Canadian Student Review

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An Essential Piece of the Puzzle

by Trevor Tombe, Simon Fraser University

First Place Winner ($1000), Fraser Institute Student Essay Contest 2004

Each day around the world, 29,000 children die of hunger, over 30,000 children die of preventable diseases, 2.8 billion people live on less than $2 per day, and–worse still–1.2 billion on less than $1 (United Nations Development Program, 2002). One often notices globalization's opponents, such as His Excellency John Ralston Saul, citing such dreadful figures as evidence that competitive market systems fail the poor. Journalist Lou Dobbs (among others) argue free trade is "exporting jobs" to foreign competitors, impoverishing domestic workers. These notions of free trade are both deeply fallacious and dangerous. The aim of self-sufficiency–the logical extension of such anti- globalisation arguments–is precisely the sort of thought that economics is most capable of proving false. A clear and empirical analysis indicates that *anti*-competitive policies increase global poverty, not the other way around. Free trade puts liberty and opportunity over exploitation and established interests. It is an essential piece to solving humanity's poverty puzzle.

The following argument addresses merely one piece of the complex free trade and globalization debate: the voluntary exchange of goods and services across national borders and its impact on global poverty.

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Welcome!

In this fall issue of *CSR*, we are pleased to present two of the winning entries from this year's Student Essay Contest, "Does Free Trade Reduce Global Poverty?" Congratulations to the winners, Trevor Tombe, Shankar Kamath, and Kristine Squires. (Kristine's article will run in the Winter 2004 issue of *CSR*.) This was a very competitive contest, with over 120 entries received from across Canada and around the world.

We would like to thank the Lotte & John Hecht Memorial Foundation, whose generous sponsorship enables to distribute the CSR free of charge to students across Canada.

–Vanessa Schneider, Editor

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An Essential Piece of the Puzzle
continued from page 1

As Jagdish Bhagwati notes in his recent book, *In Defence of Globalisation*, if one is to discuss the merits of free trade effectively, one must not suffer from the fallacy that "if one is for free trade, one must be for free direct investment, for free capital flows, for free immigration, for free love, [and] for free everything else!" (Bhagwati, p. 8). Concerns over short-term capital flows or cultural and nationalistic issues, while perhaps valid, are not addressed. Furthermore, one must recognize that free trade, while necessary, is far from sufficient. Nobel-laureate Amartya Sen notes, "[Adam] Smith's intellectual arguments were partly aimed at countering the power and effectiveness of advocacy from entrenched interests" (Sen, p. 121). If the interests of the many are to supersede the interests of the few, nations require private property, the rule of law, a fair and effective judicial system, a healthy and educated population, a transparent and honest government, and free trade. Labelling protections for the few as "precapitalist" constraints, Sen went on to observe that "many of the restrictions that bedevil the functioning of economies in developing countries today are also, broadly, of this 'precapitalist' type" (Sen, p. 123). While no doubt a complex matter, free trade will surely serve the many above the few, reducing cruel and artificial poverty.

With such qualifiers in place, an examination of the most fashionable arguments against lowering trade restrictions is appropriate. Currently, global trade is far from free, with average tariffs of nearly 14.5 percent in low-income countries and 4 percent in industrial nations added to countless non-tariff barriers such as quotas, regulations, or slow border crossings (The World Bank [online]). Opponents argue that without such barriers, cost-minimizing corporations would relocate employment to lower-wage developing nations. Such positions confuse wages with unit costs, a more applicable measure. Highly productive workers, with access to machinery, computers, and an education, produce far more per hour than unproductive workers, and justifiably receive higher wages. Developing nation workers, on the other hand, do not have adequate capital access; their low productivity causes their low wages.

Nations ought to be collectively proud of having alternative-rich, highly productive, and high-wage labourers. Firms routinely eliminate positions and simultaneously create others of more value and usually higher pay. Consider the 70,000 US computer programmer positions "outsourced" between 1999 and 2003: replaced with over 115,000 better-paying software engineer positions (Drezner, p. 30). Consider also the 1990s, a time of amazing increases in global trade, increases in real wages, and declining unemployment rates. Moreover, despite representing a trivially small portion of total layoffs,[1] job migration is beneficial for both nations. It is comparative advantage at work, causing increased demand for the services that impoverished workers abroad can supply, increased supply of productive labour for more valuable uses, and reduced world-prices (increased real incomes) for all.

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Empirical studies, of which there are many, unmistakably link free and open trade with economic growth and poverty reduction. The *Economic Freedom of the World Report*, a noteworthy example, organized 123 countries into quintiles of economic freedom and found an average per capita income of US$873 for the poorest 10 percent of the population in the bottom quintile nations compared to US$6,681 for top quintile nations (Gwartney and Lawson, 2003). Of further note, it finds

1 "The Great Hollowing-Out Myth," *The Economist*, February 21, 2004: "Even at their peak in 2001, the number of all 'trade-related' layoffs represented a mere 0.6% of American unemployment."

no link between economic freedom and income inequality, with the portion of total GDP that low-income earners generate in their own nations roughly equal in all quintiles. Jeffrey Sachs and Andrew Warner paint an even clearer picture: over the two decades ending 1989, open economy developing and developed nations grew at an average annual rate of 4.49 and 2.29 percent, respectively, while their closed economy counterparts grew at a much smaller 0.69 and 0.74 percent (Sachs and Warner, p. 36). The gains available from a *full* liberalization of trade are, of course, difficult to quantify accurately. For perspective, though, consider the World Bank's estimate of $2.8 trillion in *extra* global income by 2015–$1.5 trillion of which should accrue to developing countries, lifting over 320 million people from poverty (The World Bank, 2002, p. 176). Critics, however, argue it is unclear if increased trade is a determinant, rather than a product, of economic growth. In response, Jeffrey Frankel and David Romer investigated cross-country geographic factors (which are powerful determinants of trade unaffected by national income) and consistently found trade-friendly geography *leads to* an increase in income per worker (Frankel and Romer, 1999). It is therefore entirely plausible to reap gains *from* trade to reduce global poverty.

The celebrated trade liberalization experiences in Asia demonstrate this significant relationship between economic growth, trade openness, and a reduction in poverty. In Taiwan between 1964 and 2000, researchers found a one-to-one relationship between growth in per-capita GDP and the growth in the mean income of the lowest quintile of the population (Tsai and Tsay, p. 149). More importantly, "every 1 percent increase in the share of the sum of imports and exports in GDP leads to 0.13 percent increase in the mean income of the poor *on top of that* brought about by economic growth" (Tsai and Tsay, p. 149. Emphasis added). This indicates a distributional effect from their liberalization efforts–allowing the lower income earners to reap larger gains. For a clearer illustration, consider the liberalization of Vietnam's rice sectors, to which 70 percent of the nation's households contribute, which increased the real price of rice by 27 percent between 1993 and 1998 and directly led to a 9 percent decline in child labour rates (Edmonds and Pavcnik). Free trade does not merely increase incomes but it improves lives.

... liberalizing Vietnam's rice sector... increased the real price of rice by 27 percent between 1993 and 1998 and directly led to a 9 percent decline in child labour rates.

The sector where free trade can most drastically reduce poverty levels is, sadly, also the sector most plagued by trade distortions. Each year, OECD nations provide US$311 billion in domestic price supports, import restrictions, and export subsidies, among other things, to their agricultural producers (OECD, p. 16). In Canada, for example, above-quota tariffs are nearly 300 percent for the dairy industry. The effect: the wealth of a small group, whose margins are the highest in the sector and whose net income is nearly 2.4 times the average for agricultural income (Statistics Canada), is artificially increased, with consumers and lower cost foreign producers bearing the greatest cost. Worse still, the United States provides over $3.9 billion in direct subsidies for its 25,000 cotton producers. The results: over-production of cotton, helping to halve world cotton prices between 1997 and 2002 (*The Economist,* 2003), further harming the lives of 10 million African cotton producers (Oxfam). Despite the ridiculous nature of these developed-nation supports, one must also note that larger protectionist measures exist in developing countries and are no less damaging.

Removing all trade-distorting domestic support will permit a natural world price for agricultural goods and create innumerable benefits for the entire world. The obvious benefits are immediate: a higher world price would increase the quantity of food output from developing nations, a greater quantity demanded of farm labour and, therefore, a greater wage rate for farm workers and increased local expenditures on non-farm output. These benefits are especially important given that three quarters of the 1.2 billion extremely poor people live in rural areas (IFAD [online]). Developing economies aside, freer agricultural trade would reduce food prices for developed nation consumers because higher world agricultural prices would still be lower than the price demanded by protected, high- cost domestic producers. Lower prices would disproportionately benefit the poor in

industrial economies and will free scarce tax revenue for tax cuts, debt repayments, or use in more appropriate spending areas. Eliminating such ill-founded policies would lessen poverty levels in all nations.

It is an audacious claim that free voluntary exchange fuels global poverty. The belief in isolation is a global tragedy–its expansion of unnecessary suffering, a global shame. Arguments for explicit trade-restricting policies between countries make as little sense as advocating such measures within countries; protectionist arguments are deeply distressing to those with a global perspective. Nations must seize the opportunity to trade away their poverty[2] for freedom, opportunity, and prosperity by ensuring this essential piece the puzzle is in place.

Vanessa Schneider (left) and Annabel Addington present Trevor Tombe with a certificate of completion at the Student Leaders Colloquium in May.

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2 To paraphrase a statement by Kofi Annan to the Canadian Parliament on March 9, 2004, broadcast on CPAC at approximately 7:45 a.m., PST.

Point Counterpoint: In Defence of Free Trade

by Shankar Kamath, Université de Montréal

Second Place Winner ($500), Fraser Institute Student Essay Contest 2004

The relationship between free trade, globalization, and poverty has been one of the most hotly debated economic issues over the last 20 years. Leaders of the anti-free trade movement such as Naomi Klein and José Bosé have become household names. Protests in Seattle and Quebec City as well as the collapse of the Cancun round of WTO trade talks dominated media headlines at times during the last few years.

Unlike most other economic issues, free trade and globalization and their effects on global poverty have struck a chord with the youth of developed countries. As such, the current debate is not within the academic world (within mainstream academia, the debate was settled long ago–in favour of free trade), but rather via popular culture. Thus, it is necessary to rebut arguments as they are presented by the "anti-globalization" youth of today.

As a student, I have exchanged ideas and debated with other young people on the merits of free trade. The following are the most common anti-free trade arguments expressed to me by friends and fellow students, most of which are variants on the issue of the effect of free trade on global poverty:

Statement: Free trade hasn't worked. The poor are getting poorer.

Rebuttal: Most anti-free trade activists take it as axiomatic that inequality and poverty are rising. The empirical evidence has shown this to be simply wrong. The extent to which economic growth reduces poverty is dependent on the poverty line in the income distribution; however, Sala-i-Martin (2002), Bourgignon and Morrisson (2002), and Bhalla (2002) all show rapidly decreasing rates of poverty in the last 20 years, both in proportional and absolute terms. Notably, Sala-i-Martin finds that the percentage of people living on less than $1 per day fell from 16 percent in 1970 to 5 percent in 1998. Chen and Ravaillon (2001), using a household-survey consumption measure rather than national account data, found a more modest reduction in the proportion of poor living in poverty, from 28 percent of world population in 1987 to a 24 percent in 1998, but a reduction nonetheless.

Furthermore, the positive relationship between free trade and economic growth was studied by Wacziarg and Welch (2002). They classified each of 140 countries as being either "open" or "closed" based on the Sachs-Warner (SW) criteria.[3] Using the SW criteria, the number of "open" economies, i.e., those that have embraced free trade and globalization, has increased from 16 percent in 1960 to 73 percent in 2000. Using panel-data regression analysis, Wacziarg and Welch found that the effect of trade liberalization on growth was an increase in the growth rate of real per capita GDP by 1.42 percent. That is, countries that went from "closed" to "open" between 1950 and 1998 by liberalizing trade saw, on average, real economic growth increase by 1.42 percent more than the rate experienced prior to trade liberalization (Wacziarg and Welch, 2002, Table 11, p. 70).

Statement: Free trade didn't work in Mexico and it caused the Asian financial crisis.

Rebuttal: Free trade policy is only one of several determinants of economic performance. Nobody should claim that trade liberalization is a panacea–it will not eliminate the business cycle, the need for sound monetary and fiscal policy, nor proper regulation of financial sectors.

3 Using the Sachs-Warner Criteria, Wacziarg and Welch classify countries as "closed" if one or more of the following are true:
a. Average tariff rates of 40% or more
b. Nontariff barriers covering 40% or more of trade
c. A black market exchange rate that is depreciated by 20% or more relative to the official exchange rate, on average, during the 1970s or 1980s
d. A state monopoly on major exports
e. A socialist economic system

The importance of the Wacziarg and Welch study is that they show that, *on average*, countries will experience faster economic growth after trade liberalization. Bergoing, Kehoe, Kehoe and Soto (2002) compare the Mexican and Chilean experiences after trade liberalization. Both countries were deeply affected by the worldwide debt crisis of the early 1980s; however, Chile's economy recovered relatively quickly whereas Mexico's did not. They conclude that, "The crucial differences between Chile and Mexico were in banking systems and bankruptcy laws: Chile was willing to pay the costs of reforming its banking system and of letting inefficient firms go bankrupt; Mexico was not." The point is that correlation is not necessarily causation.

The Asian financial crisis was undoubtedly a setback for Southeast Asia; however, it must be examined in context. The Asian Tigers (Hong Kong, Taiwan, South Korea, and Singapore) experienced GDP growth per worker of 5 to 6 percent annually from 1960-1997.[4] Even if trade liberalization contributed to the crisis, and there is very little evidence that it did, it is evident that the pros of free trade vastly outweigh the cons. Regardless, currency crises are not a new phenomenon caused by free trade and globalization–there were speculative attacks on the French franc in the 1920s and on the Bretton Woods system of exchange rates in the 1970s, which led to its collapse.

Statement: Free trade and globalization make wealthy people in the industrial world richer at the expense of developing world workers. The latter are paid a pittance to work in sweatshops and live in the slums surrounding Export Processing Zones (EPZs).

Rebuttal: To be sure, conditions in many developing world factories are extremely difficult. But they are an improvement over the alternatives available to developing world workers–rural farmers are emigrating in droves to cities in the hope of getting a job in the export-led manufacturing industry.

The self-righteous moral outrage and demand for international labour standards rings hollow. This is the result of guilt and angst, rather than economic considerations: "Unlike the starving subsistence farmer, the women and children in the sneaker factory are working at slave wages *for our benefit*" (Krugman, p. 80). The primary competitive advantage of developing countries is lower wages; without them, foreign investment would dry up and the manufacturing jobs would disappear. As Ernesto Zedillo said to the World Economic Forum in Davos, the opponents of free trade are trying to "to save the people of developing countries from… development" (Zedillo, 2000).

Market forces, and not government regulations, determine wages. Pakistanis are paid less than Americans for several reasons–they are less productive,[5] they lack political stability, mature private property and financial institutions, complementary infrastructure, and proximity to suppliers of key components. Bastos and Nasir (2004) note that to "improve productivity, increase output, and reduce poverty, policymakers should focus reform efforts on removing barriers to entry and creating open, highly competitive markets."

Statement: Free trade has destroyed the manufacturing economy and is increasing poverty in the western world.

Rebuttal: Unquestionably, free trade has put pressure on lower skilled workers in the developed world, while the major beneficiaries of free trade are workers in the developing world. But the claim that isolationism and protectionism are the answer is nothing new–Frederic Bastiat satirically noted in the nineteenth century that the sun offered unfair competition to candle makers and that the boarding up of windows during the day would create thousands of jobs.

Statement: Free trade has been selectively practised by western nations to the detriment of the developing world.

Rebuttal: On this, we can agree. Free trade and globalization are vague catch-all buzzwords. But, as with anything, the devil is in the details. The USA, the EU and Canada claim to practise (and vociferously preach) free trade; however, a closer look reveals stark hypocrisies. Agricultural products form the bedrock of developing countries' economies, yet they are still subject to onerous tariffs by developed countries. Moreover, lavish subsidies to the farmers of developed nations exacerbate the problem. Europe's Common Agricultural Policy (CAP) hurts both Eu-

4 World Bank Global Development Network Growth Database. Available at *http://www.worldbank.org/research/growth/GDNdata.htm.*
5 World Bank Global Development Network Growth Database.

ropean consumers (via higher taxes and artificially high prices) and developing world farmers. In 2002, President Bush signed into law a farm bill that increases agricultural subsidies to $180 billion over 10 years. Akande (2003) notes: "The developing world faces trade barriers costing them $200 billion per annum–twice as much as they receive in aid. Industrialized nations currently spend about $350 billion a year assisting their farmers, more than the economic output for all of Africa."

Statement: Less emphasis should be put on free trade and more on foreign aid.

Rebuttal: Some believe foreign aid should be increased. But history has shown that foreign aid promotes perpetual dependence and is usually ineffective and misplaced. Alesina and Dollar (1998) find that the allocation of foreign aid is usually determined by political, not economic, considerations. Boone (1995) reports that "aid does not significantly increase investment and growth, nor benefit the poor as measured by improvements in human development indicators, but it does increase the size of government."

There is no feasible alternative to free trade. Industrialization based on low wages is the only path to reduce poverty and increase economic growth in the developing world; any attempt to restrain it, well intentioned or not, only harms the world's poor.

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A Capital Idea

by Robert Embree

The American economic climate in the second half of 2003 and the first half of 2004 hardly seemed favourable. Inflation and the price of oil were creeping up, leading to fears of interest rate increases. The US was embroiled in an overseas conflict, and its military seemed to be stretching thin. Government spending had been ramped up on defence, education, agricultural subsidies, and a massive prescription-drugs giveaway, leading to a yawning $500 billion deficit. The Sarbanes-Oxley Act of 2002 represented one of the biggest increases in business regulation in decades. Why, then, did the American economy do so well between June 2003 and June 2004?

Four words: capital-based tax cuts. The Bush administration pushed through a reluctant Congress a bill to lower taxes on dividends from as high as 38.6 percent to 15 percent, cut the capital gains tax from 20 to 15 percent, and lower the marginal tax rate from 38.6 to 35 percent. The bill was designed as an economic stimulus package. Critics said that it was too big, too small, would cause inflation, would cause deflation, or just that it wouldn't work.[6] After all, the pundits reasoned, the 2001 tax cut hadn't stimulated the economy at all. Sharp observers, however, noted that the 2001 bill had been phased in, with its provisions being implemented over a decade, and that it had been largely scattershot, full of rebates and deductions, and largely leaving taxes on effective capital use high. The '03 plan was focused on cutting capital taxes, and would be implemented right away. The difference was noticeable.

Bush's tax cut was passed in May 2003. A few weeks later, unadjusted unemployment peaked at 6.5 percent. In the third quarter of 2003, the first full quarter after the tax cuts were implemented, the US economy grew by 8.2 percent, its fastest pace in 20 years. Capital expenditures rose by over 11 percent, non-farm business sales soared by 11.6 percent, and retail sales grew by 6.6 percent.[7] Job growth, which tends to lag slightly, picked up in early 2004. After only a year, unemployment had fallen by nearly a fifth to 5.3 percent, and some 1.5 million jobs had been created.[8]

The logic behind this is simple. Taxes on capital are taxes on investment. Investment is a very positive force; it creates jobs and boosts productivity, wages, and profits, creating a virtuous cycle as those profits are reinvested. So lower capital-based taxes will lead to more investment and economic growth, *ceteris paribus.*

This is a conclusion that Ottawa would do well to heed. With an unemployment rate stuck around 7.5 percent, the mantle of "Northern Tiger" seems somewhat faded. Given the disincentives to invest contained in our tax code, this is not surprising. Depending on which provinces and states you use for your calculations, and adjusting for sales taxes, the effective Canadian capital gains tax is nearly twice that of its American equivalent. Dividend taxes and the corporate capital tax are similarly bloated, although a complicated tax credit system does somewhat offset the negative impact of the former.

Any cut in taxes on capital formation, even a small one, would have a significant impact on employment and GDP growth. And it could easily be afforded, with a federal budget that spends over $9 billion on subsidies to agriculture, industry, crown corporations, and regional agencies. Despite relatively inflexible labour markets and a smothering welfare state, the Canadian economy is not doomed to permanently high unemployment and low rates of growth. In the first quarter of 2004, according to *The Economist*, Canada's GDP grew 1.6 percent compared to the year before.[9] America's grew 4.8 percent, three times faster. This is not magic or luck; it is the result of clear policy choices.

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6 Alan Fram, *CBS News*, May 23, 2005. Available at *http://www.cbsnews.com/stories/2003/05/23/politics/main555261.shtml..*
7 Larry Kudlow, *National Review*, October 31, 2003. Available at *http://www.nationalreview.com/kudlow/kudlow200310310926.asp.*
8 United States Department of Labor, Bureau of Labour Statistics. Available at *http://www.bls.gov/news.release/empsit.t01.htm.*
9 "Overview" (June 3, 2004). Available at *http://www.economist.com/displaystory.cfm?story_id=2730240&tranMode=none*

Things Folks Know that Just Ain't So...

by Keith Godin and Niels Veldhuis

What they know...

The "rich" don't pay taxes; they figure out ways to dodge them, creating a need for a more progressive tax system.

Why it ain't so...

It turns out that Canada already engages in significant taxation of those who are relatively well-off. In fact, people in high income groups pay the majority of taxes in Canada.

In order to analyze the relative income and tax positions of Canadians, we divide all Canadian families into three broad income groups based on income deciles. The first income decile is one of 10 groups that result from arranging families according to their total income before tax, from lowest to highest, and then selecting the 10 percent of families with the lowest incomes; the second decile is the next 10 percent of families, and so on. The lowest income group includes the families in the bottom three deciles; the middle group includes the next four deciles; the upper group includes the top three deciles. The resulting groups and their income distribution from 1976 to 2003 are presented in Table 1.

Table 1: Decile Distribution of Income Before Tax (%), 1976-2003

	Income Groups		
	Lower 3 deciles (%)	Middle 4 deciles (%)	Upper 3 deciles (%)
1976	8.8	31.7	59.5
1990	8.7	33.9	57.4
2000	8.1	32.1	59.8
2003	8.1	32.9	59.0

Table 1 reveals that the relative shares of the different income groups have been remarkably constant from 1976 to 2003. However, use caution when reading these numbers; aspects of the data make them susceptible to misinterpretation. First, the data fail to make any allowance for the age of individuals. This is important since age is a principal determinant of income. Failure to account for the age of income earners can lead to a considerably distorted impression of how the income distribution changes because there have been dramatic changes in the age structure of the population in Canada. Second, income data ignores income-in-kind that people receive from government. For example, the provision of housing, medical care, education, and other services from governments are the most substantial redistributive aspects of Canadian society and yet are not reflected in the income distributions. For these reasons, it is inappropriate to infer from table 1 that there has been little change in the distribution of income since 1976. What the data on the distribution of income does provide us with, however, is a yardstick against which to measure the distribution of taxes. This yardstick will allow us to infer whether, for example, groups of people with low income will bear a disproportionate share of the tax burden.

Table 2 delineates the decile distribution of taxes for 1976 to 2003.

Table 2: Decile Distribution of Taxes (%), 1976-2003

	Income Groups		
	Lower 3 deciles (%)	Middle 4 deciles (%)	Upper 3 deciles (%)
1976	6.1	27.3	66.5
1990	5.5	31.7	62.8
2000	4.4	29.7	65.9
2003	4.3	30.1	65.6

Table 2 shows that the largest portion of the tax burden ultimately settles on the higher income groups.[10]

10 Taxes include income taxes, property taxes, and sales taxes, as well as profit taxes, health, social security and employment taxes, import duties, license fees, taxes on the consumption of alcohol and tobacco ("sin" taxes), natural resource fees, fuel taxes, hospital taxes, and a host of other levies.

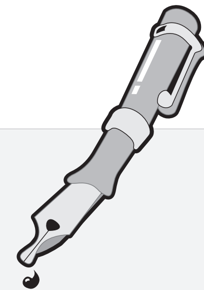
In 1976, families in the top three income deciles accounted for 66.5 percent of the total tax payments. While the total tax payments accounted for by the top three deciles dipped to 62.8 percent in 1990, as of 2003 they had risen to 65.6 percent. Conversely, over time the share paid by the lowest three income deciles fell from 6.1 percent in 1976 to 4.3 percent in 2003.

Combining the results of tables 1 and 2 reveals that, in 2003, the top 30 percent of families earned 59.0 percent of all income and paid 65.6 percent of all taxes. The bottom 30 percent earned 8.1 percent of all income and paid 4.3 percent of all taxes.

To economists these figures are nothing out of the ordinary. Our tax system is progressive. It is not surprising to find that those earning less pay less tax as a proportion of their income than those earning more. This result may, however, come as a surprise to activists and reporters who claim that the "rich" in Canada pay little or no taxes. As the data show, the "rich" bear most of Canada's taxation burden.

Reference

Veldhuis, Niels, Joel Emes, and Michael Walker (2004). *Tax Facts 13*. Vancouver, BC: The Fraser Institute.



Letter: On Fair Trade Coffee

Dear Editor:

Chris Schafer derides fair trade coffee with some tenuous arguments in the most recent issue of *Canadian Student Review*. Schafer falsely presents free trade and fair trade as opposites. What he misses is that fair trade coffee is an excellent example of the free market at work, and actually an example of the sort of free trade that he rightly encourages.

Here's the problem: As *The Economist* describes (see "Saving the Rainforest," July 22, 2004), consumers in first world countries are concerned that sections of rainforest are often felled to create coffee-growing terrain. These consumers are concerned either because they feel that such tree felling contributes to global warming, or because they inherently value such forests–even ones half-way around the world. Now, here's the great part: the free market has created a solution. Consumers with these preferences are willing to pay more for fair trade, shade-grown coffee. This labelling and monitoring program ensures that their concerns about environmental conditions are assuaged, and these consumers freely choose to pay for this extra.

Schafer may not share the concerns of consumers with an affinity for such coffee. The brilliance of the free market is that he is under no obligation to do so. But for consumers who do prefer fair trade coffee, the market has responded to their product demand–and they now have a choice.

Schafer is right to promote free trade–it does have the benefits that he described. But free and fair trade have a complementary relationship. Case in point: law enforcement is a problem in much of the third world where coffee is grown. Environmental agencies are underfunded and often open to bribes. Labour regulations are poorly enforced, if at all. Labelling programs like fair trade allow consumers in the first world to be sure that the growing country's laws were followed when their food was grown. This transfers the cost of monitoring and enforcing law-compliance to rich-world consumers who are willing to pay for such enforcement. Score one for the rule of law–an essential prerequisite for the free trade that Schafer trumpets. Fair trade improves free trade? Imagine that!

Finally, sales of fair trade coffee are facilitated by the very free trade that Chris Schafer promotes. Fair trade coffee that is traded between countries with low or no tariffs ensures that money remains in private hands where it is more likely to be efficiently spent, and, thanks to the virtues of free trade, isn't swallowed up by government tariffs that may be supporting a corrupt regime, or at any rate are likely to be spent inefficiently.

Joshua Prowse,
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