The Economist

Fair trade

This house believes that making trade fairer is more important than making it freer.

The opposition's opening remarks
May 4th 2010 | <u>Jagdish Bhagwati</u> ⧉

On the contrary. At the outset, we have a problem of ambiguity. While we know what free trade means—we mean by it the absence of price or quantity interventions in trade that prevent the translation of world prices into domestic prices, keeping in mind that trade instruments can be decomposed into a sum of domestic policy instruments—it is a phrase that has no settled meaning in policy discourse. In fact, there are three main meanings which we can assign to it today. Fortunately, in each case, we can argue that making trade fairer will have malign effects whereas making trade freer will make us better off.

In the first meaning, often, in the United States in particular, free trade is considered unfair if other nations are less open than one's own. This notion of unfair trade was also manifest in Britain at the end of the 19th century when Germany and the United States had emerged as competitors to British hegemony. Fair trade associations grew up at the time, agitating to end Britain's unilateral free trade, much as the United States saw the demands for fair trade increased when it faced the rise of Japan in the 1980s and many feared that the principal source of relative American decline was the asymmetric closed the Japanese market. This is, of course, a recurrent theme in the United States: Japan has been replaced by China, currently prospering because its markets are considered to be closed relative to the American markets.

Now, if the demand for fair trade in the sense of demanding reciprocity in openness leads to others reducing their trade barriers, that is good. But if it leads to closing of one's own, because others do not yield to such demands, that is bad. Thus, the theory of unilateral trade and reciprocity teaches that if others open their markets when we open ours, we generally speaking get a double dividend (from opening ours and others opening theirs); that if such reciprocity does not obtain, we would still profit from our own unilateral freeing of trade; and that, in fact, if immediate reciprocity is denied, it may be prompted down the road in these initially non-liberalising nations by the demonstration of success with freer trade or the relative strengthening of pro-trade lobbies in these nations as they liberalise on their own: what I have called "induced reciprocity" (see "Going Alone", MIT Press, 2002).

In the second meaning, a more potent notion in current discourse is the notion that fair trade requires that rival producers abroad should carry the same burdens on labour (and domestic-pollution) standards as one does. If the same industry carries differential burdens across countries, and yours is greater, then free trade will harm you.

These demands, when reflecting lobbying by specific industries complaining of unfair trade because their competitors are less burdened, are misplaced since

there is no reason why there should be such identity of industry standards across countries. The shadow price of domestic pollution may well be different across countries for an industry: abundant fresh air and widespread dysentery owing to polluted water in Kenya relative to the United States may legitimately mean that the polluter-pay tax be less in Kenya for air pollution and more for water pollution than in the United States.

The same goes for labour standards. Except for consensus on a very small (but possibly growing) set of universal labour standards such as the proscription of hazardous child labour, many standards will reflect local history, politics and economic circumstance. When labour unions in the United States typically ask, nonetheless, that others abroad raise their labour standards to the US standards, the argument is usually couched in terms of altruism: we are doing this for your workers. But, in truth, the argument is prompted by self-interest, that is, it is designed to raise the cost of production abroad so as to moderate competition which, it is wrongly feared, is harming one's own workers. Economists will recognise this as a form of export protectionism, as an alternative to conventional import protectionism. If a beast is charging at you, you can catch it by the horns (as with import restrictions) or you can reach behind the beast, catch it by the tail and break the charge (as with export protectionism).

Some labour groups have turned instead to asking for acceptance of the core labour conventions at ILO by a country as a requisite for freeing trade with it. Ironically, however, for several reasons, the United States has not ratified a large fraction of them. Maybe the United States will begin by suspending all its exports until all core conventions are ratified: if charity begins at home, so must trade sanctions for lack of ratification of the core conventions?

As for the third meaning, perhaps the most influential demand for fair trade today is in an altogether different sense. It derives from British charities like Oxfam and is really a demand for what economists call a just price to be paid to foreign suppliers in trade, a notion that goes back at least to Rowntree's practice of paying a higher-than-market price for cocoa beans processed into its chocolate.

This is of course a perfectly innocuous procedure, except that it turns into a form of protectionism if regular trade is sought to be eliminated in favour of fair trade. For example, retailers may be forced to carry only fair trade coffee. I believe that this is a mistake. In particular, when I pay a higher price for my fair trade coffee, I am providing a subsidy to the suppliers of this coffee vis-à-vis the market price. That may well be what I want to do as my altruistic activity. But I may want instead to use my altruistic funds on what I consider worthier causes like support of women's rights NGOs or children's nutrition. I see no reason why I should be forced to accept someone else's definition of how I should behave as an altruist.