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Fair Trade: Product Differentiation
and Warm Glow Effect

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Abstract

This paper theoretically analyzes welfare implications of the Fair Trade (FT) applying the concept of a “*warm glow*” that demonstrates altruistic preferences of final consumers from a developed country towards input producers from a developing country. The main focus is made on behavior of final goods producers in the international supply chain where the number of the firms that have decided to join 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, while the warm glow is not essential for its emergence; however, the warm glow contributes to an increase of the FT farmers’ wage. In addition, the analysis demonstrates that both countries benefit from the FT program.

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