

# A comment on the economics of Fair Trade

**Summary.** —LeClair (2002) 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<sup>1</sup> (b) that Fair Trade may have indirect repercussions adverse to other producers outside the Fair Trade sector of a particular market,<sup>2</sup> and (c) that Fair Trade deters desirable diversification.<sup>3</sup>

The purpose of the present 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 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

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<sup>1</sup> “If  $b$  is large, which is more likely in the informal sector, then there is a significant variance (in monetary terms) between the two approaches, and cash payments are therefore superior” (p. 955).

<sup>2</sup> “Since all evidence suggests that the handicraft trade is highly competitive, the producers outside the ATO are potentially harmed by the resulting shift in demand, with the exact outcome depending on the supply and demand elasticities (see caveat above)” (p. 955).

<sup>3</sup> “The ‘artificial’ increase in the price of handicrafts, textiles and commodities provides an incentive for individuals to continue to market these products, regardless of the relatively poor economic prospects of producing these goods in the long-term” (p. 956).

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 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' ( $Y$ ).<sup>4</sup> Leisure is on the horizontal axis and the consumption of other goods is on the vertical axis. A budget line  $B_I$  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  $B_I$  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  $I_I$ . The optimal choice between work and leisure is then given by the point where the budget line is tangent to the indifference curve, i.e.  $B_I$  and  $I_I$ , corresponding to  $L_I$ .

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<sup>4</sup> His subsequent argument suggests that, by using the symbol  $Y$ , LeClair means to refer to the *sale* of a good by the producer, which in turn creates income that can be exchanged for consumption goods. The substance of the argument is unaffected.

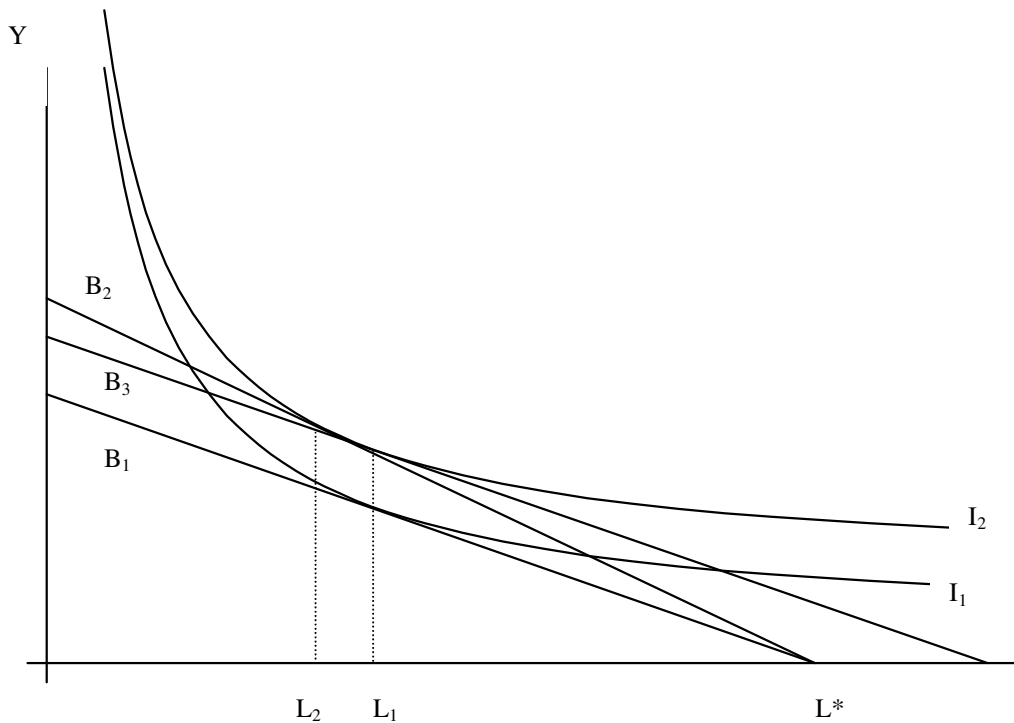


Figure 1. *Subsidization vs. direct payments*

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 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).<sup>5</sup>

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

<sup>5</sup> LeClair's version of Figure 1 (p. 954) shows the income effect dominating the substitution effect, but I understand this to be inadvertent.

buying goods at a premium. The latter involves a substitution of leisure for work, which does not increase the producer's welfare, as well as the income effect.

On these grounds, LeClair argues that Fair Trade is less effective than charitable donation in redistributing income. Furthermore, the incentive to do more work on Fair Trade goods leads to over-production relative to the market optimum and therefore an inefficient allocation of resources. LeClair points out that Fair Trade may still be the second-best option, since the ideal may not be feasible or desirable on other grounds. Nevertheless, the power of this argument is its implication that Fair Trade is an inferior method of poverty relief, and that where possible, direct transfers are both more effective and more efficient.

LeClair's argument on the relative effectiveness of Fair Trade and donation turns partly on his definition of "subsidy". In order to quantify the graphical demonstration, he sets up a model of an individual artisan producing a quantity of output  $Q$  with a unit raw material cost  $r$  for sale at a normal unit market price  $P$  (I have dropped the superfluous subscript  $H$  in the interests of clarity). The income of the artisan ( $Y$ , LeClair uses no symbol) without any Fair Trade premium is then given by

$$Y = (P - r) Q \quad (1)$$

Assuming the artisan is able to sell all her output to a Fair Trade buyer at a proportional premium  $a$  above the market price and the work/leisure substitution effect discussed above leads to a proportionate increase in output  $b$ , she obtains a revised income

$$Y' = (P(1 + a) - r)Q(1 + b) \quad (2)$$

where  $a, b > 0$

The increase in income is given by taking equation (1) from (2)

$$Y' - Y = PQ(a + b + ab) - brQ \quad (3)$$

Equation (3) quantifies the difference between income at  $L_2$  relative to  $L_1$  in Figure 1, and LeClair identifies this also with the 'subsidy' from the ethical consumer. The subsidy should rather be defined separately, as the excess of the value paid by the ethical consumer over the normal market value of the goods received: it is only this excess that can properly be compared with a donation. Any additional cash outlay in exchange for extra goods at market value does not diminish the consumer's welfare, unlike a donation (here ignoring indirect utility). The subsidy is then:

$$aPQ(1 + b) \quad (4)$$

The producer's increase in income exceeds the subsidy (or an equivalent donation), taking (4) from (3), by an amount equal to:

$$bQ(P - r) \quad (5)$$

This is simply the net income from additional work at the market price. Intuitively, equation (5) means that if there is no elasticity of supply or quantity effect ( $b = 0$ ), there is no difference between the subsidy of equation (4), an equivalent donation and the increase in income (a zero sum). If  $b < 0$ , the producer chooses less work and more leisure, so that the income effect dominates the substitution effect (the labor supply curve

slopes downward), and conversely where  $b > 0$ . The case  $b < 0$  may be relevant where production is undertaken by the household as a whole, and the higher income releases children to go to school. Nevertheless, the question remains whether any income gain in excess of the subsidy if  $b > 0$  is a welfare gain for the producer. Figure 1 suggests otherwise: if the budget line simply swivels around the same indifference curve, the producer's welfare is unaffected. The redefinition of 'subsidy' shows only that Fair Trade is no less effective than a subsidy in terms of the welfare cost to the consumer of a given increase in the welfare of the producer. For any income gain in excess of the subsidy to represent a welfare gain for the producer, we need to relax the work/leisure model's underlying assumption of full employment, to which we now turn.

### 3. THE INDIRECT IMPACT OF FAIR TRADE

The partial equilibrium argument of the previous section has considered only the direct effect of a Fair Trade preference, interpreted as an increase in the producer's wage. When it comes to the economy as a whole and the indirect impact of Fair Trade, the general equilibrium argument that Fair Trade necessarily leads to inefficient allocation assumes that all resources are otherwise fully and optimally employed under perfect competition. In such a case, an increase in the supply of one good ( $b > 0$ ) must draw resources from the production of other goods through interfering with the competitive equality between relative prices and marginal rates of substitution and transformation. It is only against the full employment benchmark that the concept of market distortion has a definite meaning, namely that the favored producer's benefit is at the expense of other producers through reduction in the market price, and at the expense of consumers through reduced consumer surplus – the classic result in the theories of taxation and tariffs.

It is worth noting that this approach has nothing to say about Fair Trade in the absence of a definable consumer price premium. If Fair Trade goods offer an intangible 'warm glow' which differentiates them from non-Fair Trade goods, the consumer preference is no more open to analysis than that between white and dark chocolate: it is purely a matter of taste. The same applies if Fair Trade addresses imperfect competition in the supply chain for homogeneous goods, without a consumer price premium. However in this comment we continue to follow LeClair in assuming perfect competition and a price premium.

It is at this point that we need to dust off Keynes's (1936) concept of involuntary unemployment in order to make proper sense of Fair Trade within a competitive model.<sup>6</sup> Involuntary unemployment means that employment is limited by effective demand rather than by the supply of available labor. If Fair Trade creates paid work for under-employed labor, aggregate income and social welfare are increased. Labor rationing need not show itself in the form of queues of unemployed jobseekers; registered unemployment is

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<sup>6</sup> Strictly, it does not matter for the present purpose whether observed under-employment is regarded as a matter of 'temporary' disequilibrium or of Keynesian unemployment equilibrium, provided that it is admitted that the temporary disequilibrium can persist for at least a decade or two and that the producers do not choose to work on inferior activities (see below) for less than the market wage because they happen to enjoy the work. Those unconvinced that Keynesian unemployment is compatible with perfect competition may wish to consult Hayes (2006b, 2007).

unusual in the context of the developing world, where the rationing normally takes the form of under-employment.<sup>7</sup> Under-employed labor must find other occupations, even if they offer a net return less than the market wage; involuntary unemployment is disguised, to use Joan Robinson's phrase (1936).

Each indifference curve of Figure 1 assumes constant welfare and, implicitly, full employment: the producer does no more work than she chooses at the margin. The normative overtones of this statement derive from the tacit assumptions of full employment and perfect competition, meaning that the value of work equals the marginal utility of leisure in the economy as a whole, i.e. its value for those who turn down offers of paid work at the market rate. "Leisure" is a term used by economists as a catch-all for preferred alternatives to paid work, including education and training.<sup>8</sup> Clearly leisure has different implications if its meaning is incorrectly stretched to activities which are *not* preferred to paid work, including inefficient subsistence farming, less productive forms of self-employment and domestic work, or enforced idleness. Such activities are indicators of under-employment, of a real wage above the marginal utility of leisure. The labor market supply decision of a low-income self-employed farmer or artisan (or more accurately, household) is best understood as placing no value on leisure-time (where leisure means refraining from any kind of work, including education as an investment): all socially available time is devoted to work of one sort or another. Thus a rising labor supply curve can represent, not a trade-off between different forms of consumption (goods or leisure), but the boundary of the household's autarkic production possibility set, as increasingly productive but still relatively inefficient household activities are dropped in favor of paid work as the wage increases.<sup>9</sup>

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<sup>7</sup> Keynes preferred to define full employment in terms of the demand-elasticity of aggregate output rather than the equality of the real wage with the marginal disutility of labour (Keynes, 1936, pp. 26, 289). Thus a switch from a less productive to a more productive employment represents a reduction in involuntary unemployment.

<sup>8</sup> Education and training are usually better regarded in this context as a form of work, by way of investment to enhance future earning potential, to avoid confusion with consumption, activities which offer immediate utility. Education can fall into either category: most people undertake MBAs and other degrees as an investment, but some people may take some degrees, even the same ones, for pleasure. Most children have an ambivalent attitude towards school, but low-income parents invariably see their children's education as an investment and ladder out of poverty.

<sup>9</sup> The argument makes the usual abstraction from the heterogeneity of labor and from imperfections of competition in labor supply. This means that skilled labour is treated simply as a multiple of unskilled labor.

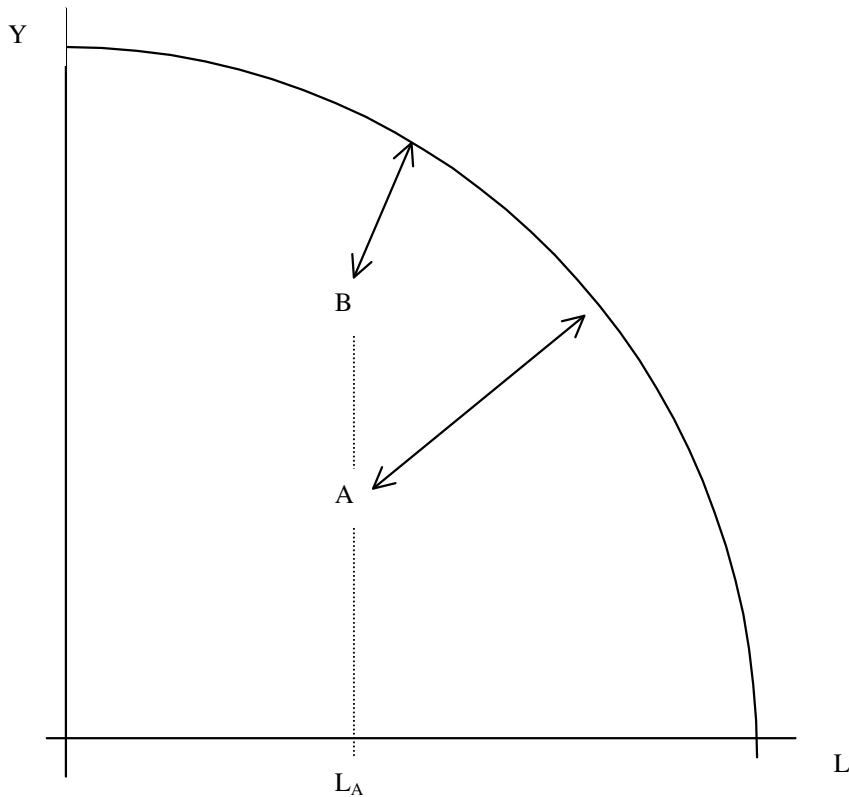


Figure 2. *Under-employment and the social production possibility set*

In conditions of under-employment, an increase in labor supply to the market represents a movement from a point of socially inefficient production, in the interior of the social production possibility set, towards the efficient boundary (a movement from  $A$  to  $B$  in Figure 2, in which  $Y$  and  $L$  now represent the aggregate income and ‘true’ leisure of society as a whole). If the household is under-employed, the household’s income gain from Fair Trade (in excess of the subsidy, as expressed by equation (5) when  $b > 0$ ) is associated with a welfare gain for both the individual household and society as a whole, as the result of the substitution of a more efficient market activity for a less efficient domestic activity. Given the terms of this analysis, the benefit of Fair Trade relative to a donation is in allowing the producer household to gain additional welfare by its own efforts in addition to the transfer from the consumer: Fair Trade multiplies the value of the consumer’s charitable impulse. This means that Fair Trade is as effective as donation in terms of the welfare cost to the consumer if there is no quantity effect, and more effective if there is.

Nevertheless, even if both the Fair Trade producers and society as a whole are better off as a result of an increase in aggregate output, there is no guarantee that this means a change of income distribution favorable to producers who do not enjoy the benefits of Fair Trade. We need to consider, in particular, the implications of any quantity effect ( $b \neq 0$ ) for producers competing with Fair Trade producers (‘non-Fair Trade producers’). If there is no quantity effect ( $b = 0$ ), the subsidy, equivalent donation and producer gain are all equal: they amount to a transfer from consumer to producer without any wider

implications. If  $b < 0$ , the child labor case, no adverse (indeed, positive) consequences for other producers would normally be expected, since on the usual assumptions, a reduction in total supply tends to increase the market price. The more difficult case is  $b > 0$ , where an increase in supply tends to reduce the market price, which is all that is available to non-Fair Trade producers, who are usually at least as poor as Fair Trade producers. The purpose of Fair Trade is to relieve poverty in aggregate, not merely to shift it from one group to another.

If Fair Trade calls forth an increase in supply in conditions of under-employment, social welfare is increased even if the increase in output results in a reduction in market price, since consumers are better off and could over-compensate producers who lose out. There is potentially a three-way trade-off here, where consumers<sup>10</sup> and Fair Trade producers may be better off, but non-Fair Trade producers may be worse off. This is not the outcome intended by advocates of Fair Trade, nor does it meet a Rawlsian definition of fairness in terms of the consequences for the poorest (Maseland and de Vaal, 2002).

Note, however, that the potential problem of an adverse change in income distribution arises equally with any measure that increases production by improving competition, including a reduction in the monopsony power of employers to restrict production and wage-rates, or by way of technical assistance to increase the productivity of labor. Indeed, it applies to any market, whether for jute baskets or microprocessors. Any change in aggregate production affects the distribution of income and welfare, the problem here is the concern that the direct benefit of Fair Trade to some poor people may be offset by the indirect cost to equally poor people elsewhere. Even if society as a whole is better off, this will be cold comfort for the supporters of Fair Trade.

In a competitive product market, any increase in supply, other things being equal (particularly demand conditions), means a fall in market price, but it does not necessarily mean a fall in the income of the producers (before taking account of any Fair Trade premium). Whether the fall in market price is associated with a fall or a rise in income depends on the price-elasticity of demand. In the case of unit elasticity, income is unchanged; if the elasticity exceeds unity ('elastic demand'), income will rise with a fall in price; and if the elasticity is below unity ('inelastic demand'), income will fall along with price.

The economic assessment of the indirect impact of Fair Trade therefore becomes, at least partly, a matter of fact: the measurement of the price-elasticity of demand for Fair Trade goods. Questions of methodology arise, of course, over the definition of goods and markets and the extent to which goods produced by Fair Trade producers are substitutes for those produced by non-Fair Trade producers. Nevertheless, some Fair Trade commodities, notably coffee, do appear to face inelastic demand at the wholesale level. By contrast, many traditional manufactures and textiles are discretionary purchases (such as gifts) where demand may be quite price-elastic.

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<sup>10</sup> Ethical consumers are in any case better off since by revealed preference they gain utility by subsidising Fair Trade: what LeClair calls the 'warm glow' (p. 954), or more technically, indirect utility. Ordinary consumers gain by the reduction in price and the increase in their consumer's surplus.

In summary, the assessment of the indirect impact of Fair Trade, even within the terms of a highly abstract economic analysis, is not straightforward. It depends first of all on whether Fair Trade increases supply as well as income. It is quite possible that the main benefit of Fair Trade is in redistributing rents within the global value chain, without significant supply consequences. Such a benefit cannot be captured by the present analysis (but see Hayes, 2006a). If Fair Trade does increase supply, the impact needs to be considered from two perspectives, those of social welfare and of income distribution. On the one hand, if Fair Trade reduces under-employment, this represents a net increase in the aggregate output and welfare of society as a whole, and not only that of the Fair Trade producers. On the other hand, it is possible that this social gain accrues to Fair Trade producers and to consumers, partly at the expense of non-Fair Trade producers. The effect on income distribution will depend upon the price-elasticity of demand and is a consequence of any increase in supply, not of any Fair Trade price premium as such. Thus, where the demand for Fair Trade goods is inelastic, the present analysis reaches an ambiguous verdict: Fair Trade is good for the producers and for society as a whole, but may harm non-Fair Trade producers of competing goods. Further research is needed to determine whether this conclusion is robust under more sophisticated, and more empirically grounded, analysis.

#### 4. ON DIVERSIFICATION

The third element of LeClair's critique is that Fair Trade prolongs dependence on products with poor long-term prospects, and deters desirable product diversification.

Strictly, there are two separate issues combined here. Diversification means a reduction of dependence on particular markets, especially markets subject to high volatility, in order to reduce the volatility of total income. In the context of developing countries, this means a reduction in dependence on products characterized by inelastic short-period supply and demand, notably primary products. A related, but separate, idea is that of shifting productive resources towards markets with better long-term prospects, which is more a matter of economic growth than of volatility.

There are several ways in which LeClair's claim can be interpreted. First, it may mean that Fair Trade operates in markets characterized by price-inelastic demand and supply and volatility. Interestingly, LeClair singles out traditional manufactures as an example, of which it is not obviously true that supply and demand are inelastic, at least in global markets, or that prices are volatile, in contrast to the primary commodities with which Fair Trade is increasingly engaged.<sup>11</sup> The case for diversification on the grounds of volatility suggests that Fair Trade should not support most forms of agriculture, in which the majority of the world's population remains engaged and which represents an increasing proportion of Fair Trade sales volume. Conversely, it can be argued that the main contribution of Fair Trade in these markets is precisely the direct reduction of volatility by the offer of a fixed price.

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<sup>11</sup> LeClair refers to the markets for traditional manufactures as competitive (p. 955), which is undoubtedly true, but this does not mean that both supply and demand are inelastic, as they typically are in agriculture in the short term. The analyses of both this comment and his own paper assume perfect competition.

Secondly, the question of diversification looks different from the perspectives respectively of the individual household and of the community or country as a whole. Diversification of product markets in order to reduce volatility is, for the most part, a matter for the large scale. The individual household may engage in diversification to the extent of planting a range of crops<sup>12</sup> or having a portfolio of seasonal jobs, but the household has limited scope to switch its existing productive resources into new industries or to invest in new resources; the existing resources are generally limited to a plot of land (in a rural context) and to traditional skills. Diversification is a matter mainly for the economy as a whole, or at least for large-scale enterprise, rather than for individual households, for whom it may simply mean a complete exit from traditional occupations and migration to the shanty-town in a perhaps futile search for work. A higher income from Fair Trade, in the first instance, may allow households to continue to generate income from marginal assets and skills, where the alternative is not a better employment of those assets and skills, but unemployment.

Thirdly, the question of diversification requires consideration from both a long-term and a short-term perspective. Our earlier analysis has been entirely short-term, considering the implications of Fair Trade for the labor supply decision of producer households and for the current incomes of households. If the premise of under-employment is accepted, we have seen that it can be socially as well as individually optimal in the short term for Fair Trade producers to apply more labor, in conjunction with a given set of physical and human capital-assets (skills), to increase the supply even of products with poor long-term prospects. It is simply a matter of making best use of their existing productive resources, of which the opportunity cost is very low or zero, given aggregate under-employment. Leaving aside the impact on non-Fair Trade producers (already considered in the previous section), the question becomes whether higher short-term income encourages producers to invest new capital resources in such markets.

Even this is not a straightforward matter. The long-term prospects of primary commodities are hard to judge: they are almost all either necessities or the ingredients of high-value luxuries for which global demand is likely to grow, and the major problem is the price volatility. The sources of this volatility are many and various, including climatic shocks, and not simply the outcome of short-sighted over-investment in the boom (e.g. the coffee cycle). Although there may be little case in certain markets for investing in increased production of raw material, Fair Trade organizations (as opposed to the individual households they buy from or employ) may have attractive long-term opportunities to invest in downstream processing facilities, distribution channels and marketing. Such investment may increase supply, not in the wholesale market with inelastic demand, but in the markets for the processed product.

The worst case is a market with poor long-term prospects as a primary product and no opportunities for investment in processing and distribution. The low-income household is risk-averse, credit-constrained, and highly unlikely to invest any hard-won cash in a poor prospect. This is quite consistent with continuing to work (say) an existing farm of little sale value, using traditional skills; given the skills of the household, this alternative may

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<sup>12</sup> Becchetti and Costatino (2008) find evidence that Fair Trade promotes diversification of crops at the household level.

offer a higher long-term return than selling the farm and buying some other form of capital-asset in an industry in which they are unskilled. In such a market, the household can be expected to apply the surplus from a higher income towards the investment of choice of the poor, the education of their children. It is possible for the younger generation to acquire new, more transferable, skills that will permit migration to somewhere more hopeful than the shanty-town. Thus Fair Trade in this context may offer the double benefit of a reduction in child-labor, reducing supply in a market with inelastic demand, and of the opportunity to diversify its human capital. Furthermore, although this paper has abstracted from the institutions of Fair Trade, it must be emphasized that much of the benefit is delivered through the local Fair Trade organization, partly by way of community benefits such as healthcare and schooling, and partly as a larger scale enterprise capable of accessing product and credit markets and of investing profitably in different industries and markets, thus achieving diversification at the local level.

The ‘diversification critique’ accepts that Fair Trade producers earn higher incomes, but questions whether this is in their long-term interests or those of their countries. If the premise of under-employment is accepted, the support of struggling households whose future lies mainly with their children may improve the lives of the older generation while providing the younger with the means to escape poverty, even if the skills and resources of those households have no long-term economic future in their present form. Low-income households will invest only in good prospects and if collectively, through a local Fair Trade organization, they invest in physical assets, those assets are likely to be highly profitable. Yet, if there are no profitable opportunities for physical investment at community or individual level, they will usually diversify by investing in the health and education of their children.

## 5. CONCLUSION

LeClair’s conclusions that Fair Trade is a second-best form of assistance to particular sets of producers, potentially at the expense of others, reflect the premises of his economic analysis, including a particular definition of subsidy and the assumption of full employment. When re-interpreted, his equations suggest that Fair Trade multiplies any charitable impulse on the part of ethical consumers, and is more effective than aid, rather than less so; furthermore, the producer’s income gain in excess of the consumer’s subsidy represents an efficiency or welfare gain for society as a whole. Nevertheless, there appears to be some force in the argument that Fair Trade producers may gain at the expense of non-Fair Trade producers; this paper has clarified that this outcome arises only in circumstances of inelastic demand, and not in all cases. The demand conditions for Fair Trade goods and the robustness of this revised conclusion offer important questions for further empirical and theoretical research.

LeClair’s second conclusion (that Fair Trade deters desirable diversification) assumes that the assessment of long-term investment prospects depends only on current income, over-estimates the value of marginal factor resources in conditions of aggregate under-employment, and neglects the importance of investment in children’s health and education. Fair Trade can provide the means for diversification, both by the individual household through education, and by the local Fair Trade organization with its greater

access to product and credit markets and its potentially wider scope for profitable investments further down the value chain or in different markets.

To repeat, LeClair's paper and accordingly this comment both employ a static perfect competition model, which takes no account of imperfect competition, nor of dynamic and intangible considerations. I have argued elsewhere (Hayes, 2006a) that the core economic benefit of Fair Trade to producer households is in the elimination of monopsony rents and in enabling them to invest and acquire competitive technology (where this term includes business organization, such as brands and distribution channels), while others have moved beyond the assumption of perfect competition in product markets (e.g. Becchetti and Rosati, 2007). These alternative analyses do not depend on the consumer price premium, which is central to the present arguments, and directly address the question of diversification. In any case, as LeClair rightly notes, no strictly economic argument can assess the social, political and psychological dimensions of Fair Trade, on which many commentators place considerable emphasis. Nevertheless, such is the apparent power and elegance of the standard welfare critique of Fair Trade (of which LeClair, 2002, is only a representative case, see also Yanus and de Vannsay, 2003, Lindsey, 2004, Booth and Whetstone, 2007) that it requires a response at a similar level of abstraction.

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## NOTES