Worksheet 29.1

Fair Trade Coffee and Economic Development

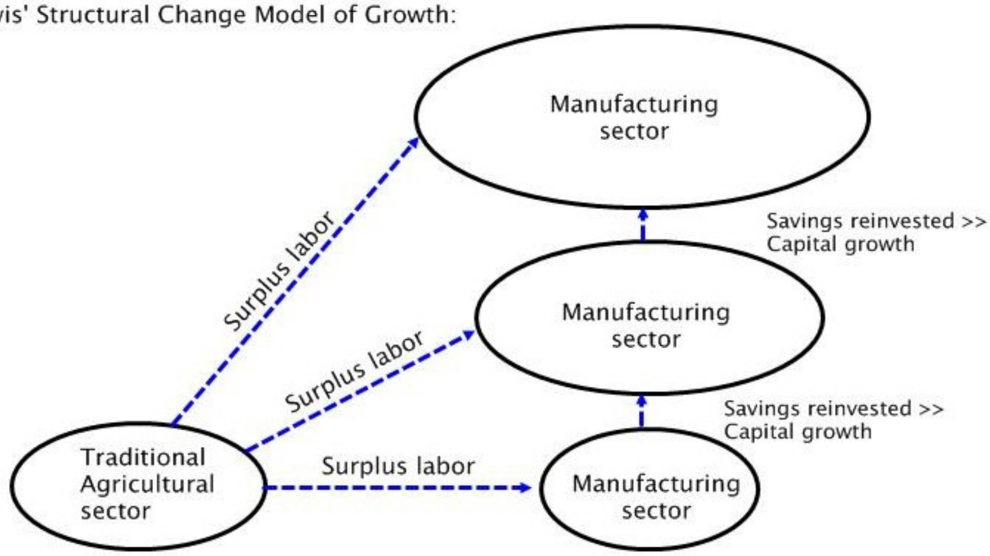
In recent years coffee consumers may have noticed more and more cafes are offering 'fair trade' coffee as an option. Usually, for an extra 10 or 20 cents per cup, you can get a beverage made from beans that were grown by farmers earning living wages and working in safe and sustainable environments. In some cases, 'fair trade' coffee is of higher standards, representing a higher quality product. The premium paid by consumers, in theory, will eventually result in better standards of living for coffee farmers and their families.

Mike Munger, chair of Duke University's economics department, argues that 'fair trade' products, while they may represent good intentions, probably don't do much to help poor farmers. While the full podcast offers even more reasons, the clip below presents one clear explanation of why 'fair trade' may actually make poor farmers worse off.

Listen to this interview.

Then read the rest of this worksheet and answer the questions at the bottom.

Lewis' Structural Change Model of Growth:



Professor Munger goes on to discuss a popular economic development model known as Lewis' Structural Change model, seen above. According to the model, the path towards economic growth, which should create conditions that lead to economic development, requires the transition of workers from the low-productivity agricultural sector to the capital-intensive, high productivity manufacturing sector.

China, in its own economic growth, has demonstrated the success of this model, which involved rural to urban migration, employment of surplus labor from the farming sector in the industrial sector, giving workers access to capital, increasing productivity, output, income, saving, and investment, putting an economy on a path towards growth and development.

According to Munger, 'fair trade' premiums paid to poor farmers create a disincentive for a farmer to migrate to the higher productivity industrial sector that may be emerging in his country. In essence, coffee drinkers in the rich world are offering a subsidy to farmers in the poor world aimed at keeping them poor. If the path to wealth and prosperity requires the transition to a capital-intensive industrial economy, then subsidies to poor farmers are only reducing the likelihood that they'll achieve significant increases in income and savings.

Munger's views are interesting and controversial. Consumers who willingly pay a premium to buy coffee that they believe is helping farmers in the developing world may take issue with the view that rewarding farmers to remain farmers is limiting the development potential of poor countries.

Question:

1. How is a fair trade scheme meant to work?
2. Economics is all about incentives, how does rewarding coffee farmers in the developing world by paying them more for their beans affect the incentive system that guides the decisions individuals make in developing countries?
3. Is industrialization the only path to economic development?