activities, depending on the national legislations, the latter have no legal constraints on their commercial development (Levi, 2005). Furthermore, co-operatives have a better access to capital and stronger economic incentives given the authorized – albeit restricted – profit distribution (Hansmann, 1999).

As a conclusion, nonprofit and co-operative ATOs seem relatively similar. Nonprofits are probably better equipped for the provision of public goods, while co-operatives have an advantage from the commercial point of view. But both types of structures can be qualified as “social enterprises”, i.e. organizations which conduct a commercial activity with an explicit goal of pursuing social missions and serving the community rather than making profit (Defourny, 2001; Defourny *et al.*, 2006; Nicholls, 2006). These social enterprises involved in Fair Trade will then choose their legal form in function of their national legislation. In Belgium, for instance, the ATOs which have split into two different structures (a nonprofit and a co-operative) have done so because of the restricting legislation applying to the commercial development of nonprofits. In Italy, the new legal framework of “social co-operative” is particularly suited for ATOs as it allows combining commercial dynamism with social purposes.

2.3. “For-profit” mainstream companies

Basically, “for-profit”¹² companies, i.e. mainstream companies which are privately held or limited by shares, only produce private goods. For public goods, as it has been mentioned, for-

¹¹ We still consider a situation where there is no Fair Trade labeling.

¹² The term “for-profit” is widely used in the literature that compares different types of organizations (“for-profit” being opposed to “nonprofit” or “not-for-profit”). We will use “for-profit” and “mainstream” as synonyms, even though it is clear that all the mainstream companies involved in Fair Trade are not necessarily aiming at

profit companies cannot overcome free-riding problems and thus cannot provide a sufficient quantity of public good to meet the demand left unsatisfied by the government. For trust goods, the suspicion of opportunistic behavior could undermine for-profit firms trustworthiness with regard to the announced quality. In brief, for-profit companies are theoretically able to provide only the “material dimension” of the FT good and find it difficult to convince the consumer about its “fair” quality. This is one of the reasons why mainstream for-profit companies have remained absent of the FT sector until the middle of the 1990s.

Thus, which factors have allowed mainstream for-profit companies to integrate the sector in the last decade? Three major evolutions can be underpinned. First, the FT sector has evolved rapidly from a small-scale charitable initiative conducted by volunteers with low-quality products to a well-organized and increasingly professional trade niche. By doing so, ATOs (mainly nonprofits and co-operatives) have revealed an existing demand for ethical products and provided a credible response. Of course, the participation of mainstream companies has further developed the scale and the professionalism of Fair Trade. But it is thanks to the initial efforts of pioneer ATOs, who have shown that Fair Trade could be profitable, that mainstream companies have become interested in joining the movement.

Secondly, there has been a dissociation between the commercial provision of the goods and the certification of their fair quality. This corresponds to the development of the labeling process. Whereas, previously, the fair quality of a good was linked to the institutional quality signals of the FT providers (i.e. the trust signals of nonprofits and co-operatives), the label gathers these quality signals in a package which can be bought by any company. As a result, it is no longer the company in itself that must demonstrate the compliance with the FT criteria, but it is the label directly linked to the goods. That is why for-profit companies have been able to join the FT sector without being suspected of lower “fair” quality.

Thirdly, with the rise of Corporate Social Responsibility (CSR), mainstream companies have seen in Fair Trade an ideal opportunity to demonstrate ethical concerns to their stakeholders at a relatively low cost. Indeed, in a context of suspicion concerning the practices of multinationals, Fair Trade constitutes a powerful ethical signal towards the company’s stakeholders even when the proportion of FT products in the total assortment is low.

maximizing their profits. The existence of alternative objectives to profit maximization for these companies is already an interesting finding that should relativize the emphasis on legal frameworks.

Now that we have understood why for-profit companies have become interested in Fair Trade, the next step is to see how these companies interact with the ATOs present on the market.

3. Market dynamics

On the one hand, we have ATOs (mainly nonprofits and co-operatives) which are generally not only active in trading but also in education, lobbying, and development activities. Some of them have volunteers and many rely on gifts and public grants, beside their commercial incomes. On the other hand, mainstream (mainly for-profit) companies are involved in the sector with trade as their core business.

Witnessing diverse types of organizations with different objectives active in the same sector, the question is: how do these organizations interact with each other and what are the results of these interactions on the FT market?

3.1. Types of interactions

Fair Trade can be qualified as a “mixed-form market”, i.e. a market in which for-profit, nonprofit and sometimes government providers coexist. The literature about mixed-form markets focuses mainly on competition between providers of different types, considering them as adversaries competing on the same type of products (Bagnoli *et al.*, 2003; Marwell *et al.*, 2005; Schiff *et al.*, 1991; Steinberg, 1987). Indeed, there are a number of markets, such as the health care or the education sectors, where there is competition between for-profit, nonprofit and governmental providers (Malani *et al.*, 2003; Marmor *et al.*, 1987).

However, competition is not the only type of relationship which can bind organizations of different forms. Two other types of interactions deserve an attention: partnership and confrontation (Abzug *et al.*, 1999). Partnerships between nonprofits and the government (Gidron *et al.*, 1992; Young, 2000) and, more recently, between nonprofit and for-profit companies (Austin, 2000; Galaskiewicz *et al.*, 2006; O'Regan *et al.*, 2000) have received a growing attention in the literature.

Confrontation is observed when nonprofit and for-profit organizations are in conflict with each other, beyond commercial competition (Abzug *et al.*, 1999). These conflicts often concern major ideological issues. Typically, “political” nonprofits (such as NGOs) raise concerns about commercial practices of multinationals which are considered as “socially irresponsible”. In the

opposite way, mainstream companies sometimes attack nonprofits because of their tax exemptions, their public grants (causing “unfair competition”) or precisely as a response to NGO denunciation campaigns.

We start by describing the dynamics of competition between ATOs (generally nonprofit or cooperative organizations) and second-mover (generally for-profit) companies, on the basis of previous theoretical models. We analyze the competition on fairly traded goods considering their “fair dimension” as a socially responsible quality. Then, we see how competition between different types of players can trigger conflicts and differentiation behaviors. The conflict between world shops, importers and labeling organizations constitutes a striking example of it. Finally, we analyze the role of the government and the extent to which its interventions could have an influence on the competition dynamics in the FT market.

3.2. Competition in the Fair Trade sector

3.2.1. Competition models

Theoretical models impose severe limitations on the richness of the reality but may be of help to disclose connections or logical questions which are not immediately evident in it.

In this perspective, some interesting hints on the dynamics of the FT market may be provided by several theoretical contributions which have tried to model FT competition in the last decade (Becchetti & Solferino, 2005; Manasakis *et al.*, 2006). The starting point has been that of working on horizontal differentiation models. In the standard textbook horizontal differentiation model, two ice-cream sellers compete on a beach by producing a homogeneous product at the same price (Hotelling, 1929). The only strategic competitive factor is location on the beach since consumers have positive costs of distance and will purchase from the closer producer. In FT competition, geographical space is reinterpreted as the space of “ethical distance” and any point on the segment identifies a given willingness to pay for the “socially responsible” features (i.e. the public good or the trust good component) of the FT product (see Figure 1) (Becchetti *et al.*, 2003).

The line which is upward sloping from the left calculates total (psychological plus monetary) costs of the consumer located on the corresponding point (perpendicular projection) of the segment when he buys the for-profit producer’s product. The more distant the consumer from the left extreme of the segment, the stronger his ethical concerns and the higher the

psychological cost added to the monetary cost of the product. The line which is upward sloping from the right illustrates the same total costs for consumers located on the corresponding point of the segment when buying the FT product. Here again, ethical distance between the consumer and the product generates psychological costs but the slope is flatter since such costs are reasonably assumed to be stronger when the consumer's "ethical" sensitiveness is higher than when it is lower than the product's ethical content. The perpendicular projection of the crossing of the two slopes on the segment identifies the consumer who is indifferent between the two products and therefore also the boundary between the two producers' market shares.

A first static version of this model assumes invariance of consumers' tastes, takes into account the history of Fair Trade and starts with the entry of FT importers into the market which was previously controlled by profit-maximizing incumbents (i.e. food multinationals)¹³. An ATO locates herself at the extreme right of the segment (the most ethical position) and conquers consumers who are closer to her (i.e. with strongest ethical concern). Considering conventionally any move to the right of the segment as an increase in the cost paid for the socially responsible features of the products on the supply side (and of the willingness to pay for them by consumers on the demand side), the crucial issue is whether ATOs' entry triggers a rightward move on the segment of the profit maximizing incumbent (ethical imitation).

What these models observe is that ATOs have positive market shares after entry and shrink the market of the incumbent under reasonable parametric conditions. They also demonstrate that the latter finds it optimal, in its profit-maximizing approach, to move to the right in order to conquer back these ethical consumers as far as the marginal cost of increasing its socially responsible stance is more than compensated by the gains in terms of recovering previously lost consumers (see Figure 1). Incumbent's imitation is necessarily partial if it wants to maintain its profit maximizing identity.¹⁴

The decision on the symmetry/asymmetry of ethical distance costs is not a trivial one when modeling FT competition. Do consumers perceive a psychological cost only when they buy a product which incorporates less, or also when it incorporates more ethical values with respect

¹³ In our previous analysis, we considered the Fair Trade niche as the starting point and thus presented for-profit companies as arriving on a market occupied by nonprofit and co-operative pioneers. In this part, the market is seen in a wider sense (for example the food market), so that it is ATOs that arrive on a market occupied by mainstream companies.

¹⁴ This result is robust to changes in the linearity/non linearity, symmetry/asymmetry of ethical distance costs, but has not been verified beyond the typical limits of standard product differentiation models (more than two players, non unit consumer demand).

to their opinion on the issue?¹⁵ Even if the doubt remains, it is reasonable to assume that the psychological cost is higher in the first case (i.e. when consumers buy a good with lower SR quality with respect to that considered optimal by them). If, on the other hand, we go to the extreme of considering null the cost of higher ethical content (i.e. when consumers do not mind buying a product with higher SR quality with respect to that considered optimal by them), we move to a vertical differentiation context in which SR is conceived exactly as an improvement in quality on which everyone agrees.

In view of these considerations it is reasonable to assume that the reality is in the middle so that the approach used for modeling FT competition can be extended to all those cases in which we have a “quality improvement” on which consumers have mixed opinions (someone may not approve the FT scheme exactly as someone may dislike the fact that a restaurant has installed indoor TV maxi-screen facilities).

3.2.2. Competition dynamics

Another interesting insight of the product differentiation models is obtained when we relax our assumption on the invariance of consumer tastes and reasonably assume that ethical sensitiveness increases with awareness and FT consumption habits, as some recent empirical findings seem to demonstrate (Becchetti & Rosati, 2005; Kohler, 2006). In such a case, the for-profit incumbent finds it optimal to be more aggressive in its SR imitation policy in order to reduce the influence of the pioneer and to slow down the process of growth of ethical concern which imposes to him to increase SR costs (Becchetti & Solferino, 2005).

A crucial question we pose in this model is whether ATOs’ entry in the market is actually necessary to explain the increased sensitiveness for SR of the incumbent. Apart from the fact that the historical course of events definitely suggests that this was the case, it is possible to demonstrate this from a theoretical point of view. First, SR products are generally low margin products which contribute little to the profits. Hence, when the law of motion of consumers’ ethical concerns is the one indicated above, the incumbent has no interest in reinforcing ethical concerns of consumers by creating SR products, even if he is perfectly informed about consumer tastes on this issue. Second, the provision of SR products is associated with costs due to the problem of information. When seeking to convince consumers of the higher SR quality

¹⁵ The first case is that of “concerned consumers” buying “non ethical” products. The second is that of unconcerned consumers buying FT products. Also in the second case there may be a psychological cost if consumers do not agree with FT principles or believe that FT is inefficient or a waste of money.

of its products, a for-profit company faces costs¹⁶ which are likely to be higher than the benefits returning from the gain of new customers. For these reasons, the arrival of nonprofit and co-operative ATOs who face less “trust costs” is necessary to put pressure on the profit maximizing incumbents and thus generate a SR dynamics.

The competition dynamics in the FT market as presented above find common points with the theoretical mixed-form market model proposed by Marwell & McInerney (2005)¹⁷. These authors identify three types of market configurations which can result from mixed-form competition: a stratified market (where NPOs and for-profit companies serve separate segments of the consumer population), a displaced market (where NPOs are pushed out by for-profits) and a defended market (where NPOs resist on the basis of specific tools that for-profit companies do not possess).

The previous analysis has shown that Fair Trade can be considered alternatively as a stratified or as a defended market. If all consumers had the same expectations in terms of SR quality, for-profit companies would try to conquer these consumers but would face resistance from NPOs which face less costs when producing ethical quality (the trust and public good dimensions). If, more realistically, we assume that consumers have heterogeneous ethical concerns, than both types of players will address the needs of the consumer population which is the closest to its ethical positioning (high SR quality for ATOs versus low SR quality for mainstream companies). Conform to the previous analysis, both types of players will try to increase their consumer population at the expense of its competitors: ATOs by trying to increase the global ethical concern and for-profit companies by slowing it down.

3.2.3. *Effects on welfare*

On the welfare point of view, one of the most interesting findings of these models is the paradox of a duopoly which generates higher social transfers to primary producers than what should be regarded as optimal by a social planner maximizing the welfare of consumers in the North. With this respect the FT market mechanism seems able to solve the political delegation problem of many contexts in which we have North-South interdependence but economic

¹⁶ Costs of providing SR products include the purchase of a label or a certification, the construction of a solid ethical reputation or, if the company tries to cheat on the SR quality, the risk of being detected and of suffering a reputation flaw that is very likely to be much more harmful than if no SR quality had been announced (Amalric *et al.*, 2005).

¹⁷ Such model has been proposed for markets of public goods linked to social needs. Even though FT goods do not only include public dimensions but also trust and private dimensions, the analysis seems valid if we consider the FT market as a new market created by nonprofit and co-operative pioneers for joint FT goods.

decisions are taken by authorities who decide only on the basis of voters of the North. This confirms our theoretical assumption that Fair Trade can be seen as a response to a state failure and more specifically as a market substitute for a missing global governance. With this we do not mean that FT bottom-up action should be a permanent substitute for the search of new global governance rules, but just that it is substituting them at present time in which such rules are not at sight and, in the meanwhile, it is positively contributing to their generation by creating tangible consensus around them.

In this sense, Fair Trade constitutes an interesting example of what we can define as the “subsidiarity principle” (Becchetti & Solferino, 2005). Under given conditions, and sufficiently high levels of corruption and “waste” on standard government aid, public authorities may find it optimal to create tax incentives for Fair Trade in order to achieve the same result with much lower public expenditure and a more tailored intervention. Indeed, as we have explained earlier, the heterogeneity of the demand for a public good such as development aid makes it easier for ATOs to provide this good than it is for the government: taxpayers may not agree on the development aid linked with Fair Trade, while FT consumers explicitly do it when they buy the product. If we consider also the “warm glow” argument of Andreoni (1990) in which consumers prefer to give directly and do not consider this action as a perfect substitute of an identical intervention realized by public authorities with money collected from their taxes, we clearly understand why a subsidiary intervention may be not just more effective but also superior in terms of consumers’/taxpayers’ utility.¹⁸

Throughout this analysis, we have considered two categories of players: ATOs and second-mover companies. However, the reality is more complex and both categories should be split into a number of sub-categories who have different goals and logics. We will address such heterogeneous behaviours through the description of the conflict among different pioneer players when confronted to the arrival of mainstream companies in the FT market.

¹⁸ These considerations provide additional arguments to the querelle on the relative convenience of the Fair Trade versus the standard trade plus donation scheme (LeClair, 2004). In addition to them, FT capacity of breaking the monopsony/oligopsony power of local intermediaries, consultancy services of fair-traders and capacity of triggering partial imitation in competitors are other arguments in favor of the FT solution. As a matter of fact, a standard trade plus donation scheme does not share with FT these three properties. A crucial issue in discriminating between the two options is related to the capacity of Fair Trade to create dynamically competitive advantages for local producers.

3.3. The conflict among world shops, importers and labeling organizations

One of the conflicts observed in the development of the FT market is the one among “world shops”¹⁹, importers and labeling organizations. The simple inspection of the different positions of these players on the value chain helps us to understand that their heterogeneous strategic goals open the way to the conflict. World shops are dedicated retailers of FT products which may help importing associations to reduce distributional bottlenecks which create a gap between potential and actual demand. On the contrary, such channels suffer the competition from any other different distribution channel (supermarkets, individual FT promoters, etc.). Finally, labeling associations may be tempted to certify new products with FT characteristics created by profit maximizing imitators.

The event which triggers the conflict is the partial imitation of food multinationals and the decision of large distribution chains to sell FT products. This decision represents additional potential business for labeling organizations while being a competitive threat for pioneer importers and world shops. The decision of the umbrella labeling organization FLO to certify products sold by these imitators has led to a conflict while demonstrating at the same time that one of the merits of FT is that of making social responsibility a competitive variable.

The reaction of one of the global networks of FT organizations (IFAT) has been that of creating a new label (the FTO mark) with the goal of marking the difference in SR quality between “partial imitators” (who insert one or a few FT products in a wide non-FT product range) and pioneer ATOs (who dedicate all their activity to Fair Trade). In order to signal the difference, the new labeling strategy of pioneers is that of 1) looking at the entire process and not just at the single product; 2) not just ensuring a mark-up on market prices for primary producers but also technical assistance and advocacy campaigns for changes in trade rules (something which for-profit imitators generally do not do, as we have explained earlier). This confirms the intuition that, even though the different actors influence each other when competing on the same market, they also conserve their basically distinct organizational missions.

The previously discussed theoretical models provide a fundamental insight in this evolution of the FT market along the two mentioned dimensions of the pioneer/partial imitator and labeling organisation/importer/worldshop competition. If at the end of the process only the partial

¹⁹ World shops are Fair Trade outlets that have been set up by pioneer ATOs. In most European countries, world shops still constitute an important distribution channel for FT products. According to the figures provided by Krier (2005), world shop sales accounted for nearly 20% of total FT sales in Europe in 2005.

imitator survives, the risk is the extinction of the FT market. If we assume that the increase of the demand for FT products leads to a decrease of the demand for non-FT products, it seems clear that the for-profit partial imitator has no interest in stimulating the SR concerns of consumers since they ultimately lead to an increase in the share of low margin products²⁰ in their product portfolio and thereby contradict the profit maximization goal.

3.4. The role of the government

Fair Trade has grown without any specific government aid and, at least at the beginning, without the cultural support of domestic and European institutions. The reason is that, in the beginning, Fair Trade was only a preoccupation for a small number of citizens who were unsatisfied with the levels of development aid and/or of regulation in international trade. Thus, the government had no incentive to intervene in a matter which didn't interest the "median voter". It is in this context that nonprofit pioneers have emerged as a response from unsatisfied citizens. However, as Fair Trade has developed tremendously and has become a concern for the median voter²¹, the government is now much more eager to be interested in this sector.

Among available policy options, a fiscal preference for ATOs is unlikely because of the very nature of FT organizations as social enterprises creating public goods but competing in the market with for-profit firms. Even by considering their social role, such fiscal policy would be likely to be considered as discriminatory and unfair in that it would establish an illicit support to one specific player in the competitive race.

More in general and beyond this specific measure, even though there is a certain consensus on the fact that public authorities should not participate directly to FT competition, it cannot be denied that their decisions on the rules of the game may have a crucial influence in promoting social responsibility as a competitive market feature. Three are the main policy suggestions which easily stem from this consideration. First, SR-oriented procurement rules may be crucial since the minimum price as the unique competitive criterion is definitely in contrast with the goal of promoting corporate social responsibility. An inspection of the current experiences in this field shows that many local authorities have incorporated this new principle by attributing

²⁰ We can assume that FT products provide lower margins compared to traditional ones since, by definition, Fair Trade gives more to local producers without passing this difference totally on to the consumers. Unless we assume that willingness to pay will grow at a very high level, this will reasonably continue to be the case.

²¹ A recent study on the notoriety of Fair Trade among the public opinion in Belgium indicates that nearly 80% of the population knows what Fair Trade is about, although only a third of the population has already bought FT products (SONECOM, 2006).

scores to SR features of bidders and, in some cases, by imposing them to provide a share of FT products in the procurement rules (Poncelet *et al.*, 2004).

Second, compulsory information on the social rating of sellers and on the social characteristics of the value chain in the main retail outlets would be a zero cost rule which could give a boost to the competition on social responsibility, bridging the gap between consumers' willingness to pay and actual market shares²² and pushing corporations to internalize negative externalities and the problem of insufficient provision of public goods.

Third, in a context of competition where some players propose different types of ethical labels and even different versions of Fair Trade ("light" FT labels), the government itself can establish a FT norm in order to determine a minimal content for what can be called Fair Trade. Such a process is already advanced in France and in Belgium, and could be extended at a European level. It seems clear that such a definition has the potential to influence strongly the competition in the FT sector, in favor of the ATOs or in favor of the for-profit imitators, thereby creating further stimulus for the diffusion of SR.

4. Conclusion

Fair Trade represents one of the most interesting examples of a breakthrough innovation in the functioning of contemporary economic systems. With their "portfolio vote", FT consumers are also a challenge to the standard reductionist definition of homo oeconomicus preferences. Their willingness to pay in excess for the social characteristics of the products (not just declared but revealed through their purchases) comes in support of a new set of theories which see fairness (Fehr *et al.*, 1999), inequity aversion, sympathy and commitment (Jensen *et al.*, 1976) as additional important motivations of economic choices. The novel feature of FT consumption is that, for the first time, fairness and inequity aversion are not related to neighbors or co-workers but to distant producers, thereby documenting a significant enlargement of the reference group which individuals consider in their choice. Furthermore, Fair Trade is, in some sense, contributing to improve the reputation of the market since it makes it not just the place in which exchanges purely reflect (often) imbalanced bargaining power and endowments of

²² Empirical evidence generally shows that "virtual" market shares extracted by the consumers' willingness to pay are higher than actual market shares (Becchetti-Rosati, 2007). A large part of this difference depends on the fact that the responses in terms of willingness to pay include the possibility of choosing between a more and less socially responsible product on the same market. This choice is often not possible in the reality but would be much more so in presence of the above mentioned compulsory information rule.

buyers and sellers but also that in which it is possible to contribute to reduce such imbalances by “exchanging values” and voting for the production of global public goods.

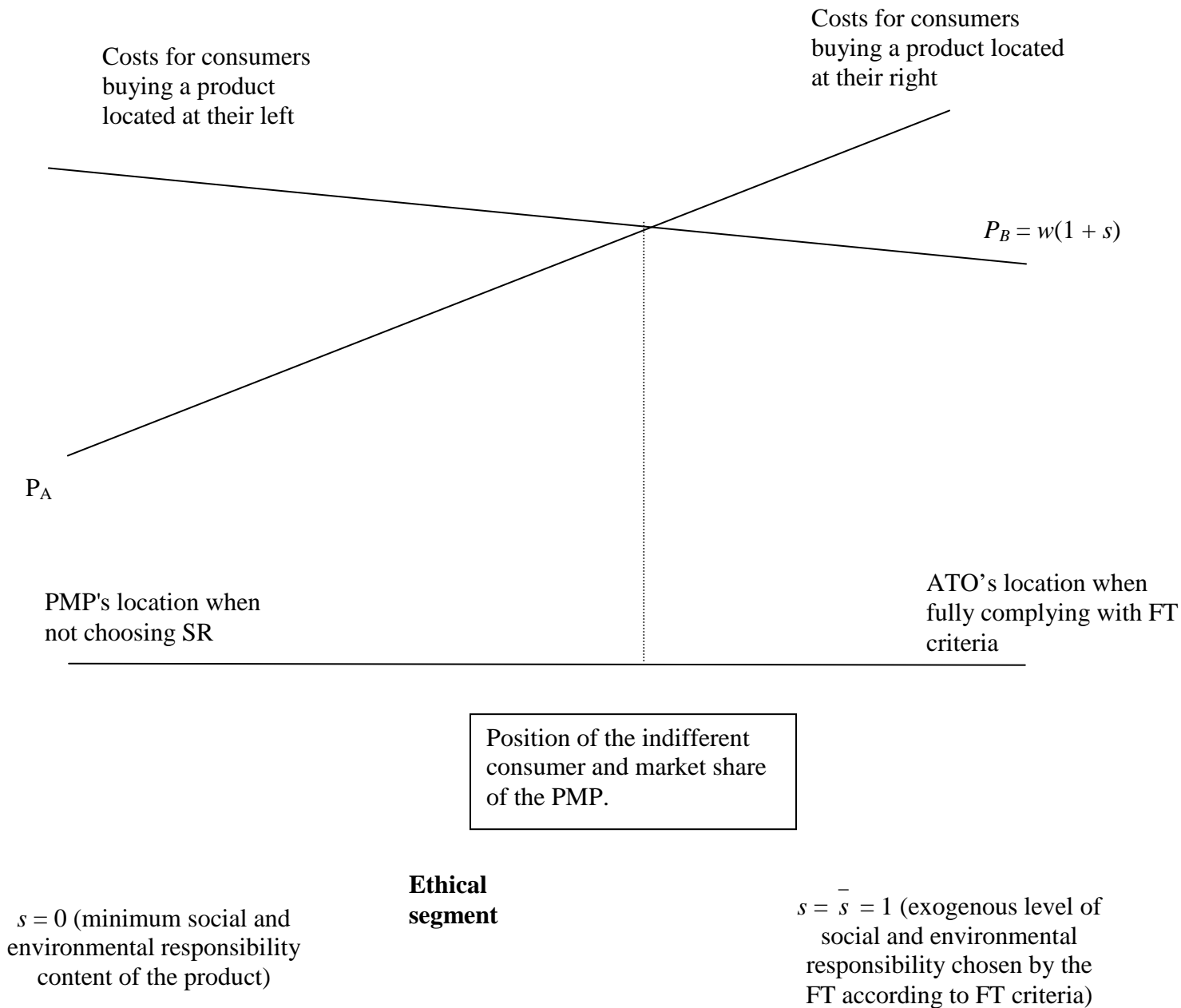
The scope of this paper was to analyze the complexity of this phenomenon by focusing on the unusual characteristics of the FT products, on how these unusual characteristics explain the emergence of a variety of players and on how these players coexist on the same market.

On the first point, our conclusion is that the FT product includes a bundle of physical and immaterial features that distinguish it from standard products. Fair Trade therefore constitutes an innovation in the sense that it allows to combine a commercial dimension with fairness and socio-political goals. We have seen, then, that the distinction between these different dimensions is crucial in explaining the emergence of FT players under different legal statuses. Finally, on the third point, we have tried to document the dynamics of the FT market through two fundamental dimensions. The first has been represented by the competition between pioneer ATOs (which started as co-operative and nonprofit entities) and for-profit partial imitators. The second has been illustrated by the conflicts of interest among different types of players such as world shops, importers and labeling organizations.

With this respect, we have tried to explain in which way the evolution of this complexity will affect the future of FT. More specifically, we have illustrated how the interaction between pioneers and imitators and that between importers and labeling organizations will be crucial for the survival and strengthening of the core of Fair Trade: that of “creating (economic) value with values”. In a very famous, stimulating and provocative quote Keynes said in 1931 that *“For at least another hundred years we must pretend to ourselves and to every one that fair is foul and foul is fair; for foul is useful and fair is not [underlined is ours]. Avarice and usury and precaution must be our gods for a little longer still. For only they can lead us out of the tunnel of economic necessity into daylight.”* (Keynes, 1931)

Keynes’ sentence focuses on the dichotomy between requirements of economic growth (on the one side) and social justice or moral values (on the other side). Since “foul” is useful (for economic growth) and “fair” is not we should follow the “law of necessity” (doing what is foul or not necessarily ethically relevant) and pretend that our action is reconciled with social values. For what we have said and for its ability of creating economic value with values, in spite of all its imperfections and limits, Fair Trade seems to overcome such dichotomy with its capacity of making the “fair useful” (or of creating added economic value with values such as fairness), thereby crucially abridging the 100-year “transition” of the Keynes’ prophecy.

Figure 1. The static Hotelling game of ethical imitation and the asymmetric costs of ethical distance



Legend: buying a product at one's left in the ethical segment implies choosing a product below one's own ethical standards while buying a product at one's right implies choosing a product above one's own ethical standards. We assume that the marginal costs of distance are higher in the first than in the second case.

P_A = profit maximizing producer's (PMP's) product price
 P_B = ATO's product price
 W = ATO's unit production cost

Source: Becchetti & Solferino (2003)

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