

Fair trade: Product Differentiation and Warm Glow Effect

Olga Strelchenko

Osaka University, Graduate School of Economics

Kenzo Abe

Chuo University, Faculty of Economics

Abstract

This paper theoretically analyzes implications of the Fair Trade applying the concept of a “warm glow” that demonstrates altruistic preferences of final consumers towards initial producers from a developing country. The main focus is made on behavior of final goods producers’ in the international supply chain with an opportunity of free entry into the Fair Trade program. Depending on the profits firms would obtain, they are making decision whether to enter FT program and initiate negotiations with the input producer’s organizations – intermediaries who negotiate the wage on behalf of the FT farmers, or to purchase the input from traditional non-FT farmers. As a result, number of the firms that decided to enter the FT program is adjusted endogenously. In this paper, we showed that the imperfect substitution of the final commodities is indispensable for the FT program emergence: a consumer in the developed country must distinguish between the FT and non-FT goods. On the other hand, the warm glow is not essential for the FT program emergence; however it contributes to an increase of the FT farmers’ wage. In addition, the analysis demonstrates that the welfare of the developing and the developed countries are always higher under the FT program, comparing to the case of the FT absence.

Keywords Fair trade; Warm glow; International supply chain; Product differentiation; Ethical consumption; North-South Trade.

Acknowledgement. We would like to express gratitude to Tsunehiro Otsuki and Erika Seki for their insightful remarks on the early version of this paper. Previous version of the paper was presented at the *OSIPP-Economics Lunchtime Seminar* (Osaka University) on May 20th, 2020 and at *the Meeting of the Kansai branch, JSIE* on June 20th, 2020. We are grateful to all the participants and to the discussant of the paper – Keisaku Higashida for helpful comments and suggestions that were carefully considered during our work on the current version of the paper.