

# Getting Prices "Right":



## The Cases of Food and Fuel

In market economies such as Trinidad and Tobago, the prices paid for goods and services play an important role in determining what and how much is produced, consumed and saved. Put another way, prices help to determine the behaviour of consumers towards the usage of fuel, food and much more. This article argues that appropriate prices or getting prices right is a very important economic issue, as much as it is a social and political one. Getting prices right, therefore, warrants close attention by policy makers as they are primarily responsible for setting the framework. Nevertheless, the necessity for getting prices right ought to be appreciated by all sections of the national community as well.

It seems that everywhere one turns these days—nationally or internationally—there are heated debates about continually rising prices. While food and energy prices stand out the world seems to be engulfed in a wave of rising commodity and other prices. In this environment, it is almost inconceivable to think that this has not always been so. There were times in the past when prices were indeed, low.

In the short-run, some sections of the population may benefit from price increases while others lose. In the end however, all are likely to endure some amount of pain as no section benefits permanently from unjustified, unnecessary or uncompetitive price increases or declines. Ultimately, all are adversely affected by a misallocation of resources, which is the outcome of any unjustified change in prices.

Very often, rising prices pit consumers against producers or so-called middlemen against consumers.

The government often finds itself somewhere in the middle, though most times, on what it considers the side of consumers. Ultimately, however, government must ensure that prices continue to encourage production and/or import on the one hand and that consumers obtain goods and services at competitive prices on the other. A major way to achieve this is to remove bottlenecks in the economy so that there are few, unnecessary cost add-ons. Most important as well, government has to ensure that liquidity does not so overwhelm the economy, fuelling price increases through too rapid increases in expenditures.

Since getting prices wrong can be very costly, for consumers, producers and politicians. What then are "right" prices?

For most goods and services, prices that are too low increase consumer demand beyond sustainable levels. Let us take the case of gasoline. Low prices encourage drivers to make more unnecessary trips, purchase less fuel-efficient vehicles and may even encourage some to purchase a vehicle thereby contributing to road congestion. Too cheap fossil fuels may also have contributed to the dangerous level of stress on the environment. In the case of food, too low prices encourage wastage and may even help in promoting bad eating habits leading to health problems such as obesity. In general, the same principle applies to electricity, water or telecommunications.

Subsidies, as a part of support to society can be helpful, especially for the less fortunate. However, because they hide the true price they often encourage consumers to behave in ways that demonstrate little appreciation for the true value of the good or service.

If the selling price is so low that farmers, say, cannot recover their costs, which include normal profits, at some point, they will not be inclined to produce more and may very well switch to some other business thereby creating a shortage and causing a jump in prices by the remaining producers. Desperate efforts to increase output now, may well result in a drastic fall of some food prices over the next year or so. This will be welcome news to consumers but farmers may very well be driven out of production.





Unjustifiable, high prices on the other hand, hurt the consumer. Such prices cannot be sustained for a long time. They have negative consequences for the poor, if applied to basic foods for example. They may also encourage overproduction, leading to low prices in the next round, which would benefit consumers but could also result in the failure of some businesses. In the next round, higher prices are likely to prevail because of insufficient production and the cycle would continue.

A contentious issue in food pricing has to do with the difference in the price at the farm or at the port compared to the final price paid by the consumer. This final price can be several times that of the farm gate price or the price at the port. The retailer is often chastised for price “gouging”. This charge is often, though not always, unfair. Among reasons for the divergence in prices are the added costs of transport, labour, traffic jams and cold storage, which would be reflected in the final price to the consumer. If farmers can get, say, ten times the price in the retail market as they get from the wholesaler at the farm gate then what prevents them from taking their goods to the market themselves to obtain the far higher retail price? The reality is that in most cases, the higher retail price is not reflective of profits but of the higher costs in bringing the product to the retail market.

Ultimately, prices are signals that businesses must heed in making decisions. For example, rising food prices indicate that there are problems in production, consumption or distribution. There may be need for more competition, consumer education

or information dissemination, or for bottlenecks to be removed; liquidity may be too high; the transport network may be poor; or some combination of some or all of the above. A recent example of competition bringing prices down is the lowering of telephone rates, as a result of a new provider in the telecommunications market.

In market economies so-called market failures may occur, where for several reasons the market might be inefficient or even if efficient, does not give rise to the most desirable result from a social standpoint. A case in point is the availability of food to the very poor. In such cases, state or state-assisted intervention can be helpful. In cases where the market does not give the most desirable outcome, the response may necessitate temporary and targeted support to those who are most adversely impacted.

Another important pricing issue from a policy standpoint is that of domestic products vis-à-vis imports. This is especially relevant to the poultry sector in the Caribbean. As far as the typical consumer is concerned, what matters is that he or she pays the cheapest price. That cannot be the whole story however. The development of entrepreneurship, maintenance of production capacity, employment and exports are also important economic activities and is promoted by all countries. From the angle of national development, reliability of supply is important too. Today, some countries are discouraging exports of food in the interest of food security for their domestic population. In this special case then, importing countries may have to produce selected food commodities notwithstanding that they might be higher cost producers. This action however must not be generalized.

Getting prices right then is important from several vantage points including that of the consumer, producer, importer and policy maker. Policy makers have the responsibility to ensure that an appropriate and balanced framework exists for meeting the varied needs of the market place. Getting prices wrong has adverse consequences for all, regrettably, a point that is poorly appreciated.

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