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"Fighting the Tide: Alternative Trade Organizations in the Era of Global Free Trade"—A Comment

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Summary. — LeClair [LeClair, M. S. (2002). Fighting the tide: alternative trade organizations in the era of global free trade. *World Development*, *30*(6), 949–958] concludes that in theory Fair Trade is a second-best alternative to aid, may impose losses on non-Fair Trade producers and prolongs dependence on unsustainable modes of production. This paper shows how these conclusions depend upon a particular definition of subsidy and upon the assumptions of full employment and that Fair Trade goods face price-inelastic demand. An adverse impact on non-Fair Trade producers is possible but not intrinsic, and the claim of economic inefficiency cannot be sustained within a more general analysis.

Key words — Fair Trade, developing countries, market efficiency, under-employment, labor supply

1. INTRODUCTION

In his seminal article in this journal (2002), Mark LeClair concludes that Fair Trade undoubtedly benefits a small but significant minority of low-income households in the developing world. Nevertheless, Fair Trade "has two significant shortcomings: that it differentially assists one set of producers, potentially at the expense of others, and it promotes continued reliance on products that are arguably poor prospects in the long-run" (p. 957). Behind LeClair's conclusions lies a short section on the economics of Fair Trade, which appears to demonstrate that Fair Trade is inherently inferior to a combination of free trade and direct aid, as a consequence of the distortion of production resulting from the price premium paid by the consumer. The argument makes three points: (a) that Fair Trade is in principle less effective than direct aid in terms of the cost to the consumer of the direct benefit to the Fair Trade producer, [1] (b) that Fair Trade may have indirect repercussions adverse to other producers outside the Fair Trade sector of a particular market, [2] and (c) that Fair Trade deters desirable diversification. [3]

The purpose of this paper is first to show in Section 2 that LeClair's analysis of the direct impact of Fair Trade depends upon a particular definition of "subsidy" and upon the assumption of full employment, rather than of the under-employment typical of the developing world. Section 3 considers the indirect impact of Fair Trade, in terms of the welfare of society as a whole and of non-Fair Trade producers of similar goods, and notes that the first shortcoming identified by LeClair depends on the assumption of price-inelastic demand for Fair Trade goods. Although this by no means overturns LeClair's conclusion in all cases, it clarifies how the conclusion depends on the circumstances (as he notes), which should therefore be a matter of concern to the advocates of Fair Trade. Section 4 considers the nature of diversification from the perspective of the individual household and the likely effect of higher incomes on its assessment of the prospects for particular products and its long-term

* I am greatly indebted to Mark LeClair for the stimulating correspondence which led to this article and which has allowed me to focus my critique as clearly as possible. I do not suggest that he will wholly agree with the outcome, and I remain responsible for any errors and omissions. I am also grateful for constructive comments from two anonymous referees. Final revision accepted: January 30, 2008.

decisions to invest in human and business capital.

LeClair's paper and accordingly this comment both assume perfect competition. A fuller evaluation of the economic efficiency and developmental effectiveness of Fair Trade is complex and requires the introduction of concepts not employed by LeClair; it is therefore beyond the scope of this note, although I have attempted the beginnings of such an analysis elsewhere (Hayes, 2006a).

2. THE DIRECT IMPACT OF FAIR TRADE

LeClair (2002) contains a diagram (Figure 1 is a slightly revised and clearer version) expressing the labor supply decision of a typical handicraft producer as a consumption choice between leisure (L) and "the purchase of a good" (Y). [4] Leisure is on the horizontal axis and the consumption of other goods is on the vertical axis. A budget line B_1 represents the opportunity cost in terms of other goods of taking a given amount of leisure. For example, at point L^* the producer does no work at all, whereas the intercept of B_1 with the Y-axis gives the maximum output of other goods possible working at full capacity ($L = 0$). The producer perceives an increasing trade-off between work and leisure, in either direction, which is expressed in a convex indifference curve I_1. The optimal choice between work and leisure is then given by the point where the budget line is tangent to the indifference curve, that is, B_1 and I_1, corresponding to L_1.

How then does Fair Trade fit into this framework? LeClair treats the preference of ethical consumers for Fair Trade as an increase in the wage. In terms of Figure 1, this means that the budget line tilts clockwise from B_1 to B_2. The intercept of B_2 with the Y-axis represents a higher maximum feasible amount of goods obtainable by work. The optimal combination of work and leisure L_2 is now given by the point of tangency of B_2 with indifference curve I_2, which is higher than I_1, as the ethical consumers would hope and expect. Figure 1 indicates that the producer will do more work and take less time off ($L_2 < L_1$), in other words, the substitution effect against leisure (arising from a negative price elasticity of demand for leisure) dominates any income effect (arising from a positive income elasticity of demand for leisure). [5]

The critique of Fair Trade follows from considering that the producer could be placed on the same higher indifference curve I_2, by a simple transfer from the consumer of an amount less than the increase in the total wage. To see this, B_3 is drawn tangent to the indifference curve I_2, this time parallel to the original budget line B_1. I_1 and I_2 are drawn so that the points of tangency of B_1 and B_3 correspond to the same amount of leisure (L_1), but this is not significant. B_3 captures the income effect alone, the increase in welfare represented by the shift from I_1 to I_2. Since the slope of B_3 is less negative than the slope of B_2, the cost of a lump-sum subsidy at any given level of output is always less than the cost to the consumer of increasing the producer's welfare to an equivalent extent by buying goods at a premium. The latter involves a substitution of leisure for

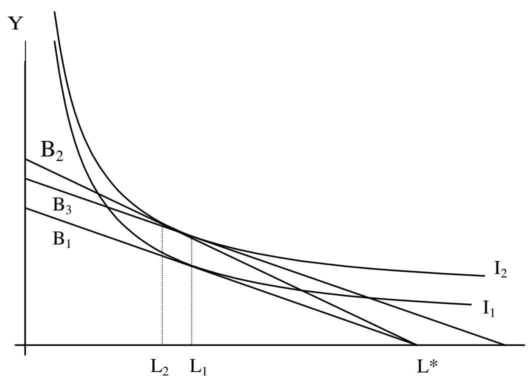

Figure 1. *Subsidization versus direct payments.*