

CONJONCTURE

PluriConseil
THINKING OUT OF THE BOX!

Bilingual Journal of PluriConseil
N u m é r o 6 - F é v r i e r 2 0 0 6

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

Entrepreneurial qualities, not demand, will save us

EDITORIAL – By Eric Ng Ping Cheun

It is commonly held that there are four growth engines, namely private consumption, private investment, government expenditure and export. Economists with a keynesian mindset affirm that it is insufficient demand that takes the steam out of the growth engines. In this view, the IS/LM model saying that consumption drives production is based on the following presumptions:

- 1) Businesses would recruit and produce if and only if they expected to generate enough sales revenue to make a profit.
- 2) Should the demand for consumer goods diminish, capital goods industries would cut production and lay off workers.
- 3) A reduction of wages would aggravate an economic crisis in that it would lead to less spending for consumer goods.
- 4) The solution is to raise public expenditure along with increases of money supply and credit expansion through a lowering of interest rates.

One cannot deny that the purchase of consumer goods has an impact on the production process. But to claim that there is a connection between demand for consumer goods and demand for labour is to commit a logical fallacy that the former incorporates the latter, that in the very moment when one buys a consumer good one hires some labour services. In fact, the two events are physically separate.

Even under the current fiat monetary system where the quantity of money can expand rapidly – M2 surged by 14.2% in 2005 –, the logic of scarcity applies to it. The economic system as a whole is constrained by the quantity of money and the volume of spending. To expend an amount of money on consumer goods is to diminish one's ability to demand labour services, for the means to hire must come from the funds saved, that is from money not spent in the purchase of consumers' goods.

Consumption has increased because households have drawn on their savings

Looking at the latest national accounts released by the Central Statistics Office, one would say that households consumption expenditure was the major driver of growth in year 2005 as it represented 69% of Gross Domestic Product (GDP) at market

prices compared to 61.4% in 2003. Over this two-year period, as a percentage of GDP, general government consumption expenditure barely increased from 14.2% to 14.6%, public sector's investment decreased from 8.9% to 6.6%, and net exports of goods and services turned from a surplus of 1.3% to a deficit of 6.1%.

One can be surprised by the buoyancy of consumption in spite of the 50% hike in the rate of Value Added Tax brought by the previous government. The explanation is simple: consumption has not increased on the back of wealth creation due to increased production, but because households have drawn on their savings. In 2005, overall consumption expenditure grew strongly at 7%

as opposed to only 2.3% growth in GDP at market prices. As a result, the saving ratio declined by a full 6 percentage points to 16.7% of GDP.

The investment ratio, as measured by the ratio of Gross Domestic Fixed Capital Formation to GDP at market prices, remained at a paltry 21.3%. This low level of investment is consistent with a real GDP growth that was at a below trend of 3% in 2005. It is to be noted that, according to the latest *Digest of Productivity and Competitiveness Statistics*, real output grew at an annual rate of 5% between 1994 and 2004.

Continued on Page 4 .../

SELECTED ECONOMIC INDICATORS

| | Unit | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|-----------------------------|-------|-------|-------|-------|-------|
| Real Economy | | | | | | |
| Per capita GDP | US\$ | 3,370 | 3,469 | 3,940 | 4,421 | 4,883 |
| Real GDP growth | % | 5.6 | 2.1 | 3.7 | 4.5 | 3.0 |
| Investment ratio | % GDP | 22.5 | 21.8 | 22.7 | 21.7 | 21.3 |
| Saving ratio | % GDP | 28.4 | 27.6 | 24.8 | 22.7 | 16.7 |
| Unemployment rate | % | 6.9 | 7.3 | 7.7 | 8.5 | 9.5 |
| Budget deficit | % GDP, June | 6.7 | 6.1 | 6.2 | 5.4 | 5.0 |
| Government debt | % GDP, June | 48.9 | 52.7 | 56.9 | 56.1 | 57.7 |
| Public sector debt | % GDP, June | 63.4 | 66.2 | 68.7 | 65.3 | 66.0 |
| Monetary Economy | | | | | | |
| Broad money growth | % | 10.8 | 12.5 | 10.9 | 13.2 | 14.2 |
| Inflation rate | % | 5.4 | 6.4 | 3.9 | 4.7 | 4.9 |
| Change in real wage rate index | %, September | -0.5 | -1.4 | +7.0 | +2.4 | n.a. |
| Unit labour cost growth | % | 2.8 | 5.2 | 6.4 | 4.2 | n.a. |
| 12-month moving average change of Rs against US\$ | % ⁽¹⁾ | -9.7 | -2.9 | +5.6 | +2.1 | -6.0 |
| Prime Lending Rate | % ⁽²⁾ | 10.00 | 9.50 | 8.25 | 7.75 | 9.50 |
| External Economy | | | | | | |
| Net exports of goods & services | % GDP ⁽³⁾ | +5.9 | +3.0 | +1.3 | -2.4 | -6.1 |
| Current account balance | % GDP | +7.7 | +5.2 | +1.7 | -1.8 | -5.8 |
| Gross official international reserves | US\$ million ⁽²⁾ | 848 | 1,240 | 1,598 | 1,630 | 1,366 |
| Import coverage | Weeks ⁽²⁾ | 32.9 | 35.2 | 36.6 | 32.6 | 34.8 |
| Debt service ratio | % Exports, June | 9.7 | 8.5 | 8.0 | 6.5 | 5.9 |
| Rs/US\$ | End Period ⁽²⁾ | 30.45 | 29.45 | 26.82 | 28.49 | 30.79 |

⁽¹⁾ A negative (positive) sign means rupee depreciation (appreciation).

⁽²⁾ End December

⁽³⁾ As from year 2002, figures include Freeport transactions.

n.a.: non available.

Sources: Central Statistics Office, Ministry of Finance, Bank of Mauritius

The key to successful strategic planning

By Kris Seeburn

Strategic planning is a business process that many companies employ to identify critical success factors that set the course for future growth and profits.

Lewis Carroll in "Alice in Wonderland" makes a good case for it: "Would you tell me, please, which way I ought to go from here?" said Alice. "That depends a good deal on where you want to get to," said the Cat. "I don't much care where..." said Alice. "Then it doesn't matter which way you go," said the Cat.

Like most business processes, the key to success is the effective implementation of the plan. Companies that do a good job of developing and executing their strategies can create a competitive edge that provides increased market share and higher gross profit margins. Organizations that turn their plan into a "dust collector" upon an executive bookshelf, will never achieve their full growth and profit potential.

Most criticism of strategic planning is aimed at the planning process. They question the validity of a plan that has been based on market "guesstimates", the questionable valuation of the depth and breadth of competitors and an optimistic assessment of the company's internal strength and weakness. The fact that strategic plans can be overly optimistic is not the core problem. Although the criticism may be appropriate, it puts the focus for improvement on the wrong end of the process – it is the implementation task that is critical to producing positive results and it is here where most companies fail at strategic planning.

Poorly implemented rational, strategic plans will produce limited positive results. On the other hand, overly optimistic strategic plans, effectively implemented, can produce results

beyond everyone's expectations. This being the case, what is the key to effective implementation? In one word – commitment!

Companies that are good at strategic planning build commitment to the planning process and to each of the strategies within the plan.

Companies that are good at strategic planning build commitment to the planning process and to each of the strategies within the plan. They build commitment throughout the organization, working with people from all business functions to build commitment before, during and after development of their strategic plan.

Winners begin early in building a commitment to the strategic plan. Suggestions are encouraged from managers at all levels, from key executives who will participate in the planning sessions, and others who will share responsibility for implementing the resultant strategies. Together, they surface issues that will require changes in business process and/or culture and identify those constraints that will need to be overcome if implementation is to be successful.

During planning sessions, key executives from each functional area are all encouraged to participate and contribute to the plan. These executives develop strategies that build on organizational strengths and consider resources required to accomplish those strategies. They assure that a key executive "owns" each strategy and commits to a time schedule for its accomplishment. The key executives give thought to resource planning – realizing that human resources are the key to making positive things happen in difficult, complex business environments – and they commit accordingly.

Following the development of their plan, those responsible for implementations develop their own "tactical plans". These action plans, when coupled with self-directed work teams, are major contributors to a successful Strategic Planning implementation. Teams use their plan to manage, to make decisions and to grow their business. Periodically, they review their "tactical plans" to monitor and report on the progress of implementation – keeping the plan "alive" by revising strategies and tactics when necessary.

Finally, to insure successful implementation of their strategic plan, they work on the planning process itself. The planning group continuously fine-tunes the planning process to insure that inputs from all business functions are given their due consideration and to insure that buy-in and commitment to the final plan is agreed upon throughout all levels of the organization.

So, why are most operations management teams outside of the strategic planning process? Why do many line managers view strategic planning as a make work project that produces little or zero value to customers? Maybe, it is because they did not participate in its development nor did they buy into its validity – let alone commit to the execution of its strategic objectives. In short, they are not connected to the process! To achieve a company's full growth and profit potential, CEOs and business owners need to insure the active participation of operation management in the strategic planning process.

Kris Seeburn is a management consultant. This article is a short version of a forthcoming paper to be published by Strategic Planning Society (UK) in the magazine *Strategy*.

OUTLOOK FROM SINGAPORE

By Daryl Liew

In his maiden appearance before Congress, New Fed Chairman Ben Bernanke reiterated his predecessor's hawkish statement that US monetary policy has to remain tight in order to combat rising inflationary pressures. Analysts are now expecting the Fed to raise interest rates by 25 basis points for a 15th consecutive time on 28th March, bringing short-term rates to 4.75%. The odds of a further hike at the May meeting also shortened considerably after Bernanke's comments. Whether this will happen will depend largely on the economic data that emerges in the interim.

With the economy in the Euro Zone slowly picking up and unemployment declining, the threat of inflation is again rising. Comments by ECB President Trichet suggest that the ECB will likely raise rates by 25 basis points in March, bringing European interest rates to 2.5%.

Short-term bonds continue to struggle on fears that there may be more interest-rate hikes in store. The US yield curve is again inverted with the 2 year yielding higher than the 10 year, a sign that the market expects rates to fall in the future. Bonds continue to look expensive relative to equities.

The fundamental and technical considerations are still supportive of our preference for equities over bonds on a tactical basis. However, we recognise that investment risks have increased over the past few months, exacerbated by widespread geopolitical problems primarily stemming from rising tensions in the Middle East, challenging market technicals and the threat of the Fed raising rates higher than previously expected. As such, we believe that we will see a lot more market volatility this year.

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Dollar faible ? Dollar fort ?

Par Jean-Yves Naudet

Le jeu de cache-cache se poursuit entre le dollar et l'euro. Les analystes ont du mal à articuler des éléments conjoncturels qui semblent incertains : la faiblesse de l'économie de l'Euroland comparée à la vitalité de celle des Etats Unis, la hausse du prix du pétrole, les tensions inflationnistes qui amènent la Fed à relever ses taux, les déficits de la balance américaine, etc.

S'il est difficile d'y voir clair, on doit prendre un peu de recul, et avoir en tête quelques évolutions significatives. Le 30 décembre 2004 l'euro valait 1,3666 dollars, depuis lors il n'a cessé de perdre de la valeur par rapport au billet vert. Pendant la même période l'écart des taux de croissance s'est creusé et les Etats Unis semblent avoir digéré les deux chocs de la hausse du baril de pétrole et des cataclysmes qui se sont abattus sur la Louisiane, le Texas et la Floride.

De la sorte, ceux qui prédisaient l'évolution du dollar à près de 1,50 pour un euro ont été bien imprudents. Il faut se rappeler que nous sommes dans un marché des changes libre, avec des parités flottantes.

Le taux de change est un prix qui doit varier librement

Nous avons vécu dans tout l'après-guerre dans une situation de changes fixes, avec le système de Bretton-Woods. Celui-ci a été abandonné dès 1971 avec la décision du Président Nixon de suspendre la convertibilité en or du dollar et de laisser peu à peu flotter la monnaie américaine. La plupart des grandes monnaies mondiales ont fait de même, à l'exception des monnaies européennes qui sont restées fixes entre elles pour aboutir à la monnaie unique, l'euro.

Il faut réaliser, avant tout, que le marché des changes est aujourd'hui un marché comme un autre, un marché libre, et que sur ce marché doit s'établir un prix, qui est le taux de change. Or sur un marché, il est indispensable que le prix varie, pour indiquer les raretés présentes et futures. Le prix (le taux de change) est un vecteur d'information, qui pousse les agents économiques à modifier leur comportement, ce qui permet peu à peu de faire évoluer offres et demandes.

Si l'on était en changes fixes, par exemple entre le dollar et l'euro, la baisse du dollar en 2004 aurait dû être compensée par des achats de dollars et des ventes d'euros, ce qui se serait traduit par une création de monnaie européenne non souhaitée, susceptible de provoquer de l'inflation en Europe. Inversement, la hausse du dollar

en 2005 aurait dû entraîner une vente (donc une création) de dollars et des achats d'euros, ce qui aurait provoqué des tensions inflationnistes aux USA. Le passage aux changes flottants fait que les banques centrales (normalement) n'interviennent plus sur les marchés des changes et peuvent mener les politiques anti-inflationnistes qu'elles souhaitent, notamment de contrôle de la masse monétaire, sans être perturbées par les facteurs externes.

L'inversion de tendance en 2005

Il faut donc se réjouir de ce que dollar et euro, yen et livre, varient : cela fait partie du fonctionnement normal de nos économies et cela permet les ajustements. Reste à savoir si le dollar doit monter ou baisser. A priori, on n'en sait rien, car cela dépend des offres et demandes de chaque monnaie, elles mêmes fonction de la confiance que l'on a en elles. Or la confiance est un phénomène complexe et l'on ne peut savoir à l'avance si c'est telle ou telle monnaie qui va s'apprécier. Seuls les marchés à terme peuvent l'anticiper et ces marchés permettent justement aux acteurs économiques (banques, entreprises) de se prémunir contre les variations intempestives des cours des monnaies, en achetant des devises à terme. Les mécanismes marchands sont ici très supérieurs aux interventions étatiques.

En 2004, c'est le dollar qui était à la baisse et l'euro à la hausse. En 2005, c'est l'inverse et, depuis le début de cette année, l'euro est passé de 1,36 à moins de 1,20. Ainsi, la monnaie unique a perdu 12,7% par rapport au dollar.

Le dollar est encore vert

Pour savoir si la nouvelle tendance est durable ou non, comprenons pourquoi la devise américaine a progressé ces derniers mois. En 2004, on avait encore des doutes sur l'économie américaine et sur ses déficits. En 2005, l'Amérique était de retour. Quoi de plus normal que l'euro se déprécie et le dollar s'apprécie quand il y a 4% de croissance économique aux USA, alors que les piliers de l'euro (France et Allemagne) se traînent à 1 ou 1,5% ? De même, on peut avoir confiance dans l'économie américaine quand on sait que le chômage y est deux fois moins élevé que dans la vieille Europe (5% contre 10%). Tant que l'on aura plus confiance dans l'économie américaine que dans celle de ses partenaires, le dollar s'appréciera.

Certes, un facteur important de la confiance repose sur la hausse des prix et les anticipations d'inflation. Or celle-ci est

légèrement plus élevée en Amérique qu'en Europe. Un si faible écart ne justifie pas une spéculation contre le dollar, d'autant plus que Alan Greenspan a augmenté le taux d'intérêt pour rassurer les porteurs de billets verts. Ainsi les taux d'intérêt sont-ils plus élevés aux USA qu'en Europe ou au Japon, ce qui contribue à soutenir le dollar en attirant des capitaux.

Reste la question souvent évoquée des « déficits jumeaux », budgétaire et commercial. Il est vrai que les Etats-Unis ont un déficit excessif des finances publiques, qu'il leur faudra résorber. Mais les marchés ont fini par réaliser que ce déficit, en pourcentage du PIB, n'était pas supérieur à ceux de la zone euro (3% environ dans les deux cas). L'Europe n'a pas à donner dans ce domaine des leçons de rigueur à l'Amérique.

Quant au déficit de la balance commerciale, il est vrai qu'il est élevé aux USA, encore que dans ce domaine la France aussi donne depuis peu le mauvais exemple. Mais on découvre peu à peu que ces déficits n'ont guère d'importance. Ce n'est pas un drame si les importations dépassent les exportations, du moment que la monnaie est acceptée en paiement par les autres pays, ce qui est le cas du dollar. Tout cela ne signifie pas que le dollar continuera à monter : on verra bien ce que décident les marchés. Mais on est loin de l'apocalypse de la monnaie américaine : le dollar est encore vert.

Jean-Yves Naudet, professeur d'économie à l'Université d'Aix-Marseille III, est rédacteur-en-chef de *Nouvelle Lettre*, un bulletin édité par l'Association pour la Liberté Economique et le Progrès Social (ALEPS), fondée par Jacques Rueff.

Entrepreneurial qualities, not demand, will save us

(continued from Page 1)

During this period, capital productivity, defined as the ratio of real output to stock of fixed capital used in the production process, declined on average by 0.5% per annum, implying that capital assets were not being efficiently used.

Savings or investments per se do not guarantee prosperity

Pandering to popular neo-classical thinking, our private sector's representatives are very influenced by the productivity theory of capital, which states that:

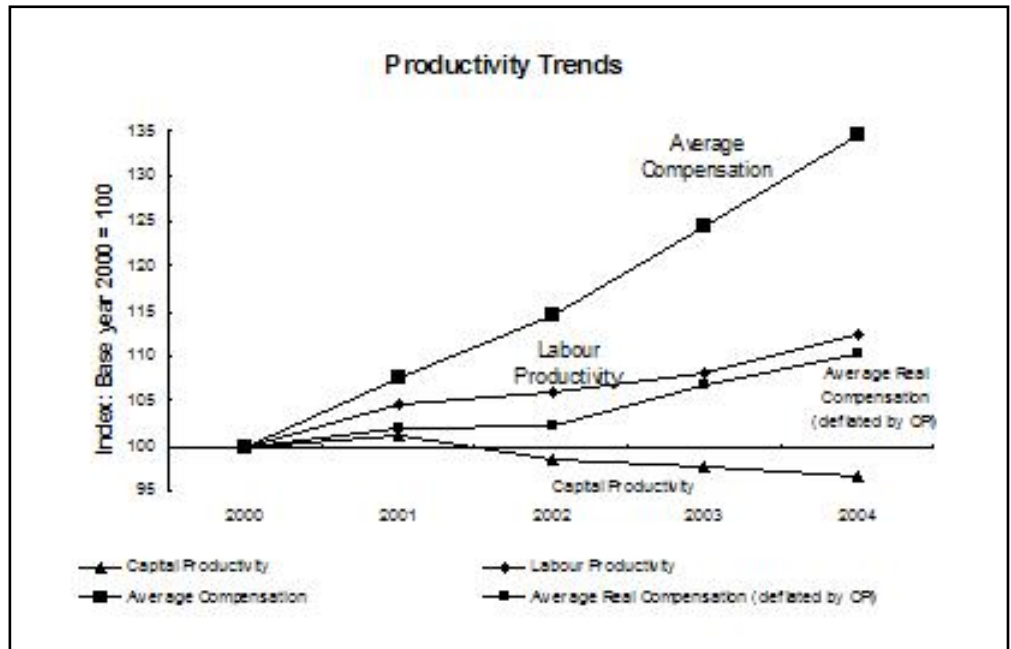
1) more saving implies more investment, and
2) more investment means a higher capital stock which, in turn, raises economic growth. True, high rates of saving and investment do bring strong GDP growth rate, but they can be deceiving indicators about the real performance of an economy.

Savings or investments per se do not guarantee prosperity. Austrian capital theory in the tradition of Carl Menger tells us that monetary saving does not necessarily translate into investment, and investment is not necessarily capital formation that promotes economic growth. Real capital does not exist as a homogeneous lump as if there were a capital stock that enters the production function to yield the national income. Rather, real capital exists as a heterogeneous ensemble of diverse capital goods.

Only in terms of accounting can capital be said to grow or to diminish. In contrast to monetary capital, real capital has a limited period of usefulness, for capital goods wear down and become obsolete when the production structure must be adjusted to a change in technology or market conditions. It is not accumulated monetary capital but real capital that yields output and, as such, only in so far as it is constantly remodelled by entrepreneurs who bring innovation, creativity, best management practices and modern technologies. Capital without entrepreneurial activity is an empty concept.

Productivity cannot be obtained without continuous rearrangement of new capital goods, which we call capital rotation. Mauritius needs capable entrepreneurs who can work out the roundabout capitalist production processes that enable their firms to stay competitive. Whatever the level of saving and investment, it is the entrepreneurial quality of the management of the capital structure that will determine the wealth of a nation. If it were merely aggregate investment that mattered, poor countries could become rich overnight by just borrowing abroad!

Less capital investment leads to a slower growth of output in the economy which, in turn, causes prices to be higher than they otherwise would be, and brings about a decline in the growth of employment. Between 1994 and 2004, labour productivity as defined by real output per worker witnessed a positive annual growth, meaning that GDP was increasing at a higher rate than employment. However, the 3.9% annual increase in labour productivity was inadequate to absorb the 8% annual rise in



average compensation of employees, which comprises all wages, salaries and payments in kind. Consequently, Unit Labour Cost grew by 3.9% annually. And the unemployment rate, which tends to be directly proportional to Unit Labour Cost, rose continuously from 4.5% in 1994 to 8.5% in 2004.

Observe that average compensation, when deflated by the Consumer Price Index (CPI), lagged behind labour productivity. Over the 2000-2004 span, average real compensation went up by 10.3% against a 12.2% increase in labour productivity. Put in simple terms, it means that workers were not sufficiently remunerated for their productivity in terms of purchasing power. As a symptom of declining living standards, it could be frustrating for people to see their efforts being eaten up by inflation.

To alleviate minimum-wage unemployment, Government must restore freedom in the labour market

Such a situation, compounded by high unemployment, breeds social ills. What condemns many to chronic unemployment is actually minimum wage legislation. The latter forcefully raises the costs of unskilled and inexperienced people and thereby prices them out of the labour market. Most victims are young with little training and know-how. The results of the Continuous Multi-Purpose Household Survey for the third quarter of 2005 show that 54% of the unemployed males, who are more inclined to turn to violence and crime, were under 25 years.

Above the minimum rate, our employers have to pay mandated fringe benefits such as end-of-year bonus, cost of living allowance, refund of travelling of work, contributions to social security, training levy and paid local leaves. Other benefits include contributions to private pension fund, contributions to health and casualty insurance schemes, foreign travel benefits, and goods and services provided to

employees free of charge.

Labour legislation is the very cause of mass unemployment. To alleviate minimum-wage unemployment, Government must restore freedom in the labour market, which would allow average compensation to readjust to labour productivity and which would create employment to every man and woman looking for work and available for work. Also, bringing a deregulation of business would lower the effective tax on capital investment, make it profitable and encourage more capital investment which would boost labour productivity.

Otherwise, if business remains heavily regulated, corporate decisions are based more on compliance with governmental edicts than on profit-making. The substitution of bureaucratic compliance for profit-making decisions reduces profitability. Worse, price control brings gross distortions of markets and destroys the country's industrial productive capacity.

Let entrepreneurs thrive

Nobody is foolish enough to believe that the current bullish trend of our stock market is a true reflection of the state of the Mauritian economy. A stock market is not a wealth-generation machine. Higher stock valuations may appear as wealth creation when, in fact, it is not the price of an asset that constitutes wealth but the solid profits that come from the production process. Financial assets will appreciate in so far as savings continue to be generated and transformed into real capital by able entrepreneurs.

Consumption expenditure is not the appropriate fuel to crank the economic engine. But saving and investment will be pure waste if companies are run by people who lack entrepreneurial qualities, or if institutional settings hinder entrepreneurs' actions. Mauritius' capacity to adapt to and compete against the forces of globalisation is linked with the overall conditions of its economy where entrepreneurs can thrive.