

**Response to Dr. Said Hassan:
On the cause of the current Ethiopia soaring inflation rate
By Teshome A.¹
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Part I

For the last few months I have been reading various commentaries written by different people regarding the cause of inflation in Ethiopia². I appreciated the commitments and efforts of these writers who came out with different reasons based on the available information and knowledge they have on the topic. Such different argument is usually common in understanding the cause of inflation or any economic variable, because the change in the price of any particular good based on many factors opens the door for most people to express their expectation in a way they understand the economic developments in the country. It is obvious that there is no Economist who argues that his/her explanation is the only way to justify the source of inflation in Ethiopia unless he/she is a pseudo Economist. That is why I was glad to see many Ethiopians or non-Ethiopian professionals debate on the cause of inflation and its remedial measure in the country. Yes, we need the economy that operates with the contemporary principles and these principles must be open for any kind of dialogue. Such kind of economic policy application in Ethiopia will get mass support and immediately bring fast economic development

Expecting this I read as usual Dr. Said Hassan's commentary paper (non-technical analysis) titled "**the cause of the current Ethiopia soaring inflation rate**" which was posted on May 6, 2008 on Ethiomedia website. When I began to read the article I was looking forward to see a different and rational explanation for the source of inflation. Though it is bad to say, from the beginning to the end of the article the writer used the simple text book relationship of economic variables to undermine the broad base progress recorded by the Government of Ethiopia. His comments become more destructive considering he is the Professor of economics and Editor of a Journal at Murray State University (USA). I know it is hard to judge the quality of the article by the status of the writer. I found the level of explanation in the paper and the status of the writer completely incomparable.

This kind of analysis misleads the reader who does not have the basic knowledge of economics in general and the Ethiopian economy in particular. It is a moral obligation and duty of any economist to make proper and factual assessment when writing an article for public consumption to save the many innocent people who might be misguided by his analysis. In this regard I took the first initiative to reply to the writer by dividing my response into two parts: The first part is to show the wrong text book analysis that was used to blame our PM's presentation to the parliament about the causes of inflation in Ethiopia. The second part is to nullify some of his erroneous explanations about the causes of inflation in Ethiopia by providing the suitable and available data. I believe that there is no need to be professor or doctor to reply to this kind of article which was purposely prepared to undermine the effort and the commitment of the Government of Ethiopia

¹ Teshome A. is the professional in economics. My response for the writer is fully based on my professional knowledge that I acquired for the last six years.

² Addisu's and Mulu's article are few of them that I looked in the cause of inflation in Ethiopia from Addis Fortune private news paper and Aigaforum website respectively.

I do not have any problem to see or hear the critics of our Prime Minister Meles Zenawi, but the line of argument used by the writer to falsify or undermine the PM's presentation to the parliament does not provide the answer to the cause of inflation in Ethiopia. Like any professional person I appreciate our PM for he has time and again demonstrated what his people need. The PM's realistic and attainable argument for Ethiopia has shown the observable social and economic change for the last decade.³ Mr. Meles Zenawi is that unlike past leaders such as Haile Selassie and Mengitsu Haile Mariam, he is short on majesty and rhetoric and long on pragmatism. He is a realist who knows what Ethiopians want and goes ahead to give it to them (Erry Okung, 2008)⁴.

To go to my point the PM said in the parliament that the current inflation arose partly because of the economic growth which increased the demand for goods and services as the writer correctly put it as the demand-pull inflation. In the same way the PM also mentioned the other factors which the writer failed to mention in the first page of his article. The PM said the increase to the price of fuel oil and other imported materials was also the other reason for inflation. The latter type of inflation is what is known as cost-push inflation. Here I am not clear why the writer did not mention it in the first page of his explanation when he tackled the PM's analysis. The funny part of the writer's analysis is he ignored many explanations PM provided and picked only one point giving the most improper method of criticism.

To make things simple let me make reference to what the writer said in his article.

- 1) **"If the Prime Minister is to tell us that the rampant inflation rate is caused by a growing economy and an increase demand we should observe reduction in the unemployment"**.
- 2) **"If the increased demand is caused by higher demand for good and service produced by individual firm, the same firms, faced with such higher prices must paying higher wage rate to attract more workers"**.
- 3) **"The higher output should increase supply and reduce the price of agricultural output"**.

I could have identified many wrong conclusions the writer made just from the first page of his article, but not to bore my readers I will only focus on the above three points to clearly show that the writer's criticisms are unfounded allegations on the PM's presentation.

1. The writer's first reason in blaming the PM was the unemployment rate could not decline when the demand increased due to an economic growth. Anyone who loves his country would be happy to see the decline in unemployment rate when there is economic growth. But the writer's intention is clear for me now. He wants to convince us that if unemployment does not

³ I appreciate our PM because of his visionary mind for Ethiopia. He has strong commitment in the establishment of strong institution, the development of enough infrastructures and the application of modern technologies which are the major ways to change the image of Ethiopia. In this regard the GoE has done many things many things which I cannot complete with this piece of paper. I advise you to look at IMF, WB and OECD annual publication

⁴ Erry Okung wrote and published about Mr. Meles Zenawi on Uganda's The New Vision website based on his observation during his stay in Addis Ababa.

decline there is no economic growth. In most developing countries the unemployment could not decline when it shows economic growth because the growth rate of labour force⁵ was much more than the growth rate of employment. The writer's text book assumption may work only in developed countries where the labour force growth rate is less than the growth of the employment.

In Ethiopia the demand for employment increased due to the economic growth recorded for the past few years (At least in the last four years). In the same way the supply of labour increased due to labour force growth in the same years. What the writer has to understand here is that the proportion of the increase in labour demands less than the proportion of the increase in labour supply. That means while we have economic growth the level of unemployment could not decline due to the surplus labour supply injected to the labour market which usually arises due to the higher increase in the labour force. I know this is not available in the text book at Murray State University because the book assumes that other factors are constant like the labour force in the case of Ethiopia. My question is how the big professor from USA failed to recognize the relationship between economic growth and unemployment before criticising our PM? Had he understood the relationship he would not have been hasty to criticize our PM.

Let me add another point in the same area. Did the writer ask what are the source of unemployment in Ethiopia?⁶ Though there has not been much study conducted regarding the source of unemployment in Ethiopia, I recall from my labor economics experience that the current source of unemployment in Ethiopia is highly dominated by structural unemployment (geographical and occupational imbalance) than deficiency in aggregate demand (cyclical unemployment). It is an open secret that our government is hiring various professionals from developing and developed countries to fill the gap created in the higher institutions or other sectors. In this case one cannot deny the outstanding economic growth. Yes we have economic growth and at the same time we have unemployment which did not decline due to geographical and occupational imbalances and the poor functioning of the labor market in the economy.

2. The second point made by the writer was that the same firms facing such higher prices must pay higher wage rates to attract more workers. It is wrong to conclude like this in a country where the unemployment rate is very high. In other words, workers do not have the bargaining power to ask the employer to increase wage proportionally to the change in the price of good in the market. That means the employers are wage makers and employees are wage receivers. In addition to this, the wage determinations made by employers is not based on the price of goods and services sold in the market. Rather it is based on the productivity of the workers (Marginal Product of labor). This indicates that whenever the price of goods increases; the firm cannot increase proportionally to the wage rate of the worker. At the same time, there is no formal law in Ethiopia which to force the employer to adjust the wage based on the inflation rate in the country. The analysis the writer suggests for 2008 in Ethiopia has

⁵ Labour force refers to the summation of employed and unemployed people. Labour force is part of the working age people. According to international convention working age people is those people whose age between 15-65 year .But this hard to apply in Ethiopia. In Ethiopia the working age people is between 10-60 year old.

⁶ Source of unemployment can be divided in to three parts: Frictional unemployment, structural unemployment and cyclical Unemployment.

been identified as failed theory when Labour Theory of Value⁷ was criticized by the popular Marginal Productivity Theory⁸ in the late nineteenth century.

3. The last one the writer argues on is that higher output should increase supply and reduce price of agricultural output. Here again the writer used his text book knowledge which says when the production increases the price of goods declines. I do not know how he forgot to mention the assumption in the book which says other factors are constant. Some time we have to know that the reality on the ground is completely different from text book explanation. Therefore, in this scenario we also have to disregard the text book assumptions like our leader in Ethiopia who work day and night based on the fact on the ground. For the writer's information the reality in Ethiopia indicates the Government of Ethiopia has done many things to improve the agricultural market in the country; For instance the construction of road, provision wireless telephone and other facilities have improved the operation of agricultural market in the rural part of the country.

As a result, we comparing the current situation with the earlier period, our farmers are now empowered in terms of; what to produce; for whom to produce and how to produce with the support of the extension program. In such kind of situation the increase in agricultural production will increase the supply of the agricultural output which can reduce the price of agricultural products in the market. Unlike before, the farmers have many options as to where and when to sell their products. That is why the writer's erroneous conclusion says "the increase of the agricultural products reduces the price of agricultural products in Ethiopia". His wrong assumption does not reflect the current agricultural market structure in Ethiopia. The incumbent government has undertaken many measures to change the fundamental problems of agricultural market in Ethiopia.

These three points I mentioned above clearly show that the writer's explanation is out of reality in Ethiopia's context or he has made this conclusion with information that can not show the reality on the ground. It is astounding to read such shallow analysis from a person who is in the US and who is an editor and professor. The students who I taught before last year would not make such unfounded and incoherent criticism. I hope the writer will understand my concerns regarding his article and do himself a favor and bring himself up to speed to Ethiopia's reality.

In Part II, I will provide data from various sources to show some of the writer's wrong conclusions about the cause of inflation in Ethiopia and it is my hope he will get a lesson from it.

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⁷ The labor theories of value (LTV) are theories in economics according to which the values of commodities are related to the labor needed to produce them

⁸ The marginal productivity theory is essentially a demand theory. It is, at the same time, a theory of income distribution; because it determines the share that each of the factors of production is to receive. The theory was developed in the late nineteenth century, essentially by John Bates Clark in the United States and Alfred Marshall in England