KEY ISSUE 4

Why Do Countries Face Obstacles to Development?

- Two Paths to Development
- Financing Development
- Making Progress in Development

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Learning Outcome 9.4.1
Summarize the two paths to development.

The gap between rich and poor countries is substantial. Poorer countries lack much of what people in richer countries take for granted, such as access to electricity, safe drinking water, and paved roads. To reduce disparities between rich and poor countries, developing countries must develop more rapidly. This means increasing per capita GNI more rapidly and using the additional funds to make more rapid improvements in social and economic conditions. Developing countries face two fundamental obstacles in trying to encourage more rapid development:

- Adopting policies that successfully promote development
- Finding funds to pay for development

Two Paths to Development

To promote development, developing countries choose one of two models:

- **Self-sufficiency.** In the self-sufficiency model, countries encourage domestic production of goods, discourage foreign ownership of businesses and resources, and protect their businesses from international competition.
- **International trade.** In the international trade model, countries open themselves to foreign investment and international markets.

Each has important advantages and faces serious challenges.

For most of the twentieth century, self-sufficiency, or balanced growth, was the more popular of the development alternatives. International trade became more popular beginning in the late twentieth century. However, the global economic slowdown since 2008 has caused some countries to question the international trade approach.

SELF-SUFFICIENCY PATH

Key elements of the self-sufficiency path to development include the following:

- Barriers limit the import of goods from other places. Three widely used barriers include setting high taxes (tariffs) on imported goods to make them more expensive than domestic goods, fixing quotas to limit the quantity of imported goods, and requiring licenses in order to restrict the number of legal importers.
- Fledgling businesses are nursed to success by being isolated from competition with large international corporations. Such insulation from the potentially adverse impacts of decisions made by businesses and governments in developed countries encourages a country's fragile businesses to achieve independence.
- Investment is spread as equally as possible across all sectors of a country's economy and in all regions.
- Incomes in the country side keep pace with those in the city, and reducing poverty takes precedence over encouraging a few people to become wealthy consumers. The pace of development may be modest, but the system is fair because residents and enterprises throughout the country share the benefits of development.

CASE STUDY: INDIA'S QUEST FOR DEVELOPMENT. For several decades after it gained independence from Britain in 1947, India was a leading example of the self-sufficiency strategy. India made effective use of many barriers to trade:

- To import goods into India, most foreign companies had to secure a license, which was a long and cumbersome process because several dozen government agencies had to approve the request (Figure 9-50).
- Once a company received an import license, the government severely restricted the quantity of goods it could sell in India.
- The government imposed heavy taxes on imported goods, which doubled or even tripled the prices to consumers.

▼ **FIGURE 9-50 SELF-SUFFICIENCY: INDIA** Clerks work on the street in Delhi, India.

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- Indian businesses were discouraged from producing goods for export.
- Indian money could not be converted to other currencies.

Effectively cut off from the world economy, businesses were supposed to produce goods for consumption inside India:

- A business needed government permission to sell a new product, modernize a factory, expand production, set prices, hire or fire workers, and change the job classification of existing workers.
- If private companies were unable to make a profit selling goods only inside India, the government provided subsidies, such as cheap electricity, or wiped out debts.
- The government owned not just communications, transportation, and power companies, which is common around the world, but it also owned businesses such as insurance companies and automakers, which are left to the private sector in most countries.

By following the self-sufficiency path, India achieved only modest development.

INTERNATIONAL TRADE PATH

The international trade model of development calls for a country to identify its distinctive or unique economic assets. What animal, vegetable, or mineral resources does the country have in abundance that other countries are willing to buy? What product can the country manufacture and distribute at a higher quality and a lower cost than other countries? According to the international trade approach, a country can develop economically by concentrating scarce resources on expansion of its distinctive local industries. The sale of these products in the world market brings funds into the country that can be used to finance other development.

ROSTOW MODEL. A pioneering advocate of the international trade approach was W. W. Rostow, who in the 1950s proposed a five-stage model of development. Several countries adopted this approach during the 1960s, although most continued to follow the self-sufficiency approach. The five stages were as follows:

1. **Traditional society.** A traditional society has not yet started a process of development. It contains a very high percentage of people engaged in agriculture and a high percentage of national wealth allocated to what Rostow called "nonproductive" activities, such as the military and religion.
2. **Preconditions for takeoff.** An elite group initiates innovative economic activities. Under the influence of these well-educated leaders, the country starts to invest in new technology and infrastructure, such as water supplies and transportation systems. Support from international funding sources often emphasizes the importance of constructing new infrastructure. These projects will ultimately stimulate an increase in productivity.
3. **Takeoff.** Rapid growth is generated in a limited number of economic activities, such as textiles or food products. These few takeoff industries achieve technical advances and become productive, whereas other sectors of the economy remain dominated by traditional practices.
4. **Drive to maturity.** Modern technology, previously confined to a few takeoff industries, diffuses to a wide variety of industries, which then experience rapid growth comparable to the growth of the take off industries. Workers become more skilled and specialized.
5. **Age of mass consumption.** The economy shifts from production of heavy industry, such as steel and energy, to consumer goods, such as motor vehicles and refrigerators.

According to the international trade model, each country is in one of these five stages of development:

INTERNATIONAL TRADE EXAMPLES. When most developing countries were following the self-sufficiency approach during the twentieth century, two groups of countries chose the international trade approach:

- **The Four Asian Dragons.** Among the first places to adopt the international trade path were South Korea, Singapore, Taiwan, and Hong Kong known as the "four dragons," Singapore and Hong Kong, British colonies until 1965 and 1997, respectively, were large cities surrounded by very small amounts of rural land and had virtually no natural resources. Lacking many natural resources, the four dragons promoted development by concentrating on producing a handful of manufactured goods, especially clothing and electronics. Low labor costs enabled these countries to sell products inexpensively in developed countries.
- **Petroleum-rich Arabian Peninsula states.** The Arabian Peninsula includes Saudi Arabia, the region's largest and most populous country, as well as Kuwait, Bahrain, Oman, and the United Arab Emirates. Once among the world's least developed countries, they were transformed overnight into some of the wealthiest countries, thanks to escalating petroleum prices beginning in the 1970s. Arabian Peninsula countries used petroleum revenues to finance large-scale projects, such as housing, highways, hospitals, airports, universities, and telecommunications networks. Their steel, aluminum, and petrochemical factories competed on world markets with the help of government subsidies. The landscape of these countries has been further changed by the diffusion of consumer goods, such as motor vehicles and electronics. Supermarkets in Arabian Peninsula countries are stocked with food imported from Europe and North America.

Pause and Reflect 9.4.1

Many countries that have adopted the international trade model are relatively small states (see Chapter 8). Why might a nation's size be a factor in the early adoption of the international trade path?

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SHORTCOMINGS OF THE TWO DEVELOPMENT PATHS

Learning Outcome 9.4.2
Analyze shortcomings of the two development paths and give reasons why international trade has triumphed.

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Shortcomings have been identified with both the self-sufficiency and international trade paths to development.

SELF-SUFFICIENCY CHALLENGES. The experience of India and other developing countries with self-sufficiency revealed two major difficulties:

- **Protection of inefficient businesses.** Businesses could sell all they made, at high government-controlled prices, to customers culled from long waiting lists, so they had little incentive to improve quality, lower production costs, reduce prices, or increase production. Companies protected from international competition were not pressured to keep abreast of rapid technological changes or give high priority to sustainable development and environmental protection.
- **Need for large bureaucracy.** The complex administrative system needed to administer the controls encouraged inefficiency, abuse, and corruption. A large number of people were employed in countries such as India to fill out documents that other countries considered unnecessary intrusions into the prerogatives of private businesses. Potential entrepreneurs found that struggling to produce goods or offer services was less rewarding financially than advising others how to get around the complex government regulations. Other potential entrepreneurs earned more money by illegally importing goods and selling them at inflated prices on the black market.

INTERNATIONAL TRADE CHALLENGES. Three difficulties have hindered countries outside the four Asian dragons and the Arabian Peninsula from developing through the international trade approach:

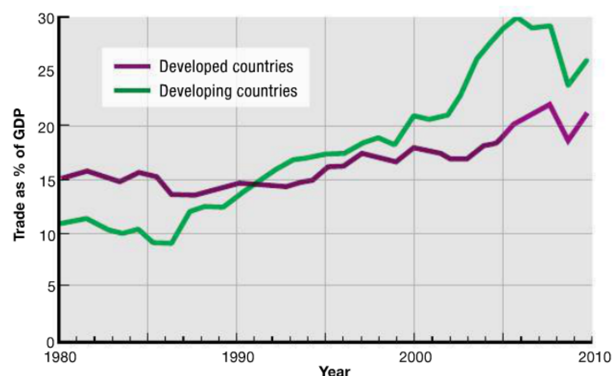
- **Uneven resource distribution.** Arabian Peninsula countries achieved successful development by means of rising petroleum prices. Other countries, however, have found that the prices of their commodities have not increased and in some cases have actually decreased. Developing countries that have depended on the sale of one product have suffered if the price of their leading commodity did not rise as rapidly as the cost of the products they needed to buy. For example, Zambia has extensive copper reserves, but it has been unable to use this asset to promote development because of declining world prices for copper.
- **Increased dependence on developed countries.** Building up a handful of take off industries that sell to people in developed countries may force developing countries to cut back on production of food, clothing, and other necessities for their own people. Rather than finance sustainable development that is environmentally sensitive, these countries may need to use funds generated from the sale of products to other countries to buy these necessities from developed countries for the employees of the take off industries.
- **Market decline.** Countries that depend on selling low-cost manufactured goods find that the world market for many products has declined sharply in recent years. Even before the recent severe recession, developed countries had limited growth in population and market size.

INTERNATIONAL TRADE APPROACH TRIUMPHS

Most countries embraced the international trade approach as the preferred alternative for stimulating development in the late twentieth century. During the late twentieth and early twenty-first centuries trade increased more rapidly than wealth (as measured by GDP), a measure of the growing importance of the international trade approach, especially in developing countries (Figure 9-51).

Optimism about the benefits of the international trade development model was based on three observations:

- Developed countries in Europe and North America were joined by others in Southern and Eastern Europe and Japan during the second half of the twentieth century. If they could become more developed by following this model, why couldn't other countries?
- Developing countries contained an abundant supply of many raw materials sought by manufacturers and producers in developed countries. In the past, European colonial powers extracted many of these resources without paying compensation to the colonies. In a global economy, the sale of these raw materials could generate funds for developing countries with which they could promote development.



▲ **FIGURE 9-51 WORLD TRADE AS A PERCENTAGE OF INCOME**
Trade as a percentage of GDP increased rapidly in developing countries, beginning in the 1990s. The severe recession that began in 2008 caused a sharp decline in trade.

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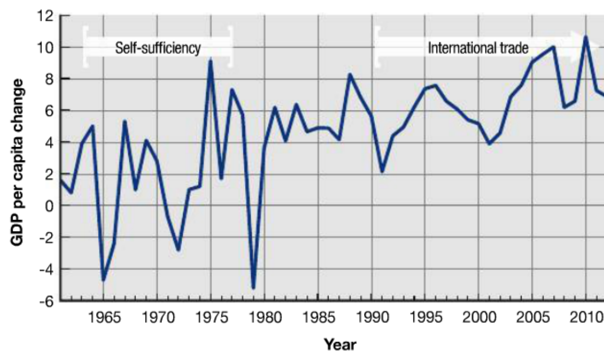
- A country that concentrates on international trade benefits from exposure to the demands, needs, and preferences of consumers in other countries. To remain competitive, the take off industries constantly evaluate changes in international consumer preferences, marketing strategies, production engineering, and design technologies. Concern for international competitiveness in the exporting take off industries can filter through other sectors of the economy.

Longtime advocates of the self-sufficiency approach converted to international trade during the 1990s. India, for example, dismantled its formidable collection of barriers to international trade:

- Foreign companies were allowed to set up factories and sell in India.
- Tariffs and restrictions on the import and export of goods were reduced or eliminated.
- Monopolies in communications, insurance, and other industries were eliminated.
- With increased competition, Indian companies have improved the quality of their products.

During the self-sufficiency era, India's auto industry was dominated by Maruti-Udyog Ltd., which was controlled by the Indian government. Nursed by import duties that rose from 15 percent in 1984 to 66 percent in 1991, Maruti captured more than 80 percent of the Indian market by selling cars that would be considered out-of-date in other countries. In the international trade era, the government sold control of Maruti to the Japanese company Suzuki, which now holds only 45 percent of India's market.

Countries like India converted from self-sufficiency to international trade during the 1990s because of overwhelming evidence at the time that international trade better promoted development (Figure 9-52). After converting to international trade, India's GNI per capita increased on average 6.5 percent per year, compared to 1.8 percent per year under self-sufficiency. Worldwide, GNI increased more than 4 percent annually in countries strongly oriented toward international trade compared with less than 1 percent in countries strongly oriented toward self-sufficiency.



▲ **FIGURE 9-52 GDP PER CAPITA CHANGE IN INDIA** India's per capita GDP has grown much more rapidly since the country converted from the self-sufficiency model to the international trade model.

WORLD TRADE ORGANIZATION

To promote the international trade development model, countries representing 97 percent of world trade established the World Trade Organization (WTO) in 1995. The WTO works to reduce barriers to international trade in two principal ways. First, through the WTO, countries negotiate reduction or elimination of international trade restrictions on manufactured goods, such as government subsidies for exports, quotas for imports, and tariffs on both imports and exports. Also reduced or eliminated are restrictions on the international movement of money by banks, corporations, and wealthy individuals.

The WTO also promotes international trade by enforcing agreements. One country can bring to the WTO an accusation that another country has violated a WTO agreement. The WTO is authorized to rule on the validity of the charge and order remedies. The WTO also protects intellectual property in the age of the Internet. An individual or a corporation can also bring charges to the WTO that someone in another country has violated a copyright or patent, and the WTO can order illegal actions to stop.

Critics have sharply attacked the WTO. Protesters routinely gather in the streets outside high-level meetings of the WTO (Figure 9-53). Progressive critics charge that the WTO is antidemocratic because decisions made behind closed doors promote the interests of large corporations rather than poor people. Conservatives charge that the WTO compromises the power and sovereignty of individual countries because it can order changes in taxes and laws that it considers unfair trading practices.

Pause and Reflect 9.4.2

Top WTO officials meet every two years in a so-called ministerial conference. Where was the most recent conference held? Google "WTO ministerial conference" to find out and to see if there were protests at the conference.

▼ **FIGURE 9-53 WORLD TRADE ORGANIZATION PROTEST** South Korean farmers march in protest during 2005 WTO meetings in Hong Kong.

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Financing Development

Learning Outcome 9.4.3

Identify the main sources of financing development.

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Developing countries lack money to fund development, so they obtain financial support from developed countries. Finance comes from two primary sources: direct investment by transnational corporations and loans from banks and international organizations.

FOREIGN DIRECT INVESTMENT

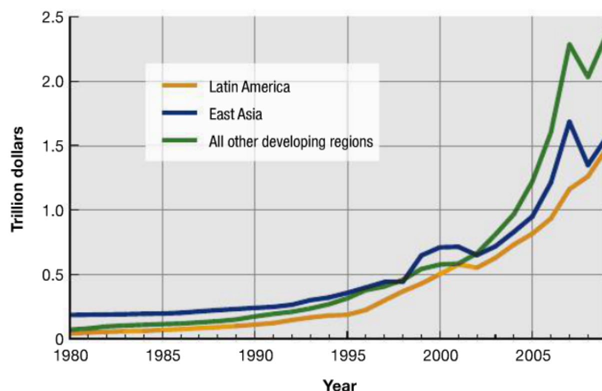
International trade requires corporations based in a particular country to invest in other countries. Investment made by a foreign company in the economy of another country is known as **foreign direct investment (FDI)**.

Foreign direct investment grew rapidly during the 1990s, from $130 billion in 1990 to $1.5 trillion in 2000 and 2010. FDI does not flow equally around the world (Figure 9-54). Only two-fifths of foreign investment in 2010 went from a developed country to a developing country; the other three-fifths went from one developed country to another. And FDI is not evenly distributed among developing countries. In 2010, nearly 40 percent of all FDI destined for developing countries went to China, and 20 percent went to Brazil, Russia, and Singapore.

The major sources of FDI are transnational corporations that invest and operate in countries other than the one in which the company headquarters are located. Of the 500 largest transnational corporations in 2011, 384 had headquarters in developed countries, including 133 in the United States and 164 in Europe. China was the location of 61 of the 116 with headquarters in developing countries.

Pause and Reflect 9.4.3

Fortune magazine names the 500 largest transnational corporations every year. What is the world's largest transnational corporation?



▲ **FIGURE 9-54 GROWTH IN FOREIGN DIRECT INVESTMENT** East Asia and Latin America have received the most FDI.

LOANS

The two major lenders to developing countries are the World Bank and the International Monetary Fund (IMF):

- **World Bank.** The World Bank includes the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA). The IBRD provides loans to countries to reform public administration and legal institutions, develop and strengthen financial institutions, and implement transportation and social service projects (Figure 9-55). The IDA provides support to poor countries considered too risky to qualify for IBRD loans. The IBRD has loaned about $400 billion since 1945, primarily in Europe and Latin America (Figure 9-56), and the IDA has loaned about $150 billion since 1960, primarily in Asia and Africa. The IBRD lends money raised from sales of bonds to private investors; the IDA lends money from government contributions.
- **International Monetary Fund (IMF).** The IMF provides loans to countries experiencing balance-of-payments problems that threaten expansion of international trade. IMF assistance is designed to help a country rebuild international reserves, stabilize currency exchange rates, and pay for imports without the imposition of harsh trade restrictions or capital controls that could hamper the growth of world trade. Unlike development banks, the IMF does not lend for specific projects. Funding of the IMF is based on each member country's relative size in the world economy.

The World Bank and IMF were conceived at a 1944 United Nations Monetary and Financial Conference in Bretton Woods, New Hampshire, to promote economic development and stability after the devastation of World War II and to avoid a repetition of the disastrous economic policies contributing to the Great Depression of the 1930s. The IMF and World Bank became specialized agencies of the UN when it was established in 1945.

Developing countries borrow money to build new infrastructure, such as hydroelectric dams, electric transmission lines, flood-protection systems, water supplies, roads, and hotels. The theory is that new infrastructure will make conditions more favorable for domestic and foreign businesses to open or expand. After all, no business wants to be located in a place that lacks paved roads, running water, and electricity.

In principle, new or expanded businesses are attracted to an area because improved infrastructure will contribute additional taxes that the developing country will use in part to repay the loans and in part to improve its citizens' living conditions. In reality, the World Bank itself has judged half of the projects it has funded in Africa to be failures. Common reasons include the following:

- Projects don't function as intended because of faulty engineering.
- Recipient nations squander or spend aid on armaments, or the aid is stolen.
- New infrastructure does not attract other investment.

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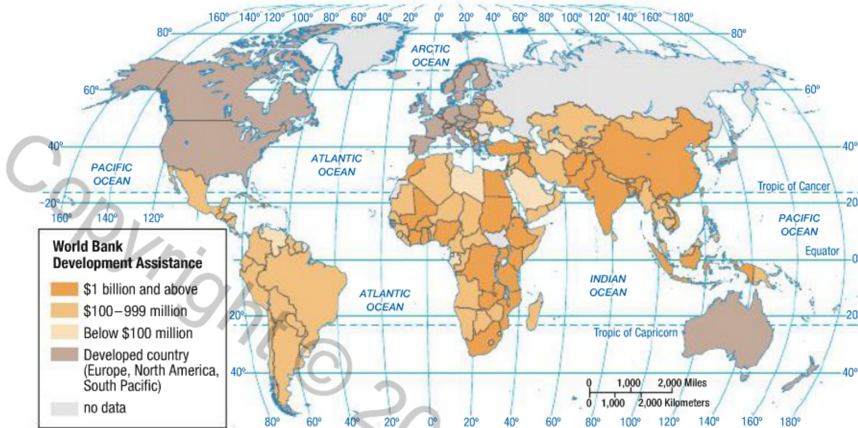

◀ **FIGURE 9-55 WORLD BANK DEVELOPMENT ASSISTANCE** Iraq and Afghanistan have been the leading recipients of aid.

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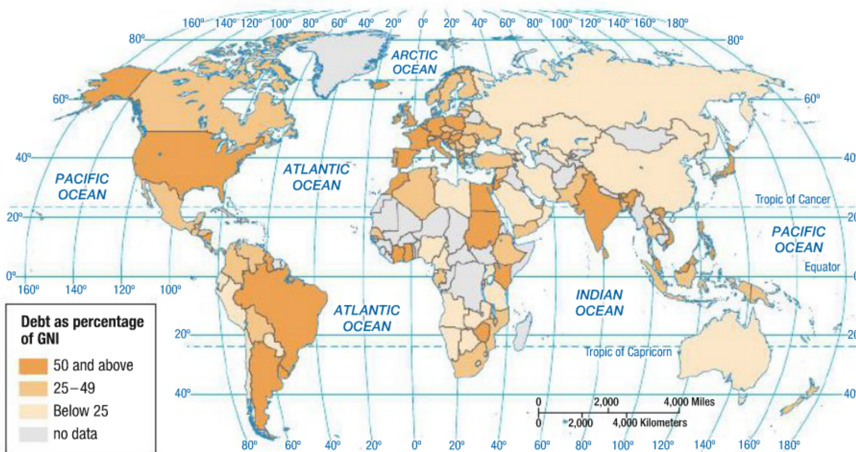
▲ **FIGURE 9-56 WORLD BANK INVESTMENT PROJECT** The World Bank has assisted in the reconstruction of Haiti after the devastating earthquake in 2010.

Many developing countries have been unable to repay the interest on their loans, let alone the principal (Figure 9-57). Debt actually exceeds annual income in a number of countries. When these countries cannot repay their debts, financial institutions in developed countries refuse to make further loans, so construction of needed infrastructure stops. The inability of many developing countries to repay loans also damages the financial stability of banks in developed countries.

The economic downturn that started in 2008 also revealed that many developed countries also have extremely high debts. Among developed countries, especially high debts have been incurred by European countries, including Ireland, Italy, Greece, Portugal, and Spain.



◀ **FIGURE 9-57 DEBT AS A PERCENTAGE OF GNI** Developed countries have joined developing countries in accumulating substantial debts.

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FINANCING CHALLENGES IN DEVELOPING COUNTRIES

Learning Outcome 9.4.4
Explain problems with financing development in developing and developed countries.

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The IMF, World Bank, and developed countries fear that granting, canceling, or refinancing debts without strings attached will perpetuate bad habits in developing countries. Therefore, to apply for debt relief, a developing country is required to prepare a Policy Framework Paper (PFP) outlining a **structural adjustment program**, which includes economic goals, strategies for achieving the objectives, and external financing requirements.

A structural adjustment program includes economic "reforms" or "adjustments." Requirements placed on a developing country typically include:

- Spending only what it can afford
- Directing benefits to the poor, not just the elite
- Diverting investment from military to health and education spending
- Investing scarce resources where they will have the most impact
- Encouraging a more productive private sector
- Reforming the government, including making the civil service more efficient, increasing accountability in accountable fiscal management, implementing more predictable rules and regulations, and disseminating more information to the public

Critics charge that poverty worsens under structural adjustment programs. By placing priority on reducing government spending and inflation, structural adjustment programs may result in the following:

- Cuts in health, education, and social services that benefit the poor
- Higher unemployment
- Loss of jobs in state enterprises and civil service
- Less support for those most in need, such as poor pregnant women, nursing mothers, young children, and elderly people

In short, structural reforms allegedly punish Earth's poorest people for actions they did not commit, such as waste, corruption, misappropriation, and military buildup.

International organizations respond that the poor suffer more when a country does not undertake reforms. Economic growth is what benefits the poor the most in the long run. Nevertheless, in response to criticisms, the IMF and the World Bank now encourage innovative programs to reduce poverty and corruption and consult more with average citizens. A safety net must be included to ease short-term pain experienced by poor people.

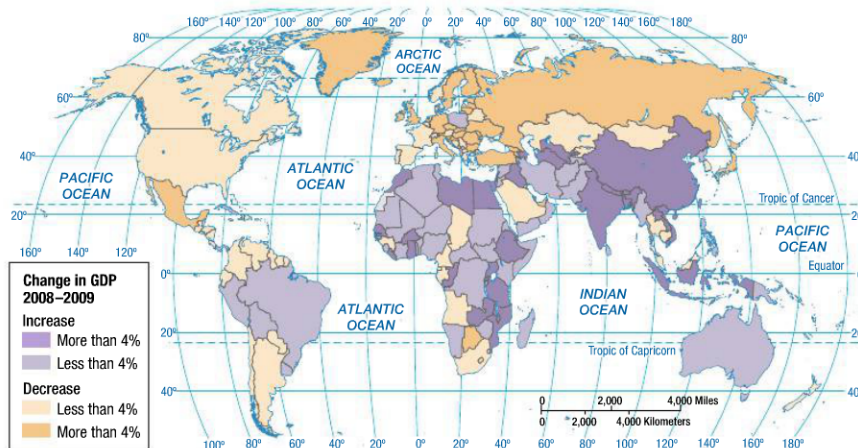
FINANCING CHALLENGES IN DEVELOPED COUNTRIES

Developed countries were especially hard hit by the severe economic downturn that began in 2008. GDP per capita declined between 2008 and 2009 in nearly all developed countries (Figure 9-58). The economic difficulties in developed regions spilled over into developing regions that were especially dependent on international trade, especially Latin America with North America and Southwest Asia with Europe. Citizens and political leaders in many developed countries questioned the benefits of orienting a country's economy to facilitate international trade, especially in Europe.

WIDENING INEQUALITY. Through most of the twentieth century, the gap between rich and poor narrowed in developed countries. Inequality was reduced because developed countries used some of their wealth to extend health care and education to more people, and to provide some financial assistance to poorer people.

Since 1980, however, inequality has increased in most developed countries, including the United States and the United Kingdom (Figure 9-59). In 2010, the richest 1 percent of Americans held 20 percent of the wealth, and 421 billionaires (representing 0.0001 percent of the population) held more than 10 percent of the wealth in the United States.

The severe recession exacerbated an inequality trend that



▲ **FIGURE 9-58 GDP PER CAPITA CHANGE, 2008–2009** GNI per capita declined in nearly all developed countries. East and South Asia were the principal regions with increases.

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had begun a quarter-century earlier. Many Americans perceived that it was unfair for very large banks to be rescued by the government and to quickly resume making substantial profits, at a time when the income of most Americans was stagnant or declining.

Pause and Reflect 9.4.4
What government policies have helped to increase the share of wealth held by the top 1 percent? What policies have tried to reduce that share?

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STIMULUS OR AUSTERITY? Political leaders and independent analysts have been sharply divided on the optimal strategy for fighting the severe economic downturn:

- **Stimulus strategy.** Proponents of stimulus argue that during a downturn, governments should spend more money than they collect in taxes. Governments should stimulate the economy by putting people to work building bridges and other needed infrastructure projects. Once the economy recovers, they say, people and businesses will be in position to pay more taxes to pay off the debt.
- **Austerity strategy.** Proponents of austerity argue that government should sharply reduce taxes so that people and businesses can revive the economy by spending their tax savings. Spending on government programs should be sharply cut as well in order to keep the debt from swelling and hampering the economy in the future.

In the United States, the stimulus strategy was initially employed by Presidents Bush and Obama. After the success of Tea Party candidates in 2010, more attention was paid to the austerity strategy. European countries divided between supporting stimulus and austerity. The lack of agreement has led to serious difficulties in Europe and may possibly result in the demise of the euro currency.

EUROPE'S SOVEREIGN DEBT CRISIS. Europe has faced an especially difficult challenge in responding to the sharp economic slowdown of the early twenty-first century. Economic difficulties call into question the region's ability to continue supporting the international trade development path.

Most European countries had adopted the euro as their common currency in 1999. Europeans believed that if every country in the region operated with the same currency, trade within the region would be enhanced. In reality, once the severe economic downturn hit, having each country saddled with the same currency proved to be a burden for the countries in Europe that had weaker economies.

Consider Germany and Italy. Germany has a strong economy, with businesses producing cars, electronics, and other goods at higher quality and lower cost than can be done in Italy. If Germany and Italy had two different currencies, as in the past, Italy could lower the value of its currency so that German goods cost more and Italian goods cost less. But with both countries using the same currency, the euro, Italy no longer has that option.

The Northern European countries argue that the Southern European countries with weaker economies need to adopt austerity programs, similar to those imposed on developing countries through structural adjustment programs. The Southern European countries argue that Northern European countries with stronger economies should fund stimulus programs that would in the long run lead to more prosperity through Europe as a whole.

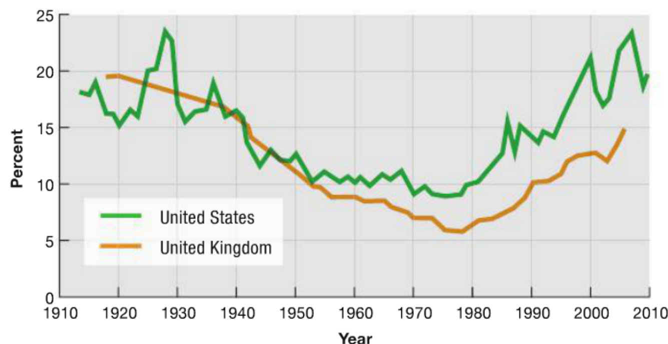

FIGURE 9-59 TOP 1% INCOME SHARE The percent of national wealth held by the richest 1 percent of people in the United States and the United Kingdom declined during most of the twentieth century, but has increased since 1980.

HOUSING BUBBLE

The heart of the global economic crisis was the poor condition of many banks and other financial institutions in developed countries. A number of financial institutions closed or were rescued by governments in North America and Europe. The shaky status of many financial institutions resulted from making loans to businesses and individuals that could not be repaid, especially after the bursting of the housing bubble beginning in 2007.

As discussed in Chapter 1, a housing bubble is a rapid increase in the value of houses followed by a sharp decline in their value. In 1637, the world's first recorded bubble occurred in the Netherlands, when tulip bulbs rapidly increased greatly in price and just as suddenly decreased.

Refer ahead on the next page to Figure 9-60, which shows the housing bubble that occurred in the United States during the first decade of the twenty-first century. The price of an average house in the United States increased rapidly from 1998 to 2006 and then decreased rapidly between 2006 and 2009 down to the level in 2002. Most developed countries and some developing ones experienced housing bubbles during the first decade of the twenty-first century.

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FAIR TRADE

Learning Outcome 9.4.5
Explain the principles of fair trade.

Fair trade has been proposed as a variation of the international trade model of development that promotes sustainability. **Fair trade** is commerce in which products are made and traded according to standards that protect workers and small businesses in developing countries.

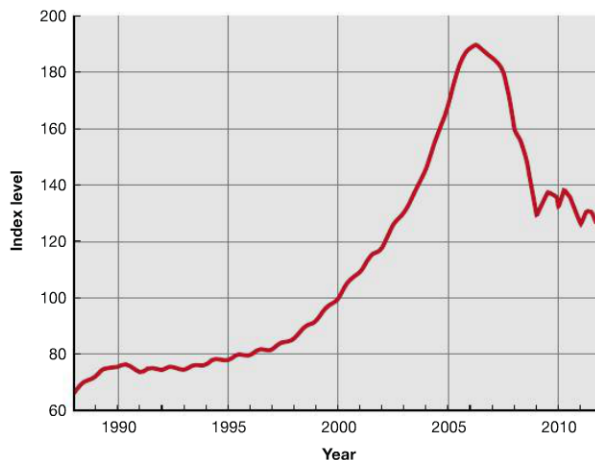
In North America, fair trade products have been primarily craft products such as decorative home accessories, jewelry, textiles, and ceramics. Ten Thousand Villages is the largest fair trade organization in North America, specializing in handicrafts. In Europe, most fair trade sales are in food, including coffee, tea, banana, chocolate, cocoa, juice, sugar, and honey products.

Two sets of standards distinguish fair trade: One set applies to workers on farms and in factories and the other applies to producers. Standards for fair trade are set internationally by Fairtrade Labelling Organizations International (FLO). A nonprofit organization, TransFair USA, certifies the products sold in the United States that are fair trade.

FAIR TRADE PRODUCER STANDARDS. Critics of international trade charge that only a tiny percentage of the price a consumer pays for a good reaches the individual in the developing country who is responsible for making or growing it. A Haitian sewing clothing for the U.S. market, for example, earns less than 1 percent of the retail price of the garment, according to the National Labor Committee. In contrast, fair trade returns on average one-third of the price to the producer in the developing country. The rest goes to the wholesaler who imports the item and for the retailer's rent, wages, and other expenses.

Fair trade advocates work with small businesses, especially worker-owned and democratically run cooperatives. Small-scale farmers and artisans in developing countries are unable to borrow from banks the money they need to invest in their businesses. By banding together, they can get credit, reduce their raw material costs, and maintain higher and fairer prices for their products. Cooperatives thus benefit the local farmers and artisans who are members rather than benefit absentee corporate owners interested only in maximizing profits. Because cooperatives are managed democratically, farmers and artisans learn leadership and organizational skills. The people who grew or made the products thereby have a say in how local resources are utilized and sold. Safe and healthy working conditions can be protected.

Consumers pay higher prices for fair trade coffee than for grocery store brands, but prices are comparable to those charged for gourmet brands. However, fair trade coffee producers receive a significantly higher price per pound than traditional coffee producers. North American consumers pay $4 to $11 a pound for coffee that is bought from growers for about 80 cents a pound. Growers who sell to fair trade organizations earn $1.12 to $1.26 a pound. Because fair trade organizations bypass distributors and work directly with producers, they can cut costs and return a greater percentage of the retail price to the producers. In some cases, the quality is higher because fair traders factor in the environmental cost of production (Figure 9-61). For instance, in the



▲ FIGURE 9-60 **HOUSING BUBBLE** House prices doubled in the United States between 1998 and 2006 and declined by one-third between 2006 and 2009. The graph displays price as an index set at 100 in 2000. For example, a house that sold for $100,000 in 2000 would have been sold for $80,000 in 1995, $190,000 in 2006, and $125,000 in 2012.

▼ FIGURE 9-61 **FAIR TRADE** Fair trade coffee is widely available.

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case of coffee, fair trade coffee is usually organic and shade grown, which results in higher-quality coffee.

Pause and Reflect 9.4.5
Do you have any fair trade products?

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FAIR TRADE WORKER STANDARDS. Protection of workers' rights is not a high priority in the international trade development approach, according to its critics. With minimal oversight by governments and international lending agencies, workers in developing countries allegedly work long hours in poor conditions for low pay. The workforce may include children or forced labor. Health problems may result from poor sanitation and injuries from inadequate safety precautions. Injured, ill, or laid-off workers are not compensated.

In contrast, fair trade requires employers to pay workers fair wages, permit union organizing, and comply with minimum environmental and safety standards. Under fair trade, workers are paid at least the country's minimum wage. Approximately two-thirds of the artisans providing fair trade hand-crafted products are women. Often these women are mothers and the sole wage earners in the home. Because the minimum wage is often not enough for basic survival, whenever feasible, workers are paid enough to cover food, shelter, education, health care, and other basic needs. Cooperatives are encouraged to reinvest profits back into the community, such as by providing health clinics, child care, and training.

Paying fair wages does not necessarily mean that products cost the consumer more. Because fair trade organizations bypass exploitative intermediaries and work directly with producers, they are able to cut costs and return a greater percentage of the retail price to the producers. The cost remains the same as for traditionally traded goods, but the distribution of the cost of the product is different because the large percentage taken by intermediaries is removed from the equation.

DEVELOPMENT THROUGH MICROFINANCE. Many would-be business owners in developing countries are too poor to qualify for regular bank loans. An alternative source of loans is **microfinance**, which is provision of small loans and other financial services to individuals and small businesses in developing countries that are unable to obtain loans from commercial banks (Figure 9-62).

A prominent example of microfinance is the Grameen Bank, which was established in 1977 (Figure 9-63). Based in Bangladesh, Grameen specializes in making loans to women, who make up three-fourths of the borrowers. Women have borrowed money to buy cows, make perfume, bind books, and sell matches, mirrors, and bananas. For founding the bank, Muhammad Yunus was awarded the Nobel Peace Prize in 2006.

The Grameen Bank has made several hundred thousand loans to women in Bangladesh and neighboring South Asian countries, and only 1 percent of the borrowers have failed to make their weekly loan repayments, an extraordinarily low percentage for a bank. Several million loans have also been provided to women by the Bangladesh Rural Advancement Committee. The average loan is about $60. The smallest loan the bank has made was $1, to a woman who wanted to sell plastic bangles door to door.

▲ **FIGURE 9-62 MICROFINANCE** Microfinance helped these women open a tailor shop in north Benin.

▲ **FIGURE 9-63 GRAMEEN BANK**
A representative of the Grameen Bank collects loan payments from women in Bangladesh.

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