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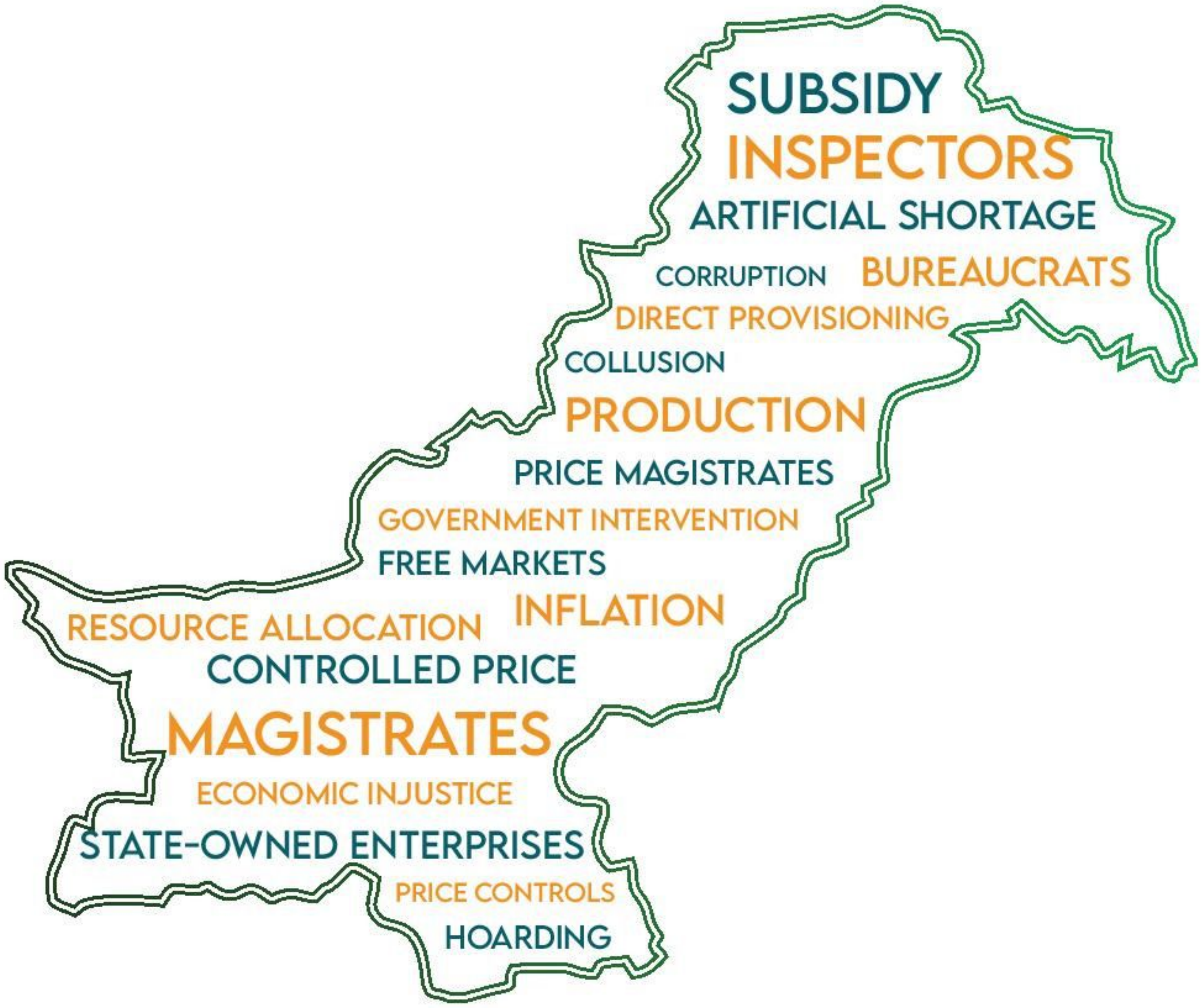
Price Controls: 10 Myths and Facts



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Advocates of free markets, not that they are many out there, usually have to face questions and criticism from various quarters. In the times of so-called market failures and global recessions, it is a daunting exercise to confront these questions as they are often couched in concerns for welfare, economic justice and populism. When it comes to food items, the price controls become even more favorite for politicians, policy makers and community workers. I present a few commonly held myths and their corresponding facts, which may help in understanding how markets work. It may be noted that the myths have been derived from popular media debates, public statements by elected officials and during general discussions while facts are grounded on history and proven laws of economics.

Myth 1: Price Controls offer protection against Inflation.

Fact: Each subsidy carries forward a hidden inflation, as the price control only artificially brings the price down; it does not actually decrease the price. Thus as soon as these subsidies are lifted, the price hikes are usually more sharp and bring even greater burden for the purchasing power than a normal increase in the price.

2

Economic 'injustices' can be undone by courts.

Myth 2: Economic 'injustices' can be undone by courts.

Fact: Whenever government intervenes through administering control for example by the price magistrates, the retailers simply stop supplying the commodity. When the court intervenes through its own formulations of resource allocation, the market does respond by further increasing the distortions. For example, when the Supreme Court announced that 70% of sugar be supplied to industrial consumers at 'free market price' and 30% to retail customers at 'controlled price', the millers allocated more than 70% to the industrial and commercial sector in the natural search for more profits.

3

Direct provisioning and production by the government is the final solution

Myth 3: Direct provisioning and production by the government is the final solution.

Fact: Centralized production and government controlled distribution systems have been tried extensively in Pakistan and badly failed during 1970s. Bureaucrats who assume control of State Owned Enterprises work without any incentives and are not trained in business. Therefore any attempt of direct production and distribution by the government is bound to fail due to both structural and historical reasons. The announcement of mechanical 'Roti Plants' by present Punjab Government and its seizure of sugar stocks is in fact a reverse step.

4

Price controls are popular.

Myth 4: Price controls are popular.

Fact: Price control can bring temporary popularity as long as they are effective and in place. The implementation of price controls laws need honest and efficient administrative machinery, which is simply absent in Pakistan. Therefore each announcement of price control meeting with failure actually brings bad repute to the political government as bureaucrats do not assume any risk of failure. Price control in the hand of a weak and corrupt administration ultimately proves unpopular and damage the reputation of political governments.

5

Traders are hoarders and must be dealt with severe punishment.

Myth 5: Traders are hoarders and must be dealt with severe punishment.

Fact: Traders are business people, who invest in certain commodities, assume risk of loss, keep a profit and then provide the goods to retailers or direct consumers. In fact, hoarding is hard to define as each businessman has the right to store some raw material and back up stocks for smooth functioning of the business, particularly in an un- certain environment. The government manhandling creates uncertainty in the market and forces the traders to stock more than the usual requirement of the business thus creating supply disruptions and artificial shortages.

6

Price control bears no costs.

Myth 6: Price control bears no costs.

Fact: Price control may sound inexpensive as it all needs is a government no- tification and using its administrative muscle to ensure implementation. However, price control drives private producers out of the market as they lose incentive to get profits. This leads to an overall reduction in the the supplies, which further increases the price levels thus setting off a vicious circle. Thus price controls ultimately invite government to comp- ensate for reduced supplies through imports which disturbs the national accounts and trade balance. Thus while price control may seem cheap in the short run, it proves to be expensive in the long run.

7

Price control effectively helps the poor people.

Myth 7: Price control effectively helps the poor people.

Fact: Price control does not distinguish the consumers on the basis of th- eir income levels- they are untargeted subsidies. Rich or poor, you pay the same Rs. 2 for buying a sasti roti (cheap bread) from one of the registered tandoors (traditional earth oven). There is no way to guarantee that only the poor, or in fact, mostly the poor, would take advantage of price control. Often, the poor resides in rural areas, as in the case of Pakistan, who does not enjoy an equivalent access to the market. Thus the urban consumers, who are more vocal, tend to take more benefit of price control because of greater access.

8

Government. Government. Government.

Myth 8: Government. Government. Government.

Fact: The influence of government on markets, supply and demand is fast vanishing as evident from a shift from direct provision to enabling regulations. Government intervention and presence is a cause of pr- oblem in the first place and solution should not be expected from the problem itself. We know for instance, that food inspectors 'seek rent' for granting favors to selected market players like flour mills and yet we insist on sending more inspectors and magistrates. It only increases the chances of collusion and corruption.

9

Political elite spends their own money for the poor.

Myth 9: Political elite spends their own money for the poor.

Fact: Political leaders and government officials get their salaries and all other expenses from the tax payers' money and in Pakistan everyone pays taxes, if not direct then indirect. The money which administration claims to spend on the poor people welfare is not their own money; it belongs to the people and people have the first right on this money. In fact, the political leaders spend people's money to perpetuate themselves into power.

10

Replace people and things will fall in place.

Myth 10: Replace people and things will fall in place

Fact: Good people cannot fight with bad laws and path to hell is paved with with noble intentions. One should argue for reforms in the system instead of searching for noble people. In markets, the best strategy is to allow free market come full circle by ensuring level playing field to all players. It would mean that the government should gradually withdraw subsidies both for producers and consumers. For example, if domestically produced sugar is not enough to meet local demand and the Trading Corporation of Pakistan cannot place import order due to any reason, the private sector, if it were allowed, could have imported sugar much earlier and eased off supplies in the local market. Similarly, if Atta is expensive, then the farmers should be paid competitive price so that they grow more wheat in the next season and thereby bringing the price of the flour down by increased supply.