

Will Fair Trade Coffee Stunt Your (Economic) Growth?

A Response
to Paul Myers

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Two Approaches to Fair Trade

One of my most treasured possessions is a backgammon set.

I purchased this beautiful handiwork in Yerevan, Armenia, in the *Vernissage*—a vast open-air market that operates every Saturday and Sunday regardless of the date or the weather. The *Vernissage* (a French word that means “varnishing”) is located in the heart of Armenia’s capital city and affords Armenia’s most talented and creative artisans a weekly opportunity to show off their wares to those who wander the sprawling marketplace.

The entire set is handcrafted from wood, and—using my limited skills in reading the Armenian alphabet—I can discern that its gifted creator is a gentleman named “Hovhannisyan.” When the set is closed, its top panel is both visually stunning and historically powerful. Constructed entirely of inlaid wood, the panel depicts Khor Virap, an Armenian monastery that was built on the site where St. Gregory the Illuminator—the patron saint of the Armenian Apostolic Church—was imprisoned in a subterranean dungeon for thirteen years near the close of the third century. In the background, towering over the monastery, sits Mount Ararat—visible both from the monastery and also from my office window during my Fulbright year.



Figure 1

Backgammon Set. Photo courtesy of T. J. Nichols.

Each detail has been created from an individual piece of inlaid wood—each piece cut, stained, and fitted to provide every nuance of shade, contour, and perspective of the monastery and its surrounding landscape. I cannot begin to estimate the number of hours Hovhannisyan must have invested in his creation, nor can I appreciate the years that he must have spent developing, honing, and perfecting the talent required to produce something so beautiful, inspiring, and useful (it is a backgammon set, after all). Craftsmanship such as this is rare, indeed.

I cannot recall how much money I spent for this memento that has grown so precious to me in the years since my Fulbright. I suspect that I must have haggled a bit over the price, as is customary in the Vernissage—though I am also sure I was not very skillful at such bargaining. Regardless of the eventual price I paid, I am confident that it was considerably lower than what I would be asked to pay for a similar set were it to be found among the inventory of a shop in the French Quarter of New Orleans, the offerings online at Amazon, or the displays at my closest Pier 1 Imports.

Why was the price relatively low for something so uncommonly beautiful? Part of the answer lies in the fact that Armenia is a poor country. According to the CIA World Factbook, Armenia's *per capita* annual GDP (purchasing power parity) was just \$5,400 in 2011, a number that places Armenia at 148 in a ranking of all countries, along with nations such as Angola (142), Syria (152), and Mongolia (154).¹

Another part of the explanation can be found in Armenia's abundant labor pool. Like several other former-Soviet republics such as its northern neighbor, Georgia, Armenia is rich in highly skilled and well-educated human beings who are chasing after few employment opportunities. As a consequence, almost any good or service that is relatively labor-intensive to produce is cheap by Western standards. I am confident that I will never again enjoy as many sumptuous gourmet meals, taxicab rides, or live music performances in one year as I did during my Fulbright for one simple reason: I will not be able to afford them on my salary, given the relatively high earnings of equivalent labor in the United States.

In the years since then, I have often reflected on how wonderful my backgammon set is in light of what I was asked to pay for it. I have also spent much time wondering why purchasing something similar here in the United States is nearly impossible. I have gone so far as to conduct some limited "research" online at sites such as Amazon and eBay, yet I cannot locate a backgammon set that is comparable to my own. This seems especially intriguing to me since the family and friends who visit my home and see it cannot help but marvel at its beauty and workmanship—especially the few who know a thing or two about woodworking.

That Hovhannisyan's handiwork appears to have no existing market beyond the Vernissage saddens me. He is creating art that few will ever see—much less have the opportunity to purchase. I cannot help but suspect—as an economist—that if Hovhannisyan's functional artworks could find their way into the correct shops and boutiques in the West, then he would be able to connect with grateful potential buyers currently unaware of the beauty he has to offer.

Today fair trade follows two approaches. One approach, pioneered a half-century ago by organizations such as Ten Thousand Villages, works with artisans such as Hovhannisyan to share their unique handiwork with potential buyers with whom they otherwise would not connect.² Laura Reynolds and Douglas Murray refer to this as the alternative-trade-organization approach (ATO).³ The second approach—currently surging in popularity—does not involve uncommon goods like my backgammon set. This newer approach focuses instead on a large and growing array of products and commodities that are relatively common in both quantity and quality, such as coffee, tea, rice, honey, bananas, and soccer balls—to name a mere few. Trade in these goods is controlled worldwide by an umbrella organization called the Fairtrade Labelling Organizations International (FLO).

I will use the remainder of this essay to evaluate each of these fair trade approaches in light of their potential to transform in lasting ways the lives of the intended beneficiaries of each. Before doing so I review the essential means through which human beings attain life-sustaining material gains. Because both economic theory and the empirical evidence are quite clear about the drivers of

enduring economic growth among the poor, the simple test of fair trade efforts should be whether they steer human action toward or away from the path of long-term economic development. On the one hand, if fair trade efforts merely keep the patient on indefinite life support, so to speak, then fair trade fails to serve the poor. On the other hand, if fair trade initiatives not only help the patient survive but also flourish, then fair trade is a cause worth celebrating.

What Are the Primary Drivers of Economic Growth?

Because we are blessed to have all of human history to study, as well as many different nations, continents, and peoples to track through time, economists have been able to develop a deep understanding of the drivers of short-term standards of living as well as long-term economic growth. Simply put, there are two fundamental ways for a person to earn a higher hourly wage tomorrow than today. One obvious way is to be able to create more value during that hour. Economists refer to the value created in one hour as *labor productivity*. For example, people earning only the minimum wage today in the United States are usually stuck there because they have relatively little to contribute in the way of specific skills, expertise, or training; that is, their labor productivity is low. I am reminded of one of my favorite installments of the *Wizard of Id* comic strip. When asked about his career plans, a young man announces his intention of becoming a minimum-wage laborer. When pressed further regarding the specific ways in which he plans to prepare for such a career, the young man enthusiastically replies, “That’s the beauty of it!”⁴

Similarly, many desperately poor people today are living on less than a dollar per day primarily because they currently have little value to contribute in the marketplace, regardless of their work effort. For reasons often beyond their control, they may lack even basic skills such as language and mathematics. These assets are so widespread in most of the West that most of us forget how essential they are to our earning potential. One of the major factors in the rise of India from a poor nation just a few years ago to one that we seldom think of as poor today is the high-quality educations—including English and math skills—possessed by many of India’s citizens.

More broadly speaking, a human being—wherever she lives—will have greater earning potential when she is rich in what economists refer to as *human capital*: her accumulated skills and knowledge that can be acquired through education, job experience, and job training. People everywhere enhance their earning potential when they increase their own human capital in ways that have worth to others.

Although a nation's stock of human capital among its people is one way of increasing the value created during an hour of labor and, as a consequence, the rate of hourly pay, there is another avenue that increases labor productivity. When people have access to tools they currently lack, or when they are able to replace their existing poor tools with more effective ones, they can accomplish more. Economists refer to such tools as *physical capital*. Think about how much (or little) digging you could accomplish if your best available tool for the job were a spoon. Now imagine the staggering increase in your hourly progress if you were able to trade in your spoon for something as simple as a shovel. Having good tools is another means through which people can create more value in an hour and, as a result, earn more per hour. Just as rich Westerners can overlook the value of basic math and language skills in a poor country, we also sometimes forget that in a poor country even the simplest tools can mean the difference between starting a business and not starting one. I am reminded of a business I observed a few years ago in downtown Yerevan in which the sole proprietor used a bathroom scale to weigh his customers as they exited a grocery store. Without that simple bathroom scale, there would be no business.

Although extremely powerful, greater labor productivity—whether by way of investments in human or physical capital—is not the only driver of higher earnings for the world's poorest people. The other source of increased hourly pay is access to potential customers. Even with great labor productivity, hard work bears no reward without someone waiting on the demand side who is both willing and able to purchase labor's fruits.

Given that (1) increases in hourly productivity and (2) greater access to potential customers are the two major means through which people everywhere are able to create and earn more per hour, we need to evaluate both fair trade models—ATOs and the FLO—in this light. If fair trade initiatives lead to either greater productivity or a greater customer base, then fair trade will lead to gains for the poor. If fair trade fails to help the poor make gains in either area, then fair trade may not be of particular service to the poor.

The FLO Model of Fair Trade

Today FLO oversees the worldwide production and sale of some two dozen commodities, though the original and now biggest fair trade product is coffee. Because I describe the details of fair trade coffee in my monograph on the subject, I will merely summarize here.⁵ Cooperatives of small coffee growers search for companies willing to purchase at least part of the farmers' crops at a guaranteed minimum price per pound, plus an additional 10 cents per pound that may be

used for community projects. Gaining access to the fair trade network is not free: because many poor coffee growers desire access to the network, FLO charges a hefty application fee to the poor farmers—usually thousands of dollars.

The overwhelming evidence suggests that the FLO fair trade model does not help the poor and may in fact be harmful, and the word is getting out. Even sources as dubious as the satirical *Cracked* magazine website get the basic facts right.⁶ For starters, in most years the guaranteed price per pound is either lower than the market price of coffee or *scarcely* higher. This implies that most of the premium price we pay at retail for fair trade coffee is not getting through to the people we are trying to help. One recent study concludes that less than 12 percent of the extra we pay for fair trade coffee actually reaches the growers.⁷ Another study demonstrates that Nicaraguan fair trade growers were actually worse off after ten years than their conventional counterparts—due largely to fair trade’s hefty entrance fees and compliance costs.⁸ Finally, fair trade efforts such as these encourage the poor to continue doing something that will never pay well. The simple fact is that coffee will always be cheap because growing it requires few tools and little skill—so just about anyone can grow it as long as the climate is right. Despite its good intentions, the FLO model of fair trade is simply a charitable effort, and it is not an effective one.

The ATO Model of Fair Trade

As we have seen, the FLO fair trade model encourages production of commodities such as coffee, tea, bananas, and rice: products that are common both in quantity and quality. Thus the FLO model creates incentives for the poor to produce even more of their product when the fundamental problem is that there is too much of it already.

The ATO model provides a more hopeful alternative. In the ATO model, a nongovernmental organization (NGO) such as Ten Thousand Villages works to connect artisans, such as Hovhannisyán, with potential buyers with whom they might not otherwise connect as well as to ensure that the exchange is worthwhile to all parties along the way. In some cases the NGO may operate its own chain of retail stores or may work with a network of for-profit retailers to bring goods into Western markets. In short, the NGO performs valuable service as a so-called middleman between the producer and consumer.

If the ATO model is effective at raising living standards and nurturing long-term development, it does so by helping highly skilled artisans gain access to markets that had previously proved to be inaccessible. The ATO connects eventual consumers with uncommonly good products, whereas the FLO model

encourages even more production of an already common good. If fair trade that follows the ATO path connects skilled producers with eventual consumers who purchase the goods—not out of charity but because the consumers genuinely desire the products—there is no harm in that, and there may be considerable good. The downside risk of ATO-style fair trade is that if demand slumps because consumers find fair trade less compelling as charity, then ATO’s artisans will see demand dry up.

Concluding Reflections

To open this essay I described my backgammon set. To close I will mention the table that we play backgammon on at my house. We have a small pub-style table that was crafted in Vietnam by skilled workers using good tools and unique, native materials. We bought it at Pier 1 Imports, and we did so because we could find nothing similar elsewhere. It is a fine table, and we are happy to have it.

Although we did not buy our table through the Fair Trade Federation, I nevertheless make this claim: *Our table is a fair trade table*. Pier 1’s buyers constantly scour the globe to find uncommonly good products to offer at reasonable prices to consumers like me. Thanks to a network of middlemen who add value along the way, everyone involved is better off as a result, and you and I can connect with gifted and talented producers from poor countries whose work we value highly. Even though Pier 1 is organized as a for-profit company, it nevertheless encourages economic development. This is especially important in Vietnam because the country is one of the world’s top coffee growers. Speaking more generally, a typical multinational corporation pays roughly eight times the average wage in developing countries.⁹

If you purchase “fair trade,” buy it because you like the good or the service. Do not do it out of mere charity. Instead, give generously to charities that you know are effectively working for human rights, development of human and physical capital, and opportunities for the poor to discover increasingly valuable ways to serve others in the global marketplace.

Notes

1. *CIA World Factbook*, accessed January 17, 2013, <https://www.cia.gov/library/publications/the-world-factbook/>.
2. Evelyn Spence, "The Future of Fair Trade," *Delicious Living*, October 2007, 29–32.
3. Laura Reynolds and Douglas Murray, "The Fair Trade Future," *Policy Innovations*, January 31, 2008.
4. *Wizard of Id*, November 27, 2002, Creators Syndicate, Inc., accessed January 17, 2013, <http://www.gocomics.com/wizardofid/2002/11/27>.
5. Victor V. Claar, *Fair Trade? Its Prospects as a Poverty Solution* (Grand Rapids: Acton Institute, 2010).
6. Gregory Myers, "4 Reasons Why Fair Trade Coffee Is a Scam," November 28, 2012, *Cracked.com*, accessed January 17, 2013, <http://www.cracked.com/quick-fixes/4-reasons-why-fair-trade-coffee-scam/>.
7. Joni Valkila, Pertti Haaparanta, and Niina Niemi, "Empowering Coffee Traders? The Coffee Value Chain from Nicaraguan Fair Trade Farmers to Finnish Consumers," *Journal of Business Ethics* 97 (2010): 257–70.
8. Tina D. Beuchelt and Manfred Zeller, "Profits and Poverty: Certification's Troubled Link for Nicaragua's Organic and Fairtrade Coffee Producers," *Ecological Economics* 70 (2011): 1316–24.
9. Zarrin T. Caldwell, "Global Trade: Free or Fair?" *Perspectives*, Issue 6, December 2005, 7, accessed January 20, 2013, <http://www.unimondo.org/content/download/17501/115349/file/OneWorldPerspectives6-FairTrade.pdf>.