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EEP 142

## **The Case for Third Party Certification**

### **Economics of Information**

As we have learned in class, symmetric information concerning product “quality” is needed to ensure efficiency in markets

Consumers must know what it is they are buying so they can determine and then pay their actual willingness to pay for an item of that quality.

Asymmetric or incomplete information lowers quality in a market and may even completely drive out higher quality goods

### **More about information**

Economist have broken down the informational qualities of goods into 3 classes: credence, search, and experience.

Search attributes can be gleaned from examining the product in the “store”, experience attributes can be gleaned from experiencing—i.e., tasting.

*Credence attributes* are those things such that the consumer cannot find out either by examining the product or experiencing the product. Examples of credence attributes are the environmental impact and labor practices of the process which results in the production of the good. Credence attributes are clearly the biggest obstacle in bringing symmetric information to the market. (Caswell and Mojduszka 1996).

### **Bringing Symmetric Information**

One method of solving the problem of making information concerning credence attributes to consumers is to turn the credence attributes into search attributes via labeling. The idea is to put all the relevant credence attributes that the consumer uses to value the product into a label on the product.

There are different ways to go about putting the credence info onto products: The company itself can do it, a industry association can do it, the government can do it, or a third party—i.e., a non-profit organization—can do it.

Having the company or industry do it is undesirable because they have a vested interest in deceiving the consumer. Both the government and third party provide a label more credible with the consumer. However, if one is a fan of the free market they prefer to have things done without the government whenever possible, this leaves third party certification as the best choice. Another point in favor of third party labeling is that it will be more responsive to the market and induce less distortions than the big clunk and clumsy government bureaucracy does.

## **Examples: Organic certification, Fair Trade certification, Rainforest Alliance**

What the **Rainforest Alliance** label guarantees: “*Environmental standards* include the prohibition of clearing of primary forest and requirements for soil and water management and conservation and buffer zones; detailed requirements for the use, storage and transport of agrochemicals; integrated pest management; criteria for waste management and recycling; and requirements for a monitoring system. With respect to the *Social criteria* the certified company should respect all ILO conventions ratified by the country in which they operate. For those issues for which the ILO conventions are not ratified the certification standards apply directly. These include requirements for a social policy and communication to workers; contracts and wages; no discrimination; no child labour below 14 and specific conditions for young and disabled workers and pregnant women; no forced labour; freedom of expression and the right to organize and collective bargaining; occupational health and safety; working hours; training; accommodation; and linkages with local communities”.

What the *Fair Trade* label guarantees: “labour standards; standards for farmer associations and cooperatives; and trade standards, including minimum prices, for licensed traders. *Labour standards* to be complied with by plantations and factories include freedom of association; criteria for wages and accommodation; occupational health and safety standards; and no child or forced labour can occur. Standards for *farmers' associations* and cooperatives set criteria for a democratic participative organizational structure. *Trading standards* stipulate that traders have to pay the FLO minimum price plus the fair-trade premium, partially pay in advance when producers ask for it, and commit themselves to a long-term trade relationship. *Environmental* criteria are included in the crop-specific standards.”

You can see that if someone knew that the product they were buying had been produced according to these guidelines they might pay more for the product. I would; would you

### **What Fair Trade means for the Farmer and What that extra money pays for: some anecdotes**

“Empowered by the economic stability provided by Fair Trade, members of the COSURCA coffee cooperative in Colombia successfully prevented the cultivation of more than 1,600 acres of coca and poppy, used for the production of illicit drugs. In Papua New Guinea, the AGOGA cooperative, is investing in a medical team to meet the healthcare needs of its isolated rural community. In the highlands of Guatemala, indigenous Tzutuhil Mayans in the La Voz cooperative are sending local kids to college for the first time. Near Lake Titicaca, in Peru, the CECOVASA cooperative is assisting members from Quechua and Aymara indigenous groups in raising coffee quality and transitioning to certified organic production.”—From Transfair USA website

## **Further Considerations**

Certifications which guarantee certain social or environmental standards were met in the production of products—sometimes called “eco-labeling”—are good for a couple of reasons. They please people concerned with social justice because they address environmental and social concerns. At the same time they should please hard nosed economist concerned just about “efficiency”. And the best part is they do all this *without government intervention*. It is the perfect free market solution to social and environmental problems. The consumers are given all the information relevant to his determining what the *true price* of the product is. Usually the complaint about market prices is that they do not reflect social and environmental externalities. This is the way to include these factors *through the free market!* Imagine the implications if this labeling practice were followed on a large scale. And to the naysayers who are sceptical it could happen on such a large scale: think about it like any other marketing scheme. First some people do it, then you get some marketing behind it, and so on, until you have a movement.

## **Sources**

Cora Dankers. *Environmental and Social Standards, Certification, and Labeling for Cash Crops*. Technical Paper for the Food and Agriculture Organization of the United Nations. 2003.

Cathy Wessells. *Product Certification and Ecolabelling for Fisheries Sustainability*. Technical Paper for the Food and Agriculture Organization of the United Nations. 2001.

[Transfairusa.org](http://Transfairusa.org)