Free Trade Can Be Fair Trade

by David Zetland

"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.

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 a 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 with 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 farmers' 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 $10 to her son for mowing the lawn when the "market price" is $5, she chooses not to 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 diminishes 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 discarded businesses, families and relationships are destabilized as the pie is redistributed.

So let's also put "fair trade" into perspective. In 2003, Starbucks bought 2.1 million pounds of fair trade coffee from worldwide sources; they also donated $3 million to these regions. The value of those purchases ($3 million) was less than 0.1 percent of total U.S. retail revenue for all stores ($3.5 billion). Advertising these (and other) achievements cost $50 million.

But even this "fairness" has limits. Starbucks competes with other (unfair) sellers for customers (you) who want low prices. One cure — requiring fair trade — would be worse than the disease; poor customers, small traders and marginal producers would be hurt first. That's why the City of Berkeley failed to require that all coffee sold within its boundaries be fair trade. The opposition to this initiative came from businesses opposed to higher costs. Their competitive edge against Peet's and Starbucks depended on lower prices, not better reputations (and advertising). Small traders were also opposed because they did not have the resources to go directly to the farmer and relied on middlemen for their coffee. Small producers would lose for the same reason; they rely on their relations with traders to get their product to market. Fair trade sounds good in theory, but it relies on centralization (fewer buyers for more farmers), which will favor those with better connections and more volume (i.e., lower costs). Fair trade, by limiting competition, helps those with market power.

"Free" Trade Agreements

A real free trade agreement would say: "There are no restrictions on trade between these countries." But NAFTA is 1,700 pages. Why? There are some legitimate reasons; dispute settlements and standards, for instance, but much of the text restricts trade. Producers lobby to restrict competition at home and to expand competition abroad. They are free traders only sometimes. As an example, the "bra war" now being fought in the European Union pits EU retailers and consumers who want cheaper Chinese textiles against EU producers who want protection from competition. Meanwhile, the Chinese producers wait on the sidelines.

And yet free trade benefits consumers and producers. Consumers with few choices (or little money) get better, cheaper goods. Producers sell in larger markets. The producers who were formerly protected go out of business and fire their workers. This may not be a bad thing if these businesses are inefficient and divert resources from better uses.

Take sugar, for example. U.S. sugar producers are the most protected in the country. Quotas (quantity limits) on sugar imports limit competition from developing countries and raise the U.S. price to twice the world level. The losers are U.S. consumers, foreign producers and the environment. (Sugar is grown in the Florida and Louisiana wetlands. This unsustainable production, by the way, worsened Hurricane Katrina's damage to the Gulf Coast.)

How does this situation persist? Concentrated benefits to a few sugar producers and diffused costs to many consumers. Sugar producers' big political contributions get protection worth $1.4 billion in higher revenue. Consumers don't notice because higher prices only cost them about $5 each. Politicians use the fig leaf of jobs to justify their acts, but each saved job costs $600,000. Workers only make about $25,000 of that; the rest goes to those well-connected producers.

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 farther. Free trade is fair trade when it is truly free. Beware of cheap imitations. ❖

David Zetland is a Ph.D. candidate in UC Davis's Department of Agricultural and Resource Economics program, which he started after five years of travel to 65 countries, many of them in the developing world.