Free Trade Can Be Fair Trade

"Free" and "fair" are powerful, often abused words when applied to the concept of trade. In this essay, I will attempt to clarify the differences between free and fair trade, show how they may coincide and discuss their application to free trade agreements and food products such as fair trade coffee. **Text / Photos** David Zetland

Why Trade? Voluntary trade benefits both the buyer and the seller. The benefits in excess of costs are the "gains from trade". An "efficient" society maximizes the gains from trade by wisely using human, natural and capital resources. Political processes redistribute these gains to promote (or reduce!) "equity". We often call these gains the "pie". An efficient society has bigger pie; an equitable society divides the pie fairly.

Free versus Fair. Free trade means that anyone can trade with anyone else. The fairness of this trade depends on the amount of competition between buyers and between sellers. Many people think that buyers and sellers compete. That is false. Stop and think of your different roles. As a worker or business, you compete with others for customers. As a consumer, you compete other consumers and drive prices up - regardless of sellers' actions. Say you go to the farmers' market to buy tomatoes.

When there are many buyers and few sellers, the price of tomatoes rises; sellers get a bigger share of the pie (the gains) because they have "market power." With few buyers and many sellers, the price falls; buyers use their market power to get a larger share of the pie. Thus, more market power - whether in the hands of the buyer or the seller - can lead to "unfair" trade, i.e., an asymmetric division of the pie.

Free and Fair. When trade is freed, competition increases, market power falls and gains are distributed more evenly. Numerous buyers and sellers in the farmer's market reduce bargaining power. Seller competition pushes prices down; buyer competition holds them up. Free trade leads to fair trade. Fair trade is not the same thing as fairness in the family, with friends or on the playground. If Mom offers her son €10 for washing the car when the "market price" is €5, she chooses to not exercise her market power. He has plenty of competition; she does not. The marketplace is different - smart shoppers bargain with many sellers; smart workers seek the greatest payment for their skills.

When trades are repeated, a relationship forms and fairness becomes more important: You may give a bigger tip, throw in a few extra tomatoes, or agree to more profit-sharing. These considerations make the long-term relationship more stable and enjoyable, where friends help each other out in times of need. Thus, we can get fairness in two ways: through competition, which destroys market power, or relationships, which make market power irrelevant.

"Fair" Trade Coffee. Coffee farmers sell their crops via many middlemen to you. These middlemen reduce the farmers' share of the pie. Do they do any good? Long-term relationships between farmers and middlemen are less about power and more about mutual insurance for when disaster strikes. A large company may be more ruthless if it does not need the farmer as much as the farmer needs it. Power changes the size and owners of the slices of the pie.

Let's call many small companies "The Network" and the large company Starbucks. The Network is a web of relationships in which many people help each other fairly. Starbucks can choose to be fair or not. When Starbucks goes directly to the farmer, many small companies (the middlemen) are removed from the supply chain between the farmer and consumer. Farmers sell for more and Starbucks buys for less, but businesses, families and relationships are destabilized as the pie is redistributed.

Let's also put fair trade in perspective. In 2003, Starbucks bought about 1 million kg of fair trade coffee from worldwide sources for $3 million (€2.5 million); they also donated $3 million to these regions. This $6 million expense was less than 0.1 percent of total U.S. retail revenue for all stores ($3.5/€3 billion). What if all coffee had to be "fair trade"? Poor customers, small traders and marginal producers would be hurt. Small businesses compete against Starbucks on lower prices or better service, not global reputation or advertising. They do not have the resources to go directly to the farmer and rely on middlemen for their coffee. These middlemen, in turn, enable small producers to sell their coffee at better prices. Fair trade matches fewer buyers to more farmers - increasing market power for buyers, not necessarily profits for farmers.

"Free" Trade Agreements. A real free trade agreement would say "There are no restrictions on trade between these countries," but most agreements are thousands of pages. Why? After legitimate reasons (dispute settlement, standards, etc.), most of the text restricts trade to protect local producers from outside competition. (The same local producers lobby for exports abroad.) The EU's "bra war" was between retailers and consumers seeking cheaper Chinese textiles and producers seeking higher profits. Chinese producers had no power.

Free trade benefits consumers, who get better, cheaper goods. It benefits efficient producers with larger sales. Inefficient producers are hurt; they go out of business and fire their workers. This is not bad from a social perspective if that industry is "value-subtracting" by diverting resources from better uses. Typical examples of businesses that subtract value are "national champions" such as steel producers, airlines, car makers and agricultural commodity producers.

European and American sugar producers protected by quotas (quantity limits) and tariffs (import taxes) sell their sugar for three times the world price. Europe even exports subsidized sugar, hurting competitive producers a second time. This situation persists because sugar producers, who get large benefits, lobby for protection; the costs are small for each consumer, so it is not worth their effort to oppose protection. Sugar protection is particularly atrocious because it prevents developing world producers from rising out of poverty.

Your Role. Free trade can be fair, but agreements that open some markets to powerful producers where they can use their market power, while keeping others closed and uncompetitive, are neither free nor fair. The little guy (the consumer, the small producer, the poor farmer, the developing country) gets hurt.

When nobody has special treatment and the field is truly level, then free and fair will mean the same thing. Competition may be tough on the level playing field, but political power and legal leverage tilt it further. Free trade is fair trade when it is truly free.

Beware of cheap imitations. <<