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"Tout l'art de la politique est de se servir des conjonctures."
Louis XIV

Lowering the costs of doing business

By Rajiv Servansingh

The cost of "doing business" in a country is becoming one of the most important determinants in the investment decision making process of potential investors. A first generation of reforms, better known as the Structural Adjustment Programs, had been initiated in developing countries in the 1970's under the umbrella of the Washington Institutions, i.e. the World Bank and the International Monetary Fund. These were mostly concerned with the macroeconomic conditions of balance of payments, fiscal consolidation and monetary and fiscal policies, generally.

This first generation of reforms has been the subject of a lot of controversy, especially following the crisis in Asia in the middle of the 1990's. The end results have been rather doubtful, so much so that the Washington institutions have themselves developed some corrective measures and introduced new elements, such as good governance objectives and social nets during transition periods to soften the dire social consequences of proposed reforms. This "new Washington Consensus" has received a rather better acceptance from the countries in which they are being applied.

Our concerns today are more related to the context of our transition to a more competitive economy gearing itself to compete on a more level playing field in the liberalized, global world. The real issues, assuming we have the maturity to create the macroeconomic conditions of low inflation and controlled budget deficits, have more to do with the "microeconomic" conditions necessary to ensure that firms in an industry are constantly under pressure to improve their productivity. The "competitiveness" of a nation is in the final analysis defined as the sum total of the productivity of the firms of that nation.

Creating the appropriate institutional environment

Creating an environment which will force enterprises to engage in a constant search for improved productivity is easier said than done. It will entail, for example, that direct government intervention in the allocation of resources to enterprises will be drastically reduced if not eliminated. The role of government will not however cease totally. It will take a radically different approach that has more to do with creating the appropriate institutional environment than with direct intervention.

Setting up the proper Regulatory institutions such as a Competition Commission or a regulator for the Utilities under monopoly, fiercely combating corruption to prevent those who have the right connections to appropriate resources, which are not rightly theirs, eliminating or minimizing bureaucracy and red tape will go a long way towards achieving this goal. These institutions will, however, only be successful if they are market friendly, in the sense that they tend to favour the second best condition of market operations in the absence of the free play of market forces.

The concept of the "virtuous circle" has long been a favourite of many commentators in development economics at the macroeconomic level. It is high time that we start thinking of the components of a "virtuous circle" in microeconomics – the main components of which would be investment, competition, innovation, productivity and profits. The role of government will be to facilitate the conditions for such a virtuous circle to operate. Lowering the threshold for doing business is a necessary pre-requisite for attracting investments and the threshold is always in terms of costs, since the potential investor always has an alternative use of his funds and time.

Rajiv Servansingh is Deputy Secretary General of the Mauritius Chamber of Commerce and Industry.

A Pukka Rupee for Mauritius

By Samad Ramoly

According to its proponents, persistent depreciation of the rupee is a cornerstone in generating foreign exchange revenue. It is supposedly an inescapable trade-off between job security and purchasing power. Oft-repeated assertions tend to acquire a status of fact, no matter how absurd they are. Consequently this flawed view, which seemed to be vindicated during the "Mauritian miracle" hype, is being debunked when facing an ailing economy.

"What matters most", Michael Porter the competitiveness guru from Harvard University argues, *"is not exports per se or whether firms are domestic or foreign-owned, but the nature and productivity of the business activities in a particular country. The need for depreciation reveals a lack of competitiveness, and holds down prosperity. Subsidies drain national income and bias choices away from the most productive use of the nation's resources"*.

Because rupee depreciation is perceived to address the immediate competitive concerns of the export sector, many business leaders (and indeed complacent governments) readily embrace the policy. In fact, real and long-term competitiveness rests on productivity which in turn hinges on the value of a nation's products and services (as measured by open market prices), the efficiency with which they can be produced and maybe more critically the nation's capacity to motivate its human resources.

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La Chine à la croisée des chemins

Par Jean-Yves Naudet

Les nouvelles qui nous viennent de Chine, à l'occasion de la réunion de l'Assemblée nationale populaire, sont contradictoires. D'un côté, aucune évolution pour le secteur agricole, qui est condamné à végéter sous un régime qui reste socialiste ; de l'autre la poursuite d'une certaine libéralisation dans l'industrie, qui a permis à la Chine de se développer et surtout de multiplier ses exportations. Mais la Chine ne pourra éternellement rester entre capitalisme et communisme. Elle approche de l'épreuve de vérité et se trouve à la croisée des chemins.

La situation des campagnes est dramatique

Chaque année, la réunion des 3 000 délégués de la session annuelle de l'Assemblée nationale populaire est un temps fort de la politique chinoise, y compris en matière économique. Non qu'il s'y passe la moindre surprise : les délégués sont bien disciplinés et tous appartiennent au parti communiste chinois. Mais c'est l'occasion pour les dirigeants de donner le la et de rendre publiques les décisions prises dans le secret du bureau politique.

Le développement de la Chine est incontestable et ce qui marche en Chine, c'est ce qui est libéral, c'est ce qui appartient à l'économie de marché, et en particulier l'industrie exportatrice et le secteur privé. La croissance économique a encore été en 2005 de l'ordre de 10% et le boom des exportations ne s'est pas démenti. Quant à l'investissement productif, il a progressé de 27,5% l'an dernier, chiffre sans équivalent.

Par comparaison, la situation des campagnes est dramatique. Il reste 750 millions de chinois dans le monde rural et ceux-ci sont dans l'ensemble très pauvres et manifestent leur mécontentement. Officiellement, la grande majorité des 87 000 affrontements sociaux survenus dans le pays se sont déroulés dans les campagnes. Et 200 millions de Chinois vivent avec moins de 1 dollar par jour, dans une économie autarcique il est vrai. Le discours officiel tenu devant l'Assemblée nationale a donc insisté sur la croissance *« équitable »* et la nécessaire solidarité avec le monde rural. Wen Jiabao, premier ministre, dans un discours de deux heures, a affirmé que *« le pays doit faire plus attention à l'équité et à la stabilité sociale afin que tous profitent des fruits de la réforme et du développement »*.

Un système agricole collectiviste

Officiellement, un vaste plan d'aide aux provinces les plus pauvres va être mis en place en 2006. Mais ici nous ne cachons pas notre scepticisme et nous relevons l'erreur d'analyse des dirigeants chinois. Ils misent sur une aide sous forme de dépenses publiques, qui seront en hausse de 13,8%. L'enveloppe consacrée à l'agriculture progressera même de 14,2%. Or on sait bien que jamais les dépenses publiques n'ont réglé le moindre problème de développement. Ce sont les initiatives privées qui permettent le développement.

Sur ce point la fermeture idéologique est totale. Pourquoi le niveau de vie des paysans a-t-il augmenté moins vite que celui des villes industrielles ? Le revenu annuel moyen des ruraux était de 403 dollars, contre 1 300 dollars pour les citadins. Réponse : le système agricole reste collectiviste. Aucune réforme de la propriété n'est envisagée. Le projet de « nouvelle campagne socialiste » présenté par le parti est effectivement socialiste, à l'exception de la suppression de l'impôt agricole (il existait depuis 2 600 ans) ! Le vrai sujet de mécontentement dans les campagnes, avec la corruption, c'est la propriété collective de la terre.

Les paysans chinois ne peuvent ni acquérir ni vendre de terrain. Ils ont au plus des baux de longue durée (30 ans) et de toutes façons les cadres locaux du parti saisissent les exploitations de qualité, soi-disant au nom de l'intérêt public. C'est un problème qui avait déjà été rencontré en URSS et lorsqu'il n'y a pas de droits de propriété exclusifs et transférables, la production agricole reste nécessairement très faible. Or dans ce domaine le régime n'a pas changé. Et le responsable de la politique agricole a rappelé qu'il n'avait jamais été question de laisser les paysans prendre le contrôle de leurs terres. Voilà pourquoi selon nous, les campagnes chinoises, qui regroupent la majorité de la population, ne se développeront pas et ce ne sont pas les aides publiques qui changeront les données du problème.

Ce qui marche, c'est le capitalisme

Par contraste, on peut être plus optimiste pour les villes, pour l'industrie et pour les exportations. Mais les tensions entre zones rurales et urbaines vont alors s'accroître et l'exode rural va s'amplifier. Peut-on durablement avoir un système capitaliste qui marche dans les villes et un système socialiste archaïque dans les campagnes ? Ingénieusement le parti souhaite ralentir la croissance urbaine pour éviter d'accentuer l'écart. Le chiffre de 8% de croissance en 2005, plus faible que les précédents, est-il une annonce de cette « stratégie » ? Ce n'est pas en bridant l'industrie qu'on sauvera les campagnes, mais il est vrai que si les dépenses publiques en soutien des campagnes augmentent, l'activité globale sera freinée.

D'autres aspects négatifs de l'économie chinoise sont à relever. Le taux de chômage est officiellement à 4,6% en ville, en réalité il est beaucoup plus élevé. La surchauffe est présente et les risques d'inflation sont importants. De plus, le régime se plaint que la répartition des investissements dans les différents secteurs reste irrationnelle. Or elle est déterminée par le marché. Si le parti veut se mêler des investissements et de leur répartition, on peut être inquiet. Et l'investissement progresserait de 18% en 2006 au lieu de 27,5% en 2005.

En revanche, en positif, on apprend que les banques seront incitées à ne plus distribuer les crédits sur ordre politique, mais en fonction de la rentabilité des projets. Toutefois on fera la guerre aux entrepreneurs *« trop dépensiers en énergie »* : le gouvernement va surveiller plus étroitement les différentes industries.

En conclusion, les contradictions dans la politique économique chinoise traduisent la difficulté du choix que le parti a du mal à faire. Mais le parti peut-il durablement maîtriser les aspirations du peuple, qui a pris goût au capitalisme et au marché ? Il y a contradiction entre les libertés économiques, réelles dans l'industrie, et l'absence totale de liberté politique. Les Chinois admettront-ils longtemps de choisir des produits ou des emplois et de ne pas pouvoir communiquer, se déplacer, s'informer ou désigner leurs dirigeants ? Pour l'instant ce qui vient de se passer à propos des campagnes chinoises montre que les durs du parti n'ont pas renoncé à garder la main : l'idéologie collectiviste n'est pas morte, alors que le réalisme capitaliste prouve chaque jour son dynamisme et le progrès social qu'il apporte.

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OUTLOOK FROM SINGAPORE

By Daryl Liew

Global Economy

News that Iran has successfully produced enriched uranium for the first time, effectively achieving nuclear capabilities, has triggered fresh concerns over possible political unrest and disruptions to global oil supplies. This has exacerbated an already worrying oil supply situation, which has been affected by rebels knocking out nearly a quarter of Nigeria's output. Meanwhile, the demand for oil remains strong, with the US and China continuing to consume greater quantities. Not surprisingly, oil prices are hovering near all-time highs of US$70 per barrel.

US non-farm payroll figures surpassed expectations in March as 211,000 new jobs were created. Household employment also rose bringing the unemployment rate down to 4.7%, a five year low. The March ISM reports showed marginal changes, with the non-manufacturing index rising to 60.5, while the manufacturing index slid to 55.2. Concerns however remain over the prospects of the housing market as pending home sales continue to fall. The US economy is still on track to grow 2.5 to 3% this year.

Japanese business confidence remains high with most companies expecting further increases in sales and profits this year. The overall economic outlook is bright as illustrated by the February leading indicator index, which came in at 80.0, the third consecutive month of strong performance. A number at or above 50 signals the economy will grow in the next three to six months. Domestic consumption is also showing signs of picking up on rising household incomes.

Business sentiment is also strong in the Euro Zone, with upbeat business confidence surveys and polls of purchasing managers. However, the hard data paints a different picture amidst stubbornly high unemployment and sluggish consumer spending figures. It remains to be seen whether the positive sentiment will translate to improved figures in the year ahead.

Interest Rate

The Fed raised interest rates by 25 basis points for a 15th consecutive time on 28th March, bringing short-term rates to 4.75%. The Fed stated that inflationary pressures are picking up as oil and commodity prices rise have now forced the market to revise their interest rate expectations. Interest rate futures show that traders are certain the Fed will raise rates to 5% at its next meeting on May 10. The odds of a further 25 bp increase in June has also shortened.

The ECB kept interest rates unchanged at 2.5% at their meeting earlier in April. ECB President Trichet also came out to douse expectations of a further rate hike in May, but cautioned that the central bank is watchful of potential inflationary pressures. Analysts now believe that European rates will only rise by another 25 bp by mid-year before reaching 3.25% by year-end.

Bank of Japan Governor Toshihiko Fukui appeared to cool speculation that the central bank will be raising rates soon by stating that the bank has no set time frame to raise interest rates. We believe that Japan will maintain a zero or near zero interest rate policy for the next few years at least to avoid destabilising the economy.

Technicals

The short-term technical indicators for US equities have turned downwards and further declines would point to a falling trend. Indicators for European and Asian markets are still a lot less challenging.

Valuation

Global equity valuations are still fair.

Ten-year US treasuries flirted with the 5% level on expectations of higher interest rates and the yield curve normalised. Bonds continue to look expensive relative to equities.

Scenarios

Base Case: Equity markets consolidate gains on the back of strong corporate earnings and improved consumer spending. The global economy grows at a sustainable pace as oil prices stabilise and the geo-political climate calms.

Worst Case: Inflationary pressures work their way through the system forcing central banks to raise rates faster than previously expected, adversely affecting both equity and bond markets. Further disruptions to oil supplies cause oil prices to shoot through the roof, fuelling spiralling inflation. Tensions in the Middle East escalate. An avian flu pandemic breaks out, causing a loss of lives and affecting global trade.

Tactical Asset Allocation

The bull is bogged down by the threat of higher interest rates and a myriad of geopolitical concerns

The fundamental and technical considerations are still supportive of our preference for equities over bonds on a tactical basis. The investment risks we highlighted back in our February outlook remain as dark clouds on the horizon. The threat of higher interest rates in all the major financial markets have risen as oil and commodity prices hover at historical highs. Widespread geopolitical problems primarily stemming from rising tensions in the Middle East are adding fuel to the fire.

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A Pukka Rupee for Mauritius

By Samad Ramoly (Continued from Page 1)

Monetary stability is one of the most important preconditions for successful reforms in other areas of economic policy, namely flexibility in the labour market

The costs of a battered currency in a country like Mauritius, where international trade is a large share of its economic expansion, can prove high in many areas:

A) Despite the obvious erosion of purchasing power induced by the massive pass-through of rupee slide to domestic prices, some business spokespersons dispute the justification for the compensation allocated in the wake of the annual tripartite. Compensation for inflation, albeit under-estimated for lower and middle income groups due to the smoothing properties of statistics, is democratically legitimate and hence non-negotiable whereas collective bargaining ought to be applied to settle claims for pay increments or bonuses and ought to be performance-related. The vicious circle drawn has contributed to embitter industrial relations.

B) Paul Krugman, the caustic economist from MIT, offers ample food for thought when brain drain and job repulsion in some sectors are pondered: *"People don't care about GDP. They care about whether jobs are available, jobs pay and how that pay compares with cost of living. When your numbers tell you that people should be feeling good, but they aren't, that means you're looking at the wrong numbers."* In addition to the status of a job, the new generation of job-seekers is concerned with whether its level of inputs will be adequately rewarded.

C) *"Confidence in the rupee precedes low interest. The converse is invalid"*. Even such rational common sense expressed by the Governor of the Bank of Mauritius has failed to convince some blinkered foreign-exchange earners who are eager to have the cake and eat it too – a junk rupee and a globally competitive interest rate simultaneously (*). Since the market, regardless of the spin of government officials, keeps anticipating a rupee slide, a significant premium is charged on domestic interest rates.

D) The prospect of creating a cyber-island would be realistic only if the whole country was sufficiently networked. Yet a large segment of the population still cannot afford a PC as the plummeting rupee has inflated its cost. One exit for the government to narrow the "digital divide" is to subscribe to the "100 dollar laptop" programme developed by techno-gurus led by Nicholas Negroponte, the founder of the fabled MIT Media Lab and slashing the price of (genuine) broadband connection to break the 500 rupees (vat inclusive) mark.

E) When an overseas person is recruited for a job, her income is naturally calculated in accordance with the average salary it would fetch on the global scene. And this is normally dollar or euro-denominated. Now imagine the disparity and frustration it fosters when the pay packet is compared to the rupee-denominated income of her colleagues. A policy of cheap rupee not only breeds xenophobia but it also dramatically affects the vital exposure to global expertise.

F) The continuous decline in the value of the rupee has provided a cost cushion for exporters, thus removing an important incentive to enhance productivity and innovate. Furthermore, it deters foreign investment and undermines the chances of sustained growth.

The case for a currency board

Monetary policy choices for emerging economies must focus on long-term goals for achieving convergence with the developed world. For a monetary authority to be credible, it must convince the capital market, the business world and residents of the country that it is capable of issuing first-class money on a sustained basis. If our much-praised financial deregulation has proved a mixed blessing, it is because regulatory efficiency has not made it on the agenda of our policymakers.

To cope with the fast pace of international capital market integration, Europeans have launched a monetary union. The "fear of floating" against the US dollar affects every country. Out of biased sensitiveness or sheer ignorance, most advocates of the commendable strategy to open the economy further have overlooked the importance of a sound currency (*).

Dubai's dirham is pegged to the US dollar. The Bahamas dollar is exchanged on a 1-to-1 basis with the US dollar. The Monetary Authority of Singapore is committed to a managed float where the Singapore dollar is allowed to move within a narrow pre-determined exchange-rate band against a basket of currencies and backed by gold reserves in unorthodox fashion. Malaysia and China have more or less similar arrangements.

Estonia, Lithuania and Hong Kong have outsourced their monetary services – in a dollar-centric world, "monetary sovereignty" is mere fetishism – via a currency board which is legally-bound not to change the exchange rate and not to have uncovered issue of money. Is this our best solution? Since the connection to the London School of Economics seems to be mighty right now, Sir Alan Walters and Charles Goodhart, who helped to devise Hong Kong's currency board, could advise the government on how to overcome the technical inadequacies and implement the mechanism (*).

Singapore's monetary model could well have been an option, but the low degree of trust in the Bank of Mauritius due to its "politicised" sloppy moves – no need to be a trained econometrist to decipher the pattern – precludes any hope of success. Monetary stability is one of the most important preconditions for successful reforms in other areas of economic policy, namely flexibility in the labour market. To begin with, government must flex its muscles and keep its wits about it to ward off the clique of fat cats willing to dictate national policies that distort prices and integrate fiscal discipline in its lifestyle.

Endemic depreciation policies are tantamount to institutionalised "expropriation": influential drivers thrive on rent-seeking while everybody else becomes a risk-taker and a hedging or damage-control specialist. No wonder people are left to drool over Zara outfits on disposable-income-squeezing satellite channels, or to settle for a bootlegged version of the latest James Blunt CD in the booming underground economy or to celebrate their privileged moments with sugar-rich fizzy drinks and top the global rate of diabetes self-infliction.

A stable rupee and high productivity of all stakeholders are mutually reinforcing and together they lay the foundation for better distributed prosperity and a decent living standard. A sound rupee may not be everything, but everything is nothing without it. It is not about a chicken-and-egg debate, it is to do with gutsy leadership capable of upholding people's dignity.

(*) See "The Sinking Feeling" and "Le piège du taux d'intérêt élevé" on www.pluriconseil.com, *Keys to Prosperity: Free Markets, Sound Money and a Bit of Luck*, by Rudiger Dornbusch (MIT Press), and www.dollarization.org.

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