THE FUTILITY AND DAMAGING EFFECTS OF ETHIOPIAN PRICE CAPS

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January 9, 2011
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I. INTRODUCTION

The government of Meles Zenawi announced that it was imposing price caps on select merchandize goods, the first round of the imposition affecting 18 food items as of January 6th, 2011. After gathering several hundred local merchants at the meeting hall of the PM Office, Messrs. Zenawi, Melaku Fanta who is the general director of Ethiopian Revenue and Customs Authority and State Minister of Trade, Ahmed Tusa, accused the businessmen and businesswomen of price gauging, hoarding and engaging in unhealthy competition. The three men said that the merchants were exploiting the existing weak government regulations while at the same time using world-wide price hikes and the recent devaluation of the birr as an excuse to jack up the prices of their goods.[i] Concurrent with the imposition of caps on prices of certain commodities, Messrs. Zenawi, Fanta and Tusa also vowed to "abolish this market disorder" and enhance competition down the road. Until the newly installed proclamation is put to effect to abolish the market disorder, they told the merchants that the authorities would use price caps and "cutting the fingers" of merchants in the short-term. For anyone who watched the entire taunting process and Mr. Meles' rants as well as the stunned faces and complete silence of the 584 businessmen and women, he/she would realize that the gathered attendee s were really frightened. They had to be reticent because they knew that Meles has made good on his "I will cut your fingers" threats in the past. They knew that he has sent quite a few of them (most of his victims being non-TPLF/EPRDF members, and those whom he "did not like the color of their eyes") to prison and closed down their businesses. The reproach was also accompanied with incredible and empty threats, two of the empty threats being his intent to supply the goods using the state-owned businesses and foreign suppliers.

Economists are generally opposed to price controls except in special circumstances (during emergencies). It is not that erecting price caps under emergencies would be without negative effects. It is just that, in crises situations, the positive effects of price controls could outweigh their negative effects. For example, imposing price caps could be necessary and morally acceptable in unusual circumstances such as during wars, unexpected crop failures, and natural disasters. Such special measures may be necessary so that some unscrupulous individuals could not use the sudden and unexpected situations to create big windfall gains for them while hurting so many others. Temporary price controls could also be effective in managing the country's reserves, such as to buy time until the reserves are put into the supply networks. Nonetheless, both economic theory and the experiences of many nations who used price controls strongly indicate that using price caps as a panacea for a rising inflation is counterproductive and in most cases, the "cure" is more damaging than the disease. In the Ethiopian case, using price controls in the face of a recent massively devalued birr is certainly a fool's errand on the part of the authorities.

The purpose of this short commentary is to explain to the general public that, even though imposing price caps on certain goods may seem to be attractive to consumers, such measures, in general, will end up harming the very people they were intended to help. I will briefly illustrate the unintended (deleterious) effects of price controls in part II below. At this point, I would like to draw the reader's attention to this important point: That the main culprits (root causes) of price hikes are **SHORTAGES** already existing in the system! Price hikes, especially those which appear to occur all over a sudden, are known to delude authorities (and consumers) as if they were artificially created by merchants. Authorities introduce price controls to appease angry consumers while at the same time shifting the blame towards the business sector. Once anger and confusion are in play, it is not uncommon to observe authorities exploiting the public's anger towards their favor, one of their common tools being the scapegoating of merchants for the price hikes. Let's turn now to the secondary effects of price controls, but those readers who are less interested in knowing the unintended and deleterious effects of price caps, they can skip Part II below, without much loss, and read the last two sections.

II. DELETERIOUS EFFECTS OF PRICE CONTROLS (in brief)

- Price caps force producers to sell the products under unacceptable and, in general, below equilibrium prices. The reader is reminded that acceptable prices include both real (differences between cost and revenue) and imagined ones, such as the price of uncertainty existing within the system. Thanks to the price caps, the underpriced goods will now be available to the buyer without reflecting the true cost of producing them. Any good that is being sold without reflecting the true costs of production would be produced inefficiently. Since some merchants will be reluctant to sell their goods below the true market price (in addition to the fears), less trade is created and this is one form of the inefficiencies that is created by the price control measures.
- Price caps kill the incentives to produce the goods that are under the price caps. The price caps also motivate producers to produce other goods that they think are more profitable and that are not under the government's radar for price controls. This will result in resource misallocation and inefficiencies. In the end, less and less of the highly valued goods will now be available to the consumers, which hurts consumer welfare.
- Price controls force producers to supply mostly low quality products into the market, which may lead the economy to be filled with lower quality products than would be otherwise. The process would create dissatisfaction on the part of the consumers. Economic history has shown that such consumer dissatisfaction, in addition to being inefficient, would force consumers to shift their attention to foreign-made goods, which could only be obtained in the black market at times. In the Ethiopian case, the price caps may help the cheap and low quality Chinese products.
- As was evident from the practices of former socialist regimes that included Ethiopia, price caps exacerbate the existing shortages. When this happens, as Ethiopians who lived during the Derg's reign mournfully remember it well, products are distributed on the first-come, first-served basis, thereby increasing the number of hours for queuing. This wasted time spent queuing (opportunity cost) lowers consumer welfare.
- If the price caps happen to be too low, the intervention could increase more demand for the underpriced products. In process, the low prices would allow and motivate more consumers, including poor fellows like myself, to desire more of them, but with so many people being anxious to buy the products at the controlled price, the process makes the already existing shortages to become even worse. Fearing the newly enacted laws and consumer backlash, merchants and suppliers may continue to sell their products at the regulated prices, but history has revealed that they sell them mostly to their favored customers. Such favored customers are usually "good neighbors", relatives, friends, and

the politically well-connected. In short, the price controls create nepotism. Since the government can only observe prices being sold at the regulated prices, it will have no basis to accuse the merchants for violating the law. In case you are tempted to tell me that the government will go after those who discriminate between consumers, you will be wrong because such a practice will be beyond and above the newly enacted law. Even if it does, prosecuting merchants for discrimination will be both difficult and arbitrary, and by trying to regulate the difficult human behavior, the regime will be introducing another element into the equation.

- Price controls most certainly create black markets, thereby encouraging people to break the laws when they try to obtain the goods which have become increasingly scarce, thanks mainly to the price control measures. This in the long-run motivates people to disrespect other laws. Economic history has revealed that black market prices are much higher than those which would prevail without the price caps. The higher prices reflect the severe shortages as well as other premiums such as compensations for being caught by government authorities (to cover the fines, etc.) Shortages, higher prices and premiums hurt the poor and the less connected more.
- Etc. Etc. Etc.

III. WHAT CAUSED THE PRICE HIKES IN ETHIOPIA

In a write –up titled as the "The Causes of the Ethiopian Rampant Inflation Rates" that was made public about three years ago, I argued that the main culprit behind the rising Ethiopian food prices were shortages existing in the system, and not caused by the high demand of Ethiopians who were becoming increasing wealthy, as Prime Minister Zenawi alleged. It is my contention that shortages are still the main culprit behind the current price hikes but we have now a new element into the picture - the massive devaluation of the birr that was implemented beginning September 1, 2010. In fact, what we are observing now was predicted ahead in my highly popular article titled as "The Devaluation of the Birr: A Layman's Guide."[ii]

As mentioned it in the first paragraph above, the authorities told us that merchants have used market concentration, the recent devaluation of the birr and world-wide price hikes to raise the prices of their goods. Let's briefly show the absurdity and contradictory nature of their claims. Speaking about the devalued birr first, as I explained and predicted in detail elsewhere, the 20 percent devaluation which took effect beginning September 1st, 2010, in collaboration to uncertainty and anticipated further devaluation of the birr were expected to result in price hikes of 20% or more. In this light, accusing the merchants for the problem that the regime itself has created is not only contradictory, but it is also absurd. Second, while acknowledging the existence of world-wide price hikes, Messrs. Zenawi and Fanta tell us that business leaders could neither engage in speculation, nor are they allowed to using the world-wide price hikes as their signals. Hello! Isn't using world-wide information signals part and parcel of an entrepreneurial activity? If Ethiopian Commodity Exchange (ECX) and the farmers could use the world-wide price signals, why would it be any different for the merchants? The writer of this commentary has bad news for the authorities: current available data indicate that there are sweeping world-wide price hikes that are already underway and these price hikes will continue as long as there are shortages. And given that the regime's current policies that are strongly geared towards exports, Ethiopia will be affected by what is happening world-wide. The interconnectedness between world-wide prices and the commodities produced in Ethiopia will intensify as the regime's policies become effective and these policies change the crop patterns produced in the country (the policies favoring exportable products.) My prediction is that the shift in crop patterns and the introduction and intensification of bio-fuel agricultural products will raise the prices of food items in the country. You get the picture when you add the rising costs of oil prices and bio-fuels, the unchecked growth rates of the Ethiopian population, etc.

Shifting gear towards the claim made about market concentration and the “unhealthy completion” in Ethiopia, one cannot avoid but speculate (hoping that Mr. Zenawi will not cut my fingers for using the word “speculate”), the regime’s already prepared to expropriating privately owned businesses under the guise of reforming the concentrated market. We saw this taking place during the so-called “Anti-Corruption Campaign” of 2001 that was effectively used to force prominent private sector operators in the trucking industry, coffee export, domestic trade services and insurance close down their businesses and flee the country. As it became evident, that carefully planned and executed exercise allowed party affiliated “endowed” companies to expand their foothold in the Ethiopian economy. As you can remember, Mr. Zenawi in 2009 also accused private coffee traders for hoarding their coffee beans and used the same orchestration to expropriate their coffee beans and to take away their licenses. Some of us cried foul, informing the world that Mr. Zenawi was using his carefully crafted orchestration in order to kick out private coffee traders and make room for his regionally owned companies. Unfortunately, our crying of foul received deaf ears, and now that Guna Trading PLC, one of the conglomerates owned by the TPLF, has become a major player in coffee trading since then, the intended transfer of the coffee trading business from private companies to a party-owned conglomerate is almost complete. On January 6, 2011, Messrs. Melaku Fanta and Zenawi told the gathered local business people that the price hikes were caused by a disorganized market system and the practice of illegal wealth accumulation exercise on the part of the traders. In order to give reason for market concentration, Mr. Fanta said that there are 147 flour factories in the country in which case only 50 of them controlled 65 percent of the flour market. “An average of 53 percent of the market in each of the commodity types is controlled by only 30 top businessmen,” Mr. Fanta declared. Frankly speaking, this does not seem to constitute a market concentration to me. Do you think so? The world economy that is filled with an oligopolistic market structure can attest to the fact that a country could enjoy cut throat competition and stellar market performance even in a market that is dominated by less than a handful companies. However, this can only take place in an economic system where the legal system prohibits collusion (tacit or otherwise), and in a system where government muddling is strictly prohibited and enforced, a situation which does not exist in Ethiopia. Now that Mr. Zenawi is telling us that he would abolish the disorganized market system, could this again end up being a tool to be used to annihilate the private flour producers and to make room for the party-owned parastatals? Only time will tell but one cannot rule this out, given the common practices in Ethiopia. For sure, both economic logic and past experience strongly indicate that, in this kind of circumstances, government interference will make things worse, not better. In addition to hindering the voluntary (impartial) exchange process, the endeavor will exacerbate the already existing partiality into the exchange of goods and services. Moreover, in addition of being used to deflect the public’s attention to the root causes of the problem, the exercise is designed to create a rift (conflict) between consumers and businesses.

To repeat, the public needs to understand that the price hikes reflect the existence of shortages and they are not artificially created by greedy merchants. The public should avoid jumping on the bandwagon of accusing merchants using wrong and flimsy excuses suggested by Messrs.

Zenawi and Fana. I also urge the public to look into the market concentration that Messrs. Zenawi and Fanta are talking about. I submit to you that nearly all the wholesale trading and transportation are in the hands of a few conglomerates that are owned by ethnic-based parties. In fact, some of the goods that the new price cap is imposed upon, such as sugar, are produced by the state-owned enterprises. Instead of pointing their fingers on the state owned parastatals that the authorities serve as board members, they decided to point their fingers on the merchants. The public also needs to understand that authorizes do not possess magic wands that would give them more advantage in allocating resources, including price hikes, than the free market pricing system set up to serve the interests of the people. For Ethiopians and those of us of Ethiopian origin, we happen to know that Mr. Zenawi has used these kinds of crises to target and attack businesses owned by certain ethnic groups. Unfortunately, I have witnessed such targeted attacks being geared towards a very highly successful and entrepreneurial ethnic group and I am not talking about the ethnic group that I belong here.

IV. CONCLUSION

Right after devaluing the birr by 20 percent, Mr. Zenawi threatened the merchants, telling them that he would pinch them by cutting some of their fingers (effectively, this means sending them to prison and/or closing down their businesses). This is in line with other dictators, such as the Hugo Chavez of Venezuela, who, who in 2007 and many times over, threatened businessmen that he would confiscate their businesses and give them to workers. In mid 2010, that country's inflation rate was about 30%, the highest in Latin America, and the only nation in the continent whose economy has contracted in consecutive years. Chavez's policy has failed so miserably that the Venezuelan currency, the bolivar, is being devalued again. In Zimbabwe, the government of Robert Mugabe physically lowered prices and even sent the" police and a pro-government youth militia swept into shops and factories, threatening arrest and worse unless prices were rolled back…" [iii] The end result was sheer chaos as "staple foods vanished from store shelves and some merchants reported huge losses."[iv] Sounds familiar? The same fate awaits Meles' policies and the birr, unless the regime changes its policies and begins to attack the root causes of the price hikes. By the way, price hikes and shortages never are observed in a country experiencing double-digit growth rates, as professed by Mr. Zenawi's regime, unless of course the double-digit growth rates have been cooked up from their sources (as several anecdotal evidence indicate.). Could these price hikes serve as signals indicating to us that the made-up propaganda growth rates are about to backfire?

It is really pretty hard for one to run a business, particularly in a resource-poor, highly corrupt, destitute, and poorly led country like Ethiopia. Even under normal circumstances, it is very difficult to run a private business, for such a venture may lead to disastrous failures resulting in the loss of one's lifesaving. Knowing that their survivals depend on their loyal customers, businesses don't like to disappoint their consumers at all. Given this cardinal fact, it is totally ridiculous on the part of the Ethiopian authorities to scapegoat merchants every time they face problems. Businessmen also worry about their successes as well as the risks that confront them, be they current or future, imagined or real. They think about their shareholders to whom that they are accountable for. They constantly think about their long term survivals. Unlike government bureaucrats who receive their regular paychecks, they have to depend on their own dollars. And the livelihoods many people, including their families and their workers can only be guaranteed if they succeed. They have to think about all of these on a constant basis. In addition to the aforementioned challenges they face, Ethiopian businessmen and businesswomen are challenged by the highly nepotistic system which favors regional party owned conglomerates. If this is not enough, imagine being repeatedly bullied by the leader of the country, threatening you to cut your fingers, scapegoating you for the problems the regime itself has created. This is hell, an absolute nightmare and I wonder for how long people can live under such a nightmarish situations.

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[i] See, Reuters (http://af.reuters.com/article/investingNews/idAFJOE70606F20110107), APA as reported on Nazret.com- http://nazret.com/blog/index.php/2011/01/06/ethiopia-fixes-commodity-prices-to-control-price-hike and Ethiopia First-
http://www.ethiopiafirst.info/news/index.php?option=com_content&view=article&id=420:ethiopian-government-massively-intervene-on-the-local-market&catid=1:latest-news&Itemid=1.

[ii] http://www.pambazuka.org/en/category/features/67399.
[iii] http://www.nytimes.com/2007/07/03/world/africa/03cnd-wzimbabwe.html.
[iv] Ibid.