Lecture 11: Midterm Review and Trade Wrap-Up

Benjamin Graham
Today’s Plan

• Housekeeping
• Extensions/Applications: Fair Trade
• Midterm Review: A chance to ask questions
Housekeeping

• IR in DC program (Spring 2014)
  • Come by THH 332 for a one-on-one chat with the director, Dr. Jeffrey Fields, on Thursday October 2nd or Thursday October 9th from 10am - 4pm.
Fair Trade(1): Why Trade is “Unfair”

- The gains from trade are generated by increases in efficiency and corresponding decreases in the price of traded goods. However:
- Trade is “unfair” when prices are so low that:
  - Producers cannot maintain a reasonable quality of life
  - When producers cannot afford to follow sustainable environmental practices
  - When traditional producers (e.g. family farmers, traditional artisans) cannot afford to stay in business
What Causes Prices to be Too Low?

- Sometimes the issue isn’t the world price, it’s the price paid to producers.
  - “Farm-gate” price vs. world wholesale price
- In an efficient market, the only difference between these two prices are the costs of shipping and storage
- In inefficient markets:
  - Middlemen have monopolies,
  - Producers have poor information
  - Coercion
Raising Farm-Gate Prices

• How do we get the farm-gate price closer to the world price?

• Solutions:
  • Transportation infrastructure
  • Cell phones have helped the information problem
  • Producer co-operatives (i.e. fair trade co-ops)
    • Can internalize storage and shipping, provide information, combat coercion
What if the World Price is Too Low?

- Market segmentation:
  - One price for goods produced in unsustainable ways or by non-traditional producers
  - One price (higher) for goods produced in sustainable ways and by traditional producers
- Solution 1: Rich countries block imports of goods from producers that don’t meet labor and environmental standards
  - Results in higher prices for all consumers in that country
  - May violate WTO rules
- Solution 2: Product labeling and certification
  - Consumers may choose to pay extra for commodities certified as “fair trade”
Issues with Labeling and Certification

- Lack of agreement on definition of “fair trade”
  - Fragmentation of certifying organizations
- Limited willingness to pay of consumers
- Costs of certification to producers

Takeaway: If consumers are willing to pay a premium, and the logistical problems of labeling can be solved, then prices paid to sustainable and traditional producers can be raised.
Other things that fall under the fair trade umbrella

- Problem: Access to credit for producers
  - Credit is expensive in developing countries (i.e. high interest rates)
  - Solutions: Subsidized loans or pre-paying by buyers
- Problem: Volatility in prices and output
  - Solutions: Long-term contracts from buyers, crop insurance
The Midterm Exam

- Key Terms, Short Answer, Mini-Essay
- Key terms:
  - Definition: 1 sentence.
  - Relevance: 1-3 sentences
  - Example: 1-3 sentences
- Short Answer: 1 sentence is all it takes, sometimes just 1 word.
- Mini-Essay: 3-6 Sentences.
  - There will be multiple points we’re looking for