

CONJONCTURE



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

Time to walk the talk

by Samad Ramoly

Thousands of citizens struggling to make ends meet were desperately seeking to cushion their everyday plight. They were magnificently served by the new government in the "100 premiers jours". They greeted the government with equal eagerness in the municipal elections. The urge to "sanz lavi dimoun" has been abundantly obvious. There is absolutely no paradox in trying to "marier la justice sociale et la bonne gestion" in typical Scandinavian fashion as long as we have a step-by-step clear-cut vision of how to make it happen in addition to the long term general ideal.

It is secondary to indulge in ideological debates about whether it is the "hand" of the State that should be made more visible or whether the market be regulated by its "invisible hand". What matters for a result-oriented government is the context within which policies are implemented. It is a daunting balancing act whereby the government creates the appropriate conditions so that every stakeholder, local or foreign, feels comforted that her inputs are adequately rewarded. The progress of a nation is critically correlated to the citizen's trust in the system.

The following customized table is an attempt to measure the degree to which the policies and institutions of countries are supportive of their competitiveness. We are open to questioning the methodologies devised for assessment therein, yet the results remain a useful and realistic benchmark.

The relatively higher competitiveness index of Scandinavian nations and Singapore suggests that only excellence-driven countries are able to cope with the unforgiving nature of globalisation. Ironically, and not surprisingly, France and India, perhaps our most influential "role models", do not enjoy glorious scores under most of these selected criteria. It is worth pointing out that the buzz attributed to India and China is widely an urban phenomenon while rural areas are shining dimly, if at all.

True, we can boast we enjoy a higher index than most of our African neighbours, but still we are laggards on a global scale. Today we are trapped in a systemic failure because we have not scrutinised our brand of development. In a recent historic *mea culpa*, Rodrigo de Rato, the Managing Director of the IMF, stated that his organisation will modify its "all-encompassing approach to a more incisive analysis of specific weaknesses and distortions that create risks of crises or hinder adjustment to the integration to the global economy".

The IMF is notorious for buying one-time compliance to "sound economic fundamentals" without foreseeing setbacks down the line. In Mauritius, the "miracle"-cum-"bubble" was bound to burst precisely because we have gullibly subscribed to the shoddy prescriptions of the IMF and the World Bank. Obviously, their accolades are of bad omen. A disruption to our economic model reflects a disruption to the IMF/World Bank model. If our policymakers do not get the message, we should better fasten

our seatbelts for a very bumpy ride ahead.

The case for a growth rate of 7% or more to ward off the doldrums is essentially founded on "voodooconomics" rather than rational common sense. Basically, the population has heavily subsidised our growth much less for its own benefits than for the lavish lifestyle of some fat cats and insatiable governments. We will not budge in terms of democratisation" should our growth remain inflationary. The challenge is to shift the engine of our economic expansion from privilege to core competitiveness.

A new paradigm

Since we did not seize the opportunity of the 1983/1987 "feelgood" period to reform the structure of the economy, we must now brace ourselves against stiff resistance from all quarters. To stimulate a thoroughly innovation-driven growth, the new paradigm must be based upon:

Strong institutions: It is not the number of times we repeat that we live in an "Etat de droit" that determines the vibrancy of a liberal democracy but how law-abiding people actually live. The "bottom of the pyramid" internalises the rule of law when the "top" leads by example, when the citizen does not feel that the laws are arbitrarily imposed on her. If not, she is offered a moral justification to flout them. To promote healthy norms of operations, enforcement of rules and regulations must demonstrate fairness and transparency.

Sound rupee: Resorting to price control to redress the purchasing power of people is self-defeating and is tantamount to mere fire-fighting when rupee depreciation persists and massively passes through domestic prices. A strong stability-bias will not only restore confidence, reduce the cost of borrowing and sever the vicious cycle: it will also provide a solid incentive to boost productivity at every level. The adoption of a currency board similar to those of Hong Kong and Estonia, but with a basket of USD and Euro as anchor for some flexibility, is a tested alternative.

| | Impartiality of courts | Protection of intellectual property | Mean tariff rate | Flexibility of hiring & firing | Red tape | Size of trade sector | Perception of corruption | Rank in growth competitiveness |
|------------------|------------------------|-------------------------------------|------------------|--------------------------------|------------|----------------------|--------------------------|--------------------------------|
| Mauritius | 4.8 | 4.2 | 4.9 | 3.0 | 2.5 | 4.6 | 4.1 | 52 |
| China | 4.5 | 4.3 | 7.0 | 5.2 | 4.7 | 10.0 | 3.4 | 49 |
| Finland | 8.7 | 8.5 | 9.7 | 4.7 | 5.8 | 3.8 | 9.7 | 1 |
| France | 6.5 | 7.8 | 9.7 | 2.0 | 2.0 | 4.1 | 7.1 | 30 |
| India | 5.8 | 4.0 | 3.8 | 2.2 | 3.7 | 5.8 | 2.8 | 50 |
| Singapore | 7.8 | 7.8 | 10.0 | 7.7 | 7.2 | 10.0 | 9.3 | 6 |
| UAE | 6.2 | 6.3 | 9.2 | 6.5 | 6.3 | 6.9 | 6.1 | 18 |
| UK | 8.8 | 8.5 | 9.7 | 5.8 | 4.2 | 4.0 | 8.6 | 13 |

Score ranges from 0 to 10 with 0 the worst and 10 the best

Sources: The Fraser Institute (www.freetheworld.com), Transparency International (www.transparency.org), World Economic Forum (www.weforum.org)

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Tariff cuts mitigated by rupee depreciation

In April 2005, the then Minister of Finance, Pravind Jugnauth, brought about a reduction in customs duty on 1,850 tariff lines as a policy towards making Mauritius a duty-free island within four years. But the new Minister of Finance, Rama Sithanen, has come with a number of measures which, according to him, will give a boost to the economy. Among the measures for the manufacturing sector are the removal of VAT on gold and jewellery products, the elimination of customs duty on a list of inputs and parts used in the non-EPZ enterprises, and the reintroduction of customs duty on a range of clothing items.

We carried out a **static one-year analysis** in respect to the reduction in tariffs made by Mr Jugnauth and to Mr Sithanen's measures. The assumptions used are:

- > All tax rates are fixed.
- > The real exchange rate is flexible whereas foreign savings and the trade balance are constant.
- > Investment is driven by savings.

Tariff reductions, as theory predicts, attract more imports of goods and these goods are sold at a cheaper price. From an individual point of view, one should be happy to have a larger variety of goods to choose on the

market and to be able to buy some goods that one could not afford previously. However, from a national point of view, an increase in imports means that the country needs more foreign currency to pay for the increased imports, and this normally puts more downward pressure on the value of the Mauritian rupee.

We assume that the current government is prudent and that they will avoid a deterioration of the balance of payments. So we believe that the current account balance will be more or less the same. We estimate that the tariff-related measures will make the rupee depreciate by around 2.9% over one year. The depreciation of the rupee makes imports more expensive and exports cheaper. Therefore, the extent to which imports will increase not only depends on the tariff cuts but also on the depreciation of the rupee. For imports with low initial tariff, the depreciation might dominate, and this would mean that their prices would rise and the volume of such goods would decline.

To give some figures, imports of food products would increase by 4.6%, wearing apparels 10%, leather products 23% and paper products 5.8%. However, imports of beverages and tobacco might fall by 0.7%, due to the fact that some traders would invest some of their capital in imports of duty free products rather than of beverages and tobacco. The quantity of domestic sales for gold and jewellery products would increase by 2.5% following the removal of VAT on them.

As far as prices **on average** on the local market is concerned, the following products will be sold cheaper: wearing apparel by 10%, leather products 27%, machinery and equipment 10%, and paper products 2%. However, though prices of some manufactured food products will certainly fall considerably, on average prices of food products will fall marginally. This is because, firstly, much of our food products are locally produced and, secondly, the rate of duty on some food products was already very low (15%) and, where the rates were high, they were reduced in most cases by only 15% or 10% (from 55% to 40%, or from 40% to 30%).

The cuts in customs tariffs, given our level of unemployment, will act as an incentive for the unemployed to operate as traders. The move towards the removal of VAT on gold and semi-finished jewellery is an attempt to protect local manufacturers in that field and to avoid job losses. Overall, the tariff-related measures are likely to increase the employment level by 3.8%, the level of individual income by 3.5%, the consumption level by 2.7%, and the gross domestic product by 1.7% in real terms, over one year.

The above analysis, based on the assumption that the policies announced will be implemented, will be affected if other policy measures or major changes at the international level arise in the future.

OUR METHODOLOGY: GENERAL EQUILIBRIUM MODELLING

General Equilibrium is an analytical approach looking at the economy as a complete system of interdependent components such as industries, households, investors, government, importers and exporters. A general equilibrium model can be best understood as one in which there are markets for each of N commodities, and consistent optimization as part of equilibrium. Consumers maximize utility subject to their budget constraint, leading to the demand side specification of the model. Producers maximize profits, leading to the production-side specification. In equilibrium, market prices are such that the required equilibrium conditions hold. Demand equal supply for all commodities, and in constant returns to scale case, zero-profit conditions are satisfied for each industry.

ECLAIRAGE : BALANCE DES PAIEMENTS

Un déficit commercial (importations supérieures aux exportations) n'est pas nécessairement mauvais pour un pays dont l'économie dépend des importations pour être en forte croissance. On a défini la balance commerciale de manière habituelle, c'est-à-dire par rapport au commerce extérieur des biens, qu'on appelle le commerce visible, car ce sont des produits visibles, enregistrés à la Douane. Pour être plus précise, la balance commerciale doit inclure les services – les "invisibles" – qui concernent les voyages et le transport, donc principalement le tourisme. Si l'on ajoute au commerce des biens et services les mouvements des revenus de placements et les transferts de paiements, on obtient le compte courant.

La balance des paiements comprend le compte courant, mais aussi le compte capital qui sert à mesurer les flux financiers, tels les achats d'actions et d'obligations, les investissements directs et toutes les transactions sur les actifs internationaux exécutées par la banque centrale. La valeur d'une importation entre comme débit dans le compte courant. Son paiement représente la vente d'un actif à l'étranger, et il entre comme crédit dans le compte capital. En somme, tout déficit du compte courant doit être compensé par un surplus équivalent du compte capital, et vice versa. Donc, en théorie, la balance des paiements est toujours égale à zéro.

Extraits de : Eric Ng Ping Cheun, *Mieux comprendre l'économie*, 2005

OUTLOOK FROM SINGAPORE - By Daryl Liew

Global Economy

US payrolls for September fell by 35,000, the first decline since May 2003. The September ISM ("Institute for Supply Management") reports showed mixed results, with manufacturing rising to 59.4 from 53.6 in August, while the services ISM fell sharply by 11.7 points to 53.3. This larger than expected fall in the services report spooked the market, fuelling fears of economic weakness. The most recent post-hurricane statistics are however relatively positive and the US economy is still showing signs of growth. Concerns now have switched to the rising threat of inflation which may well derail the US economy.

The Japanese Tankan index rose by one point from the previous quarter, as respondents were more upbeat about profits for the current fiscal year. Investment plans have also been revised upwards, with capital expenditures forecast to increase by 6.8%. The Japanese economy continues to look in good shape heading into the final quarter of the year.

Manufacturers in Western Europe reported a pickup in activity in September, possibly a result of the increased retail activity in August. A rise in inflation and uncertain labour market conditions however continue to weigh on consumers' willingness and ability to spend. The 0.3% jump in German unemployment in August illustrates just how fragile the Eurozone's economy is at present. With no new catalyst in sight, Europe is still poised to lag the other major regions.

Interest Rate

Opinions remain divided as to how much further the Fed will go on their "measured approach" to interest rate hikes. With interest rates currently standing at 3.75%, some analysts scrambled to raise their forecasts from 4 to 4.5% on the back of stronger than expected economic data. Fed speakers also fuelled expectations of higher rates as they reiterated their concerns of preventing an "inflation virus" from disrupting the economy. Expect the Fed to raise rates by another 25 basis points on 1st November. Subsequent inflation indicators will then determine

whether there will be more tightening to come.

The Bank of Japan has hinted that it may gradually shift away from its extremely accommodative monetary policy as core consumer prices are expected to rise by year-end. The BOJ flooded the banking system with money in 2001 in order to combat deflation, a policy known as quantitative easing. Expectations are that the BOJ will end this quantitative easing possibly in six months time once inflation works its way through the economy.

The ECB and the Bank of England kept their rates at 2.0% and 4.5% respectively after its latest monthly meetings. While the BoE's interest rate cycle is now on a downtrend, Jean-Claude Trichet continues to hint that the ECB will raise rates at the earliest opportunity to battle rising inflation. This however probably won't happen until next year as the Eurozone's economy continues to struggle.

Technicals

Short-term technical indicators are in a downtrend with most indices hitting new lows after the highs of September. While the indicators may be approaching the lower support levels, the market may fall further before stabilising.

The technicals for bonds are also looking bleak, with prices falling in tandem with equity markets.

The fundamental and technical considerations are still supportive of our preference for equities over bonds on a tactical basis.

However, inflation is the current concern topping the lists of the investment community as Fed watchers eagerly look for signs that the Fed is approaching the end of its tightening cycle. Much now depends on crucial inflation indicators which will dictate the Fed's next action. We believe equity markets will continue to struggle and range trade until this matter is resolved.

Valuation

Global equity valuations are looking a little less stretched as prices have corrected in the last week after rallying for the past five months. Forward earnings are still in

line with expectations.

Bond prices have fallen as inflationary fears take hold. 10 year US bond yields are now hovering around 4.40%. Despite this, bonds continue to look expensive relative to equities.

Scenarios

Base Case: Equity markets stabilise as inflationary fears in the US prove unfounded. The global economy grows at a sustainable pace on the back of more stable oil prices and a calmer geo-political climate.

Worst Case: Inflationary pressures work its way through the system forcing central banks to raise rates faster than previously expected, adversely affecting both equity and bond markets. A harsher winter season and further disruptions to oil supplies cause oil prices to escalate, fuelling spiralling inflation. Terrorist attacks and an increasing geo-political risk premium paralyse the markets.

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Rumeurs et signaux

Elle court, elle court, la rumeur. Comme la rumeur politique, la rumeur économique a ceci de pervers qu'elle alimente les spéculations. Si l'on n'y met pas fin rapidement, elle peut se transformer en prophétie auto-réalisatrice. Une rumeur ne s'entretient que par l'absence de signaux de la part de ceux qu'elle interpelle. Entre rumeurs et signaux, il ne faut pas jouer à l'ambiguïté constructive.

C'est quoi donc cette rumeur qui affole tant les milieux financiers ? La roupie sera dévaluée de 25% ! Le dollar américain s'échangerait alors à Rs 38, l'euro à Rs 46, et la livre sterling à Rs 67. Nos exportations du textile, gagnant ainsi en compétitivité, seraient en mesure de concurrencer les produits chinois, et l'industrie sucrière survivrait à la baisse annoncée de 39% du prix du sucre.

Une telle politique est inimaginable parce que suicidaire. D'abord, elle mettrait à mal la crédibilité même de la Banque de Maurice qui, depuis l'abolition du contrôle des changes en 1994, est officiellement chargée d'assurer un système de flottement impur – "managed float" – dans lequel la roupie est supposée fluctuer librement, avec toutefois la possibilité pour la banque centrale d'intervenir via la vente ou l'achat de dollars. De fait, la roupie n'a cessé de se déprécier sans même qu'elle soit

l'objet d'une dévaluation.

Il n'est point question de sémantique. Dévaluation veut dire dépréciation FORCÉE de la monnaie. De août 1998 à aujourd'hui, soit une période de plus de sept ans, le dollar s'est apprécié de 25% par rapport à la roupie. Si le gouvernement décidait de dévaluer, de déprécier par décret, la roupie du même montant du jour au lendemain, il changerait les règles du jeu. Ce serait une forme d'autoritarisme monétaire, contraire au principe de "predictability", et qui déstabiliserait tout l'environnement économique.

Ensuite, la "dévaluation compétitive" serait désastreuse pour l'économie mauricienne tant au plan de l'éthique que de l'efficacité. Premièrement, est-il moralement juste de pénaliser des activités émergentes ou en pleine croissance, au profit de deux secteurs mourants qui contribuent à peine 12% du Produit intérieur brut ? La politique nationale ne saurait être dictée par des groupes de pression. Elle doit plutôt servir l'économie dans son ensemble. Et ce n'est pas en asphyxiant les Petites et Moyennes Entreprises par une dévaluation monétaire que le gouvernement parviendra à démocratiser l'économie.

Deuxièmement, la "dévaluation compétitive" a montré ses limites : des subventions monétaires aux exportateurs ne remplacent pas la compétitivité

naturelle, mais la diminuent à la longue. On en est déjà là après vingt ans de perfusion monétaire artificielle. Y continuer ne sauverait pas des emplois, car le malade est condamné.

La politique monétaire n'est pas la gestion d'une usine, mais celle de l'économie d'un pays. Alors que la croissance stagne actuellement sous un chômage de masse, l'inflation à deux chiffres induite par une dévaluation de 25% casserait les ressorts d'une reprise encore introuvable. Le prix du pétrole, déjà très élevé, coûterait beaucoup trop cher en roupies dévaluées. Le gouvernement serait obligé de renoncer à la gratuité du transport public au risque d'attiser la tension sociale. Crise monétaire, crise économique et crise sociale se conjugueraient pour éloigner les investisseurs étrangers.

Un ministre des Finances trop silencieux, un gouverneur de banque centrale trop effacé : il y a de quoi faire courir les rumeurs. Même si elles sont des plus farfelues, il est temps de les faire taire. Par un signal clair et net.

Time to walk the talk

by Samad Ramoly (Continued from Page 1)

Revenue optimisation and Global integration: The dilemma with global capitalism is that it imposes more flexible and free market policies on us all the while inducing lots of casualties. To convince employees of the importance of a flexible labour market, the government will have to introduce jobless benefits. The government will need to launch proactive "job centres" as they do in Denmark for instance that will not pamper the unemployed and will keep her on her toes to look for a new job. Moreover, to achieve the inevitable objective of transforming Mauritius into a duty-free destination, say through a four year elaboration, the government must be groomed to spend efficiently every rupee it receives from us. Singapore has a mean tariff rate of almost zero and a sales tax of 5% and yet runs surpluses in its public accounts. To satisfy a zero-tolerance promise, cracking down on corruption will have to go through an amnesty law that starts prosecutions on a new slate.

Pro-market climate: We are caught in a "producer capture" in much of the corporate sector and the trading arms of the State. Businesses are run for the benefit of the "few" at the expense of customers in general. For a country to be competitive, as many players as possible must be able to contribute to reduce business costs by delivering value-for-money goods and services. The Canadian business

watchdog, hailed for its success in fostering competition, can enlighten us. Entrepreneurs thrive on level playing fields. Mauritian future prosperity is tributary to the quality of private investments today.

Smarter Mauritians: Mauritian educational and training methods must be radically revamped. The American entrepreneurial spirit is mainly the product of a learning system that focuses on applied knowledge and lateral thinking rather than memorisation of questions and answers. We should begin by urgently addressing the decline of English language and Mathematics. HeyMath is an E-learning system implemented at several progressive schools in Singapore and India that is worth considering. It is articulated around "animated online lessons, interactive activities and assessment modules that help students strengthen their understanding of concepts and enhance their problem-solving skills". There is also a pressing need to invest aggressively in research and development programmes. Only a creative human capital will enable us to narrow the widening gap with the main stars of globalisation.

Win-win ethos

When the citizens of Sweden, one of the most competitive countries in the world, were asked by their government whether they

wished to reduce the top marginal income tax rate of 60%, a loud "no" resounded to preserve the generous social safety net. This is not an advocacy of high taxes but an anecdote to inspire us the following: that as long as policies are implemented with a win-win ethos, as long as efforts are coordinated and as long as people's dignities are upheld, productivity is guaranteed.

It is crucial to refresh the mindset behind the formulation of our policies. Cut-and-paste measures rarely work because they fail to meet specific needs. Truly successful countries or companies bear the hallmark of a maverick approach capable of reinventing itself on a permanent basis. Instead of flocking to summits of the IMF or courting the World Bank "expertise" for almost everything, it might be more profitable to spend the money and the time by regularly visiting countries such as Chile, Dubai, Estonia, Finland and Singapore in search of new ideas.

Our integration to the global economy must be boosted. We cannot afford to accommodate complacency and procrastination any more. Our Prime minister is expressing his ethical commitment to his mandate and he seems to have the necessary global culture. He must now prove that he has the mettle to embrace Nike's shibboleth: Just do it!