

# CONJONCTURE

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THINKING OUT OF THE BOX!

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

## Slow recovery ahead By Philippe Lam - (Cont Pg 2)

The global economy has been through its worst recession since World War 2. According to The Business Cycle Dating Committee of the US National Bureau of Economic Research, the economy of the United States has been in recession since December 2007. So the world's largest economy has now been officially in recession for 21 months, its longest period of recession for the past sixty years. By comparison, its last two periods of recessions of 1990/91 and 2001 lasted only 8 months. This recession is exceptional not only by its length but also by its depth and, above all, by its causal factors, namely risky lending and investment practices by financial institutions, mainly in the US and Europe.

### There must be an increase in both private consumption and capital investment for sustainable growth

Lately, there are signs indicating that the worst may be over with unemployment losses in the US in July 2009 reaching 247, 000 compared with 443, 000 in June and both Germany and France registering positive growth rates of 0.3% in the second quarter of 2009. The global economy is apparently reaching a trough and optimists would argue that the recession will soon be over with green shoots of recovery appearing regularly.

Some economists expect the Zarnowitz rule, which states that deeper recessions are followed by steeper recoveries, to hold during the present recovery phase. However, from a historical perspective such optimism may be misplaced given the source of the crisis and its financial origin.

There are a number of reasons explaining why there are still grave risks being faced by the global economy and why difficult economic conditions may prevail for a number of years to come. First and foremost among these is the rising level of unemployment. Although the US did experience a drop in its unemployment rate lately, this is partly due to about 400,000 individuals leaving the job market.

These are people who are too discouraged to look for a job. This discouraged worker effect tends to depress the rate of unemployment during a recession. The decline in US retail sales in July by 0.1 % (-0.6 % if auto sales benefitting from a government-financed incentive scheme are excluded) reflects the weakness in the jobs market and its adverse impact on consumer confidence.

During the last recession of 2001 which ended in November of that year, unemployment only peaked 8 months later in August 2003. The level of unemployment is thus expected to rise after the end of the current recession to 11% in 2011. Part of the reason is that during a recession, firms tend to hang on to their most valuable workers as they believe that it would be difficult to hire such high calibre labour at the end of the

recession if they resorted to sacking these workers.

When the economy improves, the firms first try to fully employ their hoarded labour until they are convinced the recession is really over and it is only then that they start recruiting new labour. In addition, some firms will carry on dismissing workers as they are not convinced the recession is in indeed over. It is only when there is sustained growth at levels in line with trends established during the pre-recession period that sizeable recruitment will take place and then and only then will the unemployment situation improve.

The upturn is largely due to the effects of the various Government stimulus measures put in place in Europe, the US and China. The 0.3 % growth rate in both France and Germany can largely be attributed to rising car production and exports resulting from incentives for the purchase of new more fuel efficient cars. The big stimulus package initiated by the Government in China has not only benefited the Chinese economy but also has had positive effects on Japan and other countries of the region, including Australia.

However, for there to be sustainable growth, there must be an increase in both private consumption and capital investment as the effects of the stimulus packages wear off. The so-called 'cash for clunkers scheme' to encourage car purchases in the US has just ended and it would be interesting to note the level of car sales over the coming months in the American market, which is the world's largest car market.

In the US, it is saving that is on the increase as highly-indebted consumers reduce their consumption in order to pay their debts. The savings rate, which was zero and at times negative during the period preceding the crisis, is 5% and is expected to go up. Historically, before the onset of the debt-financed consumption boom leading to the current mess, the US household saving rate was 11% of disposable income about a decade ago. Should the US consumer go on reducing its consumption and save more, then the adverse impact on global demand and trade will be felt for a number of years.

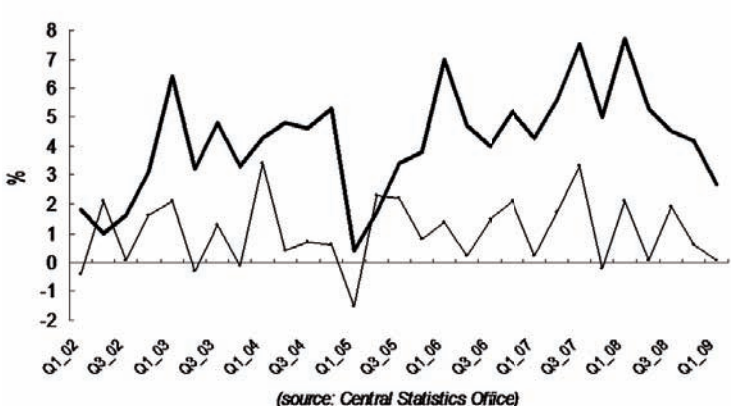
The growth of the Chinese and Indian economies will not be sufficient to compensate for the depressed demand from the US whose economy is around three times the size of these two emerging economies put together. Furthermore, growth in these two countries tend to put upward pressure on prices of minerals and commodities, thus reducing global growth prospects.

As far as US private investment is concerned, this component of aggregate demand will more likely increase if there is a sustained increase in private demand. With unemployment still rising, albeit more slowly, private demand and hence US private investment will be slow in picking up. Latest figures available show that it actually fell by 20% year-on-year in April 2009.

The level of government indebtedness and the budget deficit in the major economies have increased as a result of expenditure incurred to finance the stimulus measures. In the US, the budget deficit for this year is projected to reach 11% of gross domestic product (GDP) and the public debt is expected to double from 40% to 80% of GDP. In the United Kingdom, the level of public debt is already around 80% of GDP.

Such high levels of deficit and indebtedness will prove unsustainable and are already driving up long-term interest rate which will adversely impact future growth rates. To remedy the situation, the authorities will have no choice but to either cut spending or increase taxes, with both options having a negative effect on demand and growth.

Mauritius' Quarterly GDP growth rates



— Unadjusted year-on-year quarterly GDP growth rates  
- - - Seasonally adjusted quarter to quarter GDP growth rates

### Consumers, corporations, governments and financial institutions all face indebtedness

Although a few banks have been reporting record profits, this by no means reflects growing private consumption activities but partly fees charged for raising capital for both governments and corporations.

## Management in the 21<sup>st</sup> century

By Vikram Jeetah

Management has been around since the dawn of civilization. It was used to build the Great walls of China, to erect the Pyramids, to cross the oceans for the first time, to run armies. It was Peter Drucker's greatest achievement in identifying management as a timeless, human discipline. His two brilliant books, *The practice of Management* (1954) and *Management: Tasks, Responsibilities, Practices* (1973) encapsulate the essence of management thinking and practice.

Since then best practice management concepts in the late 20th century also included excellence and total quality management, business process reengineering, systems thinking, performance management, knowledge and information management, empowerment, supply chain management, learning organization, management of human assets, change programme and project management.

At the start of the 21st century, new programmes are designed for managers with responsibilities for business development, competitive or market intelligence, industry and market research, forecasting, scenario planning, and risk analysis. For instance, a programme in Competitive Intelligence is designed to provide participants with a fresh and innovative approach to the theory and practice of intelligence analysis.

### The relevance of Blue Ocean strategy

Let me dwell on the concept of Blue Ocean strategy which challenges companies to break out of the red ocean of bloody competition by creating uncontested market space that makes the competition irrelevant. Instead of dividing up existing – and often shrinking – demand and benchmarking competitors, blue ocean strategy is about growing demand and breaking away from the competition.

Insead Professors Chan Kim and Renée Mauborgne (2005) have introduced a set of analytical tools and frameworks that show how to systematically act on this challenge. They

elaborated the principles that define and separate blue ocean strategy from competition-based strategic thought.

Let me illustrate this concept with an example I have experienced last month. Air Asia has managed to avoid the red ocean (compete with Malaysia Airline and regional airline) by looking into the factors that the industry takes for granted and also factors that are important to customers. With the Four Actions Framework proposed by Blue Ocean Strategy authors, Air Asia has implemented many strategic moves to ensure it is making Malaysia Airline and regional airline company irrelevant.

With this strategic move, Air Asia is able to focus on factors that really bring value to the customers such as point to point travel system and easy booking system. This has helped Air Asia to reduce cost and at the same time increase the value to the customers, what Kim and Mauborgne term as Value Innovation. I bought my return ticket from Kuala Lumpur to Bali at Rs 3,700 for a 3 hour flight compared to Rs 20,800 for a 6.5 hours flight from Mauritius to Kuala Lumpur.

And just when you thought you know sufficiently about management, someone introduces another new concept. In his latest book *The Well-Timed Strategy* published in 2006, Peter Navarro asked a fundamental question: How can the modern executive team strategically and tactically manage through the various recessionary and expansionary phases of the business cycle to gain competitive advantage over rivals?

Navarro showed how to align every facet of business strategy, tactics, and operations to reflect changing business conditions – so you can ride with the business cycle, not get run over. The author addressed everything from inventory, production and supply chain management to marketing, pricing and long-term capital investment.

### Proactive and tactical opportunism

Southwest Airlines' "tactical opportunists" shrewdly exploit the company's sophisticated forecasting capabilities to adjust their fuel hedges as conditions warrant – and stay three steps ahead of their competitors and the OPEC cartel. Although virtually all airlines maintain a partial hedge against fuel price increases, Southwest has tactically increased its hedging at key intervals when its macroeconomic forecasting models suggested an approaching oil price spike. This kind of proactive and tactical opportunism is the true mark of a great company.

Do our Managers have the competencies to take the right decisions in these times of accelerating turbulence and change? The difficulties facing Air Mauritius, our national carrier, and other organisations prove to the contrary. On the other hand the troubles of the US subprime mortgage market, which have now mushroomed into a global financial and economic crisis, are putting Mauritian Managers under tremendous pressure on how to manage through the downturn. Companies that nurture flexibility, awareness and resiliency are more likely to survive the crisis, and even to prosper.

New skills are therefore needed by Mauritian Managers on how to understand dominant issues and trends shaping the strategy landscape for business in the turbulent global economy; to be familiar with evolving constructs on the nature and purpose of business that are presenting organisational architectures for the future; to leverage talent across the organisation; to manage re-organisation, restructuring and redundancies; and to motivate and engage staff in the context of change.

To conclude, I have two maxims to share. Spending: If you buy things you don't need, you'll soon sell things you need. Savings: Don't save what is left after spending; spend what is left after saving.

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## Slow recovery ahead

By Philippe Lam - (Cont from Pg 1)

In the US, the closure of Bears Stern and the take-over of Merrill Lynch have resulted in those firms like Goldman Sachs that have survived the crisis enjoying a bigger market share and hence profits. In the UK, Barclays has also reported record profits but mostly from its investment banking arm and not from retail activities.

It is worth noting that HSBC has recently made provisions for losses on non-performing loans, mostly unpaid mortgages, for a total of USD 15 billion for this year. This figure is expected to peak next year as a result of rising unemployment in both the US and the UK affecting loan repayment by those who lose their jobs. Banks will thus face growing losses in their retail banking activity and this will constrain their ability to lend over the medium term.

With consumers, corporations, governments and financial institutions all facing problems of indebtedness and solvency, the current crisis will have a long-lasting effect on growth prospects. In the US, the end of the current depression is not expected to be announced quickly by the NBER Business Cycle Dating Committee as, in addition to GDP figures, the Committee will take into account other indicators like wholesale and

retail trade, industrial production and job losses.

Even if the end of the recession is announced this year, future prospects are not bright. Indeed, it is expected that US growth rates will be below trend at 1% compared to trend rate of 2.75%. The possibility of another recession occurring in 2010 cannot be ruled out as the effects of the stimulus package wanes and both private consumption and capital investment remain sluggish. The shape of the recovery may thus be in the form of a double-dip or W-shaped. Some well-known economists have forecast that difficult economic conditions are likely to last for a number of years, with Paul Krugman, the 2008 winner of the Nobel prize in Economics, predicting that these may last between 5 and 10 years.

### The property market may turn out to be the Mauritian economy's Achilles Heel

In Mauritius, the last budget assumes that the global economy will recover in 2010. This is unlikely to be the case and Mauritius will have to prepare itself for a period of slow global growth which will affect both consumer confidence and investor sentiment worldwide.

The tourism sector will remain one of the most affected sectors. Indeed, according to Intercontinental Hotels, the world's biggest hotel group, the travel trade would take two years to get back to pre-crisis levels. Other sectors like business process outsourcing may actually benefit from Western companies relocating part of their activities off-shore as part of their cost-cutting measures.

The Integrated Resorts Scheme and property activities have been generating significant inflows of foreign currency over the past few years. However, with the current slowdown, the property market may turn out to be the Mauritian economy's Achilles Heel, should recessionary conditions persist. The example of Spain, which is suffering from an unemployment rate of 18%, the highest among the EU countries, should serve us as a reminder that the property market can drag an economy into a deep recession when business turns sour.

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## Managing portfolios and central bank independence

By Sameer Sharma - (Cont Pg 4 & 5)

The 2008 stock market collapse was a terrible event for mutual funds because they were simply not dynamic enough when it came to rebalancing their portfolios. The layman will tend to think that a financial professional would be reducing his exposure to equities before or during a crisis and increasing it on time when markets pick up. After all, the fund manager is supposed to be a highly qualified professional who can manage your money best for a fee. The reality is a bit different and you need to understand how they are compensated in order to gain more insight.

### Fund managers perform against a benchmark

In most countries on the planet, a fund manager will not be graded based on how much money he makes for you but by how much he is able to outperform his benchmark. If his benchmark is the S&P500 for example, the fund manager is required to invest in stocks that are part of the index and all he/she needs to do is outperform it. Whether stock prices go up or down is a secondary issue because his/her job only depends on the benchmark that he is supposed to beat while of course having a similar portfolio. If my priority as a fund manager is to outperform a benchmark, I will not have the same level of urgency when it comes to raising cash or shorting futures contracts that I would have if I had a hurdle rate like most hedge funds do.

To be fair, hedge funds are not as restricted in terms of what they can do and what instrument they can use like mutual funds are but because their compensation depends on making your money during most market conditions; they tend to do a better job at managing your money than mutual funds do. Of course, you cannot replace a mutual fund investment with a hedge fund which has its own set of risks but what we have noticed over the past year is that mutual fund managers who were more flexible and dynamic rather than static did much better than the others.

We also found out that many average investors who received moderate education in investing were able to massively outperform these traditional benchmark following mutual funds simply because they were able to sell and then buy much faster. The market has become a traders' market these days and you need to invest with someone who is more dynamic.

In my last article some two months ago, I talked about how the S&P500 was engaged on the right shoulder of a head and shoulders pattern and that the S&P500 needed to breach 950 (the head of the pattern) in order for this rally to continue. The neckline of the pattern, a

clear short signal of the market was around 874 and during the first week of July we got very close to those levels. Many traders had in fact taken short positions while some mutual fund managers who were already behind in the market either bought puts or sold off some stocks in anticipation of the neckline breach. This did not happen because the economic and company financial results data were much better than expected.

Now you must understand here that analysts who make earnings estimates on stocks got it completely wrong during the 4<sup>th</sup> quarter of 2008 and the first quarter of 2009 and hence reduced the estimates so much that any slight improvement in the economy would have been enough to beat these estimates. We did not see much in terms of second quarter company revenue growth, in fact, that was bad (although not as bad as feared) but we did see better than expected earnings per share data due to cost cutting.

After all, many Americans have been losing their jobs lately. But we were getting good indications that the housing market was bottoming and that was enough for the SP500 to touch the neckline level of 874 intraday and move up again. Now all those traders and managers who had either taken short positions or bought puts had to unwind those positions which resulted in a short squeeze.

### The Achilles heel of US moderate recovery is unemployment

In the last article, I said that one of the bullish signs about this market has been the amount of cash that is sitting on the sidelines. Most fund managers are behind their benchmarks and once the head and shoulders pattern did not pan out, they had to chase the market and come back in because their jobs depended on it. So short squeeze coupled with the need to invest in stocks that are found in various benchmarks have led to this great summer rally.

We have seen hundreds of billions of dollars coming out of money market funds towards the stock markets of the world in recent months because of the need to outperform a benchmark and yes economic data helped a bit too but that was an official reason rather than the main reason. Now the cash for clunkers program and the \$8000 tax credit for first time home buyers have helped the economy but all these measures are expiring now.

The Achilles heel of this moderate recovery is unemployment because the American consumer needs to come back

to life and so far we have mixed signals. American companies on average however have maintained their productivity levels and this economic recovery is not a dud. One has to be cautiously optimistic here because this v shaped recovery may turn out to be a w once the stimulus is taken out of the system. We do not know that yet.

Housing prices may have bottomed and I know that many of you must have read the sales growth figures recently but if you break it down, growth has really been in the low price segment and with first time home buyers (because of the tax credit which may or may not be extended). When you look at the upper segments of the housing market, demand has been extremely weak and it remains a renters' market. The reality is that we are at best looking at below trend line growth over the next few years at least because the consumer has been severely impacted by this crisis.

Now much has been made about Chinese growth. Recently we found out that in March when commodities were dirt cheap, the Chinese came around and bought everything it could from oil to aluminum and stocked it like only a central command economy can. This is why commodities rallied and energy stocks rallied. Even in China however, we recently heard about the fables of the stimulus package and exaggerated economic figures. For example the Chinese have been giving out nice data in terms of washing machines and fridges sold which looks amazing on paper minus the fact that the way they measure a sale is not by looking at actual store sales but by estimating the value of goods shipped which is completely different from a sale.

In fact in many of the villages where those washing machines have been shipped to, there is no electricity or running water and there are no actual sales. So as investors, we need to be a bit more dynamic here because the bank stock rally, the company financials and the credit markets are telling us that the worst is over and that a recovery is taking shape but the risks of stagnation or of a leg down from here remain real.

### Equity and commodities markets follow the dollar

If you want to understand where markets will go, you need to understand that the dollar is the conductor and that equity and commodities markets play to its tune. Look at the dollar-yen or look at the dollar index DXY and then chart the market and you will see what I mean. The correlation is astounding. When the dollar weakens, stock markets tend to go up and you can make a lot of money by being dynamic with this one tip.

## Managing portfolios and central bank independence

By Sameer Sharma - (Cont from Pg 3)

But here too, we need to be careful, over the past two weeks; the charts have been telling us that the dollar is bottoming while fundamentally, especially after the new US debt projection, it needs to weaken. This confusion is perfectly reflected in equity markets despite the fact that there is a lot of money coming into it. We have seen resistance for the S&P500 at 1040 because of it while on the other hand we have seen strong support at 1015 or so, a bullish sign. The market may be slightly ahead of itself here and we have continued to see the Relative Strength Index fall as the S&P500 has inched slightly higher than 1028.

The best strategy right now remains the same, it is to buy on any dips and take some money off the table, especially in financials which have rallied massively when prices make a new high. The dollar simply needs to give us a direction here although a freefall will also not be good for markets. We are looking at a 74 dollar earnings target on the S&P500 for next year applied to a 16x multiple in the most bullish case and we are not that far off from that level already.

I am explaining all this because you need to be more dynamic in order to make money these days and mutual funds are slowly coming to this realization as buy and hold fades off. Increasingly pension funds who are giving out these mandates to those fund managers are looking at more than just the benchmarks which is a positive development.

### Trail fees equal underperformance and conflict of interest

This brings me to the case of Mauritius. I recently had a look at the factsheet of a fund domiciled in Mauritius and in that factsheet, the manager tried to justify his 50% cash holding (during the rally of a lifetime) by talking about the need not to chase returns. Now I believe that cash is a great investment in uncertain times but going above 20% is a recipe for continued low performance. When markets are going up, you cannot participate but you have to be smart about it and use instruments that allow you to get in and out more quickly because quite frankly this is where mutual funds are heading.

A related problem with fund houses in Mauritius is the trail fee and this needs to end. Most people do not know about it but most fund houses in Mauritius have agreements with a selected number of foreign mutual funds and in some agreements you have a trail fee which is a function of the amount of money you put in these funds and there is a huge conflict of interest there between your investor and your commission.

If I am investing into a fund of funds structure which already has a double layer of fees, at least I want the fund manager to select the best funds out there knowing full well that over time those rankings change and so should the funds in my fund of funds. The reality of it all is that the trail fee complicates things a bit and is certainly a part of the selection process in the first place and sadly pension funds that give mandates to fund houses never ask about it.

Before you invest a single penny in any local fund, you should make sure that there is no trail fee because for me, trail fees equal underperformance and conflict of interest. These days, there is so much information out there that you do not need to be operating a funds of funds structure, you simply need to hire the right managers and give them the right compensation and make sure that they do their homework rather than transfer the risk to another fund for a fee. I also do not understand why you would want to keep fund managers that consistently underperform because finance is all about making money but that is another story!

### Risk management becomes more dynamic with derivatives

That being said, I have noticed a young crowd (like myself) entering the business with CFAs and MBAs and that is an encouraging sign. Now that the local stock market will soon have futures, you will need qualified people and pay them well because things are going to become more complicated.

Here is a potential local example. Suppose that you have calculated the ratio (LogMCB/LogSBM) and that based on your technical chart, you expect SBM which may have been lagging (hypothetical situation) to catch up to the other bank. You could take a long futures position on SBM and a short futures position on MCB with the dollar equivalent amount in a pairs trade that would bet on the spread itself. That is an example of a market neutral hedge fund strategy for you.

In general mutual funds will invest about 70% of their equity money in the benchmark itself via an ETF for example and the remainder can be invested in a few stocks they like. This is known as core satellite investing and that is how most mutual funds manage your money. Rather than put all your millions in stocks and replicate the benchmark, you can simply buy futures contracts on the benchmark (say SEM-7) that will give you the exposure you want with a much lower cash outlay in the margin account and the rest of the money you can keep for other stocks that are not in that index or that you want to own more of.

Of course you will need to keep some cash on the side above your margin requirement, normally twice your weekly adjusted value at risk VaR for risk management purposes. But you will notice here that it is possible with the amount of money you have to engage in a portable alpha strategy while maintaining the exact same exposure to your benchmark.

The most obvious strategy that you can employ of course is to hedge your equity exposure, even with simplistic derivatives; you will be able to employ a wide range of strategies that have their own risk reward characteristics. More importantly, futures allow you to be more flexible but here again the regulator must make sure that there are proper restrictions imposed on mutual funds and that investors must more closely evaluate the qualifications of the manager because management itself becomes more dynamic with derivatives.

On the whole, index futures on the SEM-7 and futures contracts on a few stocks will allow for more price discovery to take place but investors will need to make sure that the fund house that manages their money has a sophisticated understanding of risk management. Will the manager be dynamic enough on the local market? Will the manager do his homework when it comes to foreign investments and will trail fees play a role? Will the trail fee make him slow to react or maintain investments in funds that have deteriorated? Due diligence is the responsibility of the investor and finance is all about making money. It is as cold a business as that and when fund managers underperform, you change them.

### No proper derivatives market without a truly independent central bank

Earlier in this article, I talked about how the dollar is currently the conductor of equity markets. All equity traders have apparently become currency traders lately by default. In the previous issue, I had also talked about how the bid ask average 31.75 Rupee/dollar rate was a key test level for the local currency. We saw the Rupee breach this level towards 31.40 but due to some unease in emerging markets (the Chinese stock market gave us a sell signal by end July), we saw a certain degree of movement towards the dollar again. The Rupee is essentially stuck close to that key 31.75 level which has now become support. Volatility of the USD/MUR as measured by a GARCH equation has continued its downward trend as equity markets have rallied globally (the dollar has until recently come under pressure).

Locally, politicians have stopped talking on behalf of the central bank in terms of "more room for monetary easing" which has made speculators calm down drastically.

Expectations are that the key Repo rate will remain unchanged during the next rate-setting meeting on 22 September as uncertainties still exist with regard to global growth. There is excess liquidity in the system but unlike last year it has not caused the same problems to the transmission mechanism and is not a major worry for now despite the fact that some key rates are again coming close to the limits of the repo corridor. Things appear to be much more manageable and the Bank of Mauritius (BoM) has shown its willingness to prepare much better and detailed reports on the financial system and has finally shown its worry for the savings rate, a function of negative real interest rates in 2007 and 2008.

A few articles ago, I had talked about how the lack of independence of the central bank and lobby groups that control the media and from time to time influence politicians too will prevent the healthy development of a proper derivatives market and a secondary bond market: that view remains true. The news that futures on the Rupee will soon be traded in Mauritius has created a certain degree of enthusiasm in the media in recent months. The same people who were blaming oil speculators for out of control inflation and volatility in the oil market last year are now telling us that having futures on the currency will reduce volatility and allow for price discovery to take place.

That is not necessarily true and here is why. If the BoM is not independent, if prior to elections we have politicians putting pressure on the people they appointed at the Monetary Policy Committee (MPC) to have an

expansionary stance towards monetary policy, then you are in essence giving away the future direction of interest rates and the Rupee to investors. If many of us do the same thing in the futures market, then I fail to see how this will reduce volatility. It will have the opposite impact not because futures are bad but because a futures market in a country where institutions are not always that independent is bad.

**No central bank can now forecast year-on-year inflation**

Then we have the issue of year on year inflation. A well functioning central bank needs to look forward because monetary policy has a 12-18 month time lag and so forecasts of inflation are important before setting the appropriate interest rate. This leptokurtic rightly skewed year on year inflation essentially behaves like a commodity (see its composition). If folks at the BoM can forecast commodities 12 months out, then Wall Street is waiting for them because no one over here can do it yet.

This measure of inflation is so volatile and yes we know that next year, inflation should pick up especially if the dollar weakens and the global economy recovers, but we cannot know by how much commodities will rally and we just cannot forecast year on year inflation without some statistical adjustments and we cannot hence decide on the appropriate interest rate.

Being off by one or two percentage points can have a huge impact on the effectiveness of monetary policy and on the real economy in the longer term and of course this is important to the currency

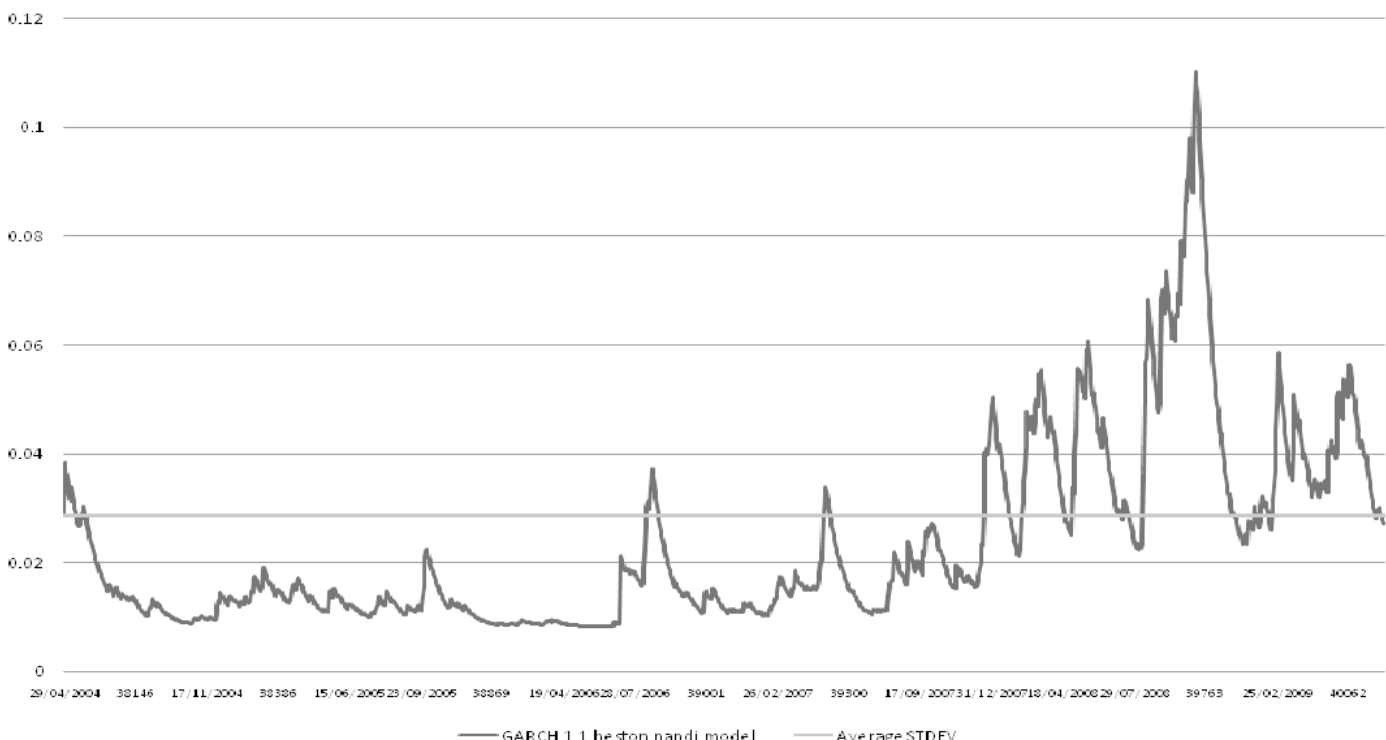
whose direction is also a function of the differential. At every post MPC meet, we often hear the Governor talk about an inflation target but so far we do not really know what is happening with that although it seems to be year on year inflation. I have heard about the neutral real interest rate, about PEPI and the moon, perhaps it's time to let the market know too?

We seem to be moving ahead into a more sophisticated environment without fixing up the institutions. Index futures on stocks are one thing but contracts on the Rupee can be another story. My advice to the investor and hedger would be to be careful about investing in currency futures in Mauritius until the central bank becomes more credible and politicians develop a culture of staying out of the business of the BoM. Just calculate a simple 30 day rolling volatility of the USD/MUR and plot the dates when politicians make some noise about interest rates and tensions at the bank and you will know what I mean.

There are two sides to a futures contract, a loser and a winner and when you lose, you really lose! For those who have currency portfolios, it is important to remain heavily diversified. To have a strong commodity currency component and some gold at 10% of the portfolio cannot but help these days. This is another area where dynamic and flexible investing will be key over the next few years.

Sameer Sharma is a Canada-based Chartered Alternative Investment Analyst.

**GARCH (1,1) USD/MUR Mid Rate**



## Benoît XVI : un pape économiste ?

Par Jean-Yves Naudet

« Un pape économiste », c'est ainsi que le *Journal des économistes*, il y a bien plus d'un siècle, saluait l'élection de Léon XIII. Peut-on dire la même chose de Benoît XVI ? Ne reproche-t-on pas souvent à l'Eglise de ne rien comprendre à l'économie ?

Il est vrai que Benoît XVI est un grand intellectuel, un grand spirituel et un remarquable théologien, et c'est bien là l'essentiel pour un pape. Mais il semblait jusqu'à maintenant peu intéressé par l'économie, en dehors de quelques passages de ses deux premières encycliques, notamment sur le thème « justice et charité ».

Enfin est sortie le 7 juillet dernier l'encyclique sociale de Benoît XVI (*Caritas in veritate*), la première du magistère romain depuis Jean-Paul II (*Centesimus annus* 1991). Les spéculations allaient bon train et certains experts annonçaient que le Pape allait affirmer que Marx avait vu juste et publier un manifeste contre le capitalisme. Il n'en n'a rien été.

Le texte, s'il est très sévère pour certains comportements humains, surtout dans la crise actuelle, n'en reste pas moins dans la ligne de Jean-Paul II et de ses prédécesseurs dans sa défense des institutions de l'économie de marché. Benoît XVI rappelle qu'il n'y a pas deux doctrines sociales « l'une préconciliaire et l'autre postconciliaire ».

L'encyclique est adressée aux Chrétiens, mais aussi « à tous les hommes de bonne volonté » : c'est dire que le pape joue à la fois sur le registre de la foi, propre aux croyants, et sur celui de la raison, accessible à tous.

### L'homme et sa liberté sont premiers

Dans ce texte d'une grande profondeur, on retiendra ce qui est directement lié à la crise actuelle, puisqu'il a été publié à la veille du G8 : des institutions assez classiques, mais toutes passées au crible de l'éthique : une sorte de « moralisation du capitalisme », surtout au chapitre III, « Fraternité, développement économique et société civile ».

Remarque préalable (§17) : « Le développement humain intégral suppose la liberté responsable de la personne et des peuples : aucune structure ne peut garantir ce développement en dehors et au dessus de la responsabilité humaine ». C'est l'homme et sa liberté qui sont premiers.

La mondialisation est évoquée avec ses forces et ses limites, mais ce processus « a été le principal moteur pour que des régions entières sortent du sous-développement et il représente en soi une grande opportunité » (§33). Tout en mettant en garde contre certains risques de la mondialisation, le pape met en cause « les tarifs douaniers élevés » imposés par certains pays pour empêcher les produits des pays pauvres d'entrer sur leurs marchés.

### Le marché est fondé sur une confiance réciproque

Le marché est mis en avant « lorsqu'il est fondé sur une confiance réciproque et générale » : il est « l'institution économique qui permet aux personnes de se rencontrer, en tant qu'agents économiques utilisant le contrat pour régler leurs relations et échangeant des biens et des services fongibles entre eux pour satisfaire leurs besoins et leurs désirs » (§35). Mais

évidemment, pas de marché sans justice ni sans éthique. Et « sans formes internes de solidarité et de confiance réciproque, le marché ne peut pleinement remplir sa fonction économique.

Aujourd'hui, c'est cette confiance qui fait défaut, et la perte de confiance est une perte grave ». Mais le marché a besoin de morale : « il n'est pas en mesure de produire de lui-même ce qui est au-delà de ses possibilités. Il doit puiser des énergies morales auprès d'autres sujets, qui sont capables de la faire naître » (§35).

Mais les conséquences mauvaises qui peuvent exister dans le marché ne viennent pas de lui, en soi : « c'est la raison obscurcie de l'homme qui produit ces conséquences, non l'instrument lui-même. C'est pourquoi, ce n'est pas l'instrument qui doit être mis en cause, mais l'homme, sa conscience morale et sa responsabilité personnelle et sociale » (§36).

On appréciera aussi l'affirmation suivant laquelle Benoît XVI, après Jean-Paul II, souligne « la nécessité d'un système impliquant trois sujets : le marché, l'Etat, la société civile » (§38). On retrouve ici la distinction des ordres marchand, politique et communautaire, même si les trois sont liés comme le montre son insistance sur la question du don et de la gratuité, celle-ci étant plutôt propre à la société civile (les fameux « corps intermédiaires »), mais pas exclue des deux autres domaines.

Très novatrice aussi est sa vision de l'entrepreneuriat, qui doit avoir une « signification plurivalente » : l'entrepreneur n'est pas seulement le « capitaliste », mais chacun de nous, chaque travailleur doit pouvoir apporter sa contribution propre comme s'il travaillait à son compte car « tout travailleur est un créateur » (§41).

### Le capitalisme sera éthique ou ne sera pas

C'est donc une économie éthique que propose Benoît XVI pour faire face à la crise et humaniser le capitalisme, (même s'il n'est pas dupe (§43) du fait que certains utilisent le mot éthique comme une mode, parfois fort éloignée de la morale). La leçon de Benoît XVI : le capitalisme sera éthique ou ne sera pas.

En prélude de cette encyclique sociale, Benoît XVI avait publié un document à l'occasion du 1<sup>er</sup> janvier 2009, où il s'est penché sur le thème « combattre la pauvreté, construire la paix ». Tout mériterait d'être lu ([www.vatican.va](http://www.vatican.va)) et le message porte largement sur la mondialisation et les questions économiques.

Le pape commence par écarter les soi-disant causes démographiques de la pauvreté (« La population est une richesse ») (§3), parle des maladies pandémiques dont certains se servent pour conditionner « les aides économiques à la mise en œuvre de politiques contraires à la vie » (§4), des préjudices pour les enfants dus à l'affaiblissement de la famille (§5), du désarmement (§6), de la crise alimentaire (§7) et du fait que la mondialisation élimine des barrières, rapproche les peuples, mais que cela ne suffit pas à créer « les conditions d'une véritable communion » (§8).

Nous avons retenu les paragraphes 9 à 12 qui nous semblent les plus novateurs dans le

domaine de la doctrine sociale de l'Eglise et, pour ne pas trahir la pensée de Benoît XVI, nous les citons à chaque fois intégralement, en les faisant suivre de quelques commentaires qu'un économiste peut faire sur ces questions.

### Le protectionnisme est une forme d'égoïsme

§9. « Dans le domaine du commerce international et des transactions financières, des processus sont aujourd'hui en place qui permettent une intégration positive des économies, ce qui contribue à l'amélioration des conditions générales ; mais il y a aussi des processus en sens inverse, qui suscitent des divisions entre les peuples et la marginalisation, créant ainsi de dangereux risques de guerres et de conflits. Dans les décennies qui ont suivi la seconde Guerre mondiale, le commerce international des biens et des services s'est accru de manière extrêmement rapide, avec un dynamisme qui n'avait jamais eu de précédents au cours de l'histoire. Une grande partie du commerce mondial concernait les pays d'industrialisation ancienne, auxquels se sont ajoutés de manière significative de nombreux pays émergents qui en sont devenus des acteurs importants. Mais d'autres pays, dont le revenu est bas, demeurent largement en marge des mouvements d'échanges commerciaux. Leur croissance s'est trouvée ralentie par la chute rapide, dans les dernières décennies, du cours des matières premières qui représentent la quasi totalité de leurs exportations. Dans ces pays, africains pour la plupart, la dépendance par rapport aux exportations des matières premières continue à représenter un puissant facteur de risque. Je voudrais ici renouveler un appel afin que tous les pays aient les mêmes possibilités d'accès au marché mondial, en évitant toute exclusion et toute marginalisation. ».

On retrouve ici ce que Jean-Paul II avait déjà parfaitement expliqué dans *Centesimus Annus*, à savoir le fait que le commerce international est un puissant facteur de développement pour les pays émergents et de croissance pour tous. D'autres n'y participent pas autant, surtout quand ils se concentrent sur quelques matières premières, et la question essentielle, posée par le pape in fine, est celle de l'accès au marché mondial, c'est-à-dire du protectionnisme des pays riches, surtout en matière agricole. On ne rappellera jamais assez que le protectionnisme est non seulement un mauvais calcul, mais avant tout une forme d'égoïsme, qui prive les pays pauvres d'un puissant moteur de développement.

### On ne construit rien de solide dans la facilité

§10. « Une réflexion similaire peut être conduite à propos du domaine financier, qui concerne l'un des aspects premiers du phénomène de la mondialisation, grâce au développement de l'électronique et aux politiques de libéralisation des flux monétaires entre les différents pays. La fonction objectivement la plus importante de la finance, celle qui consiste à soutenir à long terme la possibilité d'investissements et donc de développement, se révèle aujourd'hui tout à fait fragile : elle subit les contrecoups négatifs d'un système d'échanges financiers – au niveau national et mondial – basé sur une logique du très court terme, qui a pour but l'accroissement de la valeur des activités financières et se concentre sur la gestion technique des diverses formes de risque. La récente crise démontre aussi comment l'activité financière est parfois guidée par des

logiques purement auto-référencées et dépourvues de considération, à long terme, pour le bien commun. Le nivellement des objectifs des opérateurs financiers mondiaux à l'échelle du très court terme, diminue la capacité de la finance de jouer son rôle de pont entre le présent et l'avenir, pour soutenir la création de nouvelles possibilités de production et de travail sur une longue période. Une finance limitée au court terme et au très court terme devient dangereuse pour tous, même pour ceux qui réussissent à en tirer profit dans les périodes d'euphorie financière ».

Ici, le pape analyse d'une manière scientifiquement inattaquable le rôle de la finance dans le financement de l'investissement, donc du développement. Au moment où, dans la crise financière actuelle, certains sont tentés de jeter le bébé avec l'eau du bain et de condamner la finance elle-même, et non ses dérives, il est essentiel de rappeler qu'il n'y a pas d'économie de marché sans finance et que celle-ci, lorsqu'elle est bien utilisée et comprise, est un puissant facteur de progrès économiques. C'est, comme le dit le pape, un « pont entre le présent et l'avenir ».

D'autre part, le pape a raison de condamner les logiques à très court terme, souvent d'ailleurs suscitées par les autorités monétaires qui veulent forcer la marche économique, par exemple par des taux d'intérêt artificiellement bas, ne correspondant pas aux réalités du marché. La facilité monétaire, l'argent qu'on se procure sans efforts et qui est mal utilisé, le crédit inconsidéré, tout cela vient d'abord du laxisme des banques centrales, qui entraînent dans leur sillage les autres agents économiques.

Les vrais entrepreneurs, eux, savent bien que ce sont ceux qui raisonnent à long terme qui rendent des services utiles et finissent par y gagner eux-mêmes et que ceux qui n'ont qu'une vision à court terme ne font que des gains illusoire et passagers. Même ceux qui croient un instant y gagner finissent par y perdre. On ne construit rien de solide dans la facilité.

### L'économie est un jeu à somme positive

§11. « Il ressort de tout cela que la lutte contre la pauvreté exige une coopération aussi bien sur le plan économique que sur le plan juridique qui permette à la communauté internationale et en particulier aux pays pauvres de trouver et de mettre en œuvre des solutions coordonnées pour affronter ces problèmes en donnant un cadre juridique efficace à l'activité économique. Elle requiert en outre des incitations pour créer des institutions efficaces et participatives, ainsi que des soutiens pour lutter contre la criminalité et promouvoir une culture de la légalité. On ne peut nier, par ailleurs, que les politiques fondées sur l'assistance sont à l'origine de nombreux échecs dans l'aide aux pays pauvres. Investir dans la formation des personnes et développer sur un mode inclusif une culture spécifique de l'initiative constitue actuellement, semble-t-il, la démarche appropriée à moyen et long terme. Si, pour se développer, les activités économiques ont besoin d'un contexte favorable, cela ne veut pas dire qu'il ne faut pas accorder d'attention aux problèmes du revenu. Si l'on a fort à propos souligné que l'accroissement du revenu par tête ne peut pas constituer de manière absolue la fin de l'action politico-économique, on ne doit pas pour autant oublier que celui-ci représente un moyen important pour atteindre l'objectif de la lutte contre la faim et l'extrême pauvreté. À cet égard, doit être écartée comme une illusion

l'idée selon laquelle une politique de pure redistribution des richesses existantes puisse résoudre le problème définitivement. Dans une économie moderne, en effet, la valeur de la richesse dépend dans une importante mesure de sa capacité de créer du revenu pour le présent et pour l'avenir. La création de valeurs devient donc une obligation incontournable, dont il faut tenir compte pour lutter de manière efficace et durable contre la pauvreté matérielle. ».

Le pape commence par rappeler le rôle central des institutions. L'activité économique ne se déroule pas dans un vide juridique et la qualité des institutions est essentielle pour le développement : sans état de droit, sans droits de propriété bien définis, sans respect des contrats, l'économie n'est qu'une jungle. Il suffit de comparer les États coupés politiquement en deux, dont une partie avait des institutions conformes à la nature humaine, et une autre partie ne disposait pas de ces institutions, mais de pseudo-institutions contraires à la nature de l'homme : le résultat est sans appel.

Ensuite, prolongeant Jean-Paul II qui avait critiqué l'État providence (l'État de l'assistance), Benoît XVI condamne « les politiques fondées sur l'assistance » qui ont conduit à de nombreux échecs. Suit un appel à « investir dans la formation des personnes », ce que les économistes appellent investir en capital humain, ce qui est reconnu par tous comme le principal facteur de développement. On est frappé de voir, ici comme ailleurs, comment Benoît XVI, après Jean-Paul II, rejoint les développements les plus récents de la science économique.

Quant à la « culture de l'initiative » (Jean-Paul II avait parlé du droit à l'initiative économique) elle met l'accent sur l'homme créateur, qui ne peut créer que s'il est libre de ses initiatives. Le Pape insiste donc sur le fait que cet esprit d'initiative s'enracine dans une culture, et donc dans une certaine conception de l'homme, participant à la Création (qui nous vient en fait directement de la Bible et notamment de la Genèse : « Dominez la terre »).

Enfin, Benoît XVI réduit à néant les critiques adressées à l'Église qui verrait l'économie comme un jeu à somme nulle, la lutte contre la pauvreté ne reposant que sur le partage : le pape affirme au contraire l'importance de la création de richesses nouvelles pour le bien de tous (« la création de valeurs ») : l'économie est donc vue comme un jeu à somme positive. Pour pouvoir partager, il faut commencer par créer et la seule redistribution de ce qui existe ne supprimera pas la pauvreté ; il faut d'abord la croissance et le développement.

### Pour une bonne application du principe de subsidiarité

§12. « Mettre les pauvres à la première place suppose, enfin, que les acteurs du marché international construisent un espace où puisse se développer une juste logique économique, et que les acteurs institutionnels mettent en œuvre une juste logique politique ainsi qu'une correcte logique de participation capable de valoriser la société civile, locale et internationale. Les Organismes internationaux eux-mêmes reconnaissent de nos jours combien sont précieuses et profitables les initiatives économiques de la société civile ou des administrations locales pour permettre la sauvegarde et l'insertion dans la société des couches de population qui, souvent, sont au-dessous du seuil de l'extrême pauvreté et qui, en même temps, sont difficilement atteintes par les aides

officielles. L'histoire du développement économique du XX<sup>e</sup> siècle montre que de bonnes politiques de développement relèvent de la responsabilité des hommes et de la création de synergies positives entre marchés, société civile et États. En particulier, la société civile a un rôle de premier plan dans tout processus de développement, parce que le développement est essentiellement un phénomène culturel et que la culture naît et se développe dans le domaine civil. ».

Cette insistance sur les initiatives économiques et sur le rôle de la société civile mettra du baume au cœur de tous ceux qui ne cessent d'expliquer que ce sont les personnes, les entreprises, les initiatives qui créent des richesses pour le bien de tous. C'est particulièrement vrai en matière de solidarité ou les aides officielles centralisées atteignent rarement leur but, alors que la richesse de l'action de la société civile, c'est qu'elle se situe au plus près des personnes. Après tout, ce n'est qu'une bonne application du principe de subsidiarité. Cela ne fait pas disparaître l'État, mais le pape parle des synergies entre marchés, société civile et États, chacun à sa place donc. Et le pape est clair : le rôle de la société civile est premier, c'est un rôle « de premier plan », notamment pour faire naître la culture favorable au développement.

§13. « Comme mon vénéré prédécesseur Jean-Paul II l'a affirmé, la mondialisation « se présente avec un caractère très marqué d'ambivalence » et elle doit donc être gérée avec une sage vigilance. Cette forme de sagesse requiert que l'on tienne compte en premier lieu des besoins des pauvres de la terre, en mettant fin au scandale de la disproportion entre les problèmes de la pauvreté et les mesures prévues pour les affronter. Cette disproportion, si elle est d'ordre culturel et politique, est avant tout d'ordre spirituel et moral. Souvent, on s'arrête sur les causes superficielles et instrumentales de la pauvreté, sans aller jusqu'au cœur de l'homme où s'enracinent l'avidité et l'étréitesse de vues. Les problèmes du développement, des aides et de la coopération internationale sont parfois envisagés sans qu'il y ait un véritable engagement des personnes, mais simplement comme des questions techniques face auxquelles on se limite à la mise en place de structures, d'accords tarifaires et à la concession de financements anonymes. La lutte contre la pauvreté requiert au contraire des hommes et des femmes qui vivent en profondeur la fraternité et qui soient capables d'accompagner les personnes, les familles et les communautés sur les chemins d'un authentique développement humain. ».

Que la mondialisation, comme toute réalité humaine, ait besoin d'être gérée avec sagesse et de reposer sur des hommes sages est une évidence. La lutte contre la pauvreté doit évidemment être prioritaire, et elle passe par les moyens rappelés ci-dessus par le pape : commerce extérieur, capital humain, institutions, initiatives, société civile... Mais, au-delà, l'essentiel est bien d'ordre spirituel et moral. C'est en développant les vertus humaines et chrétiennes, en s'appuyant sur une éthique forte, que les hommes feront évoluer l'économie dans une bonne direction. C'est, au-delà des nécessaires techniques et institutions, le cœur de l'homme qu'il faut d'abord toucher et convertir pour construire « la civilisation de l'amour ».

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## Business as unusual

### By Eric Ng Ping Cheun

Corporate social responsibility (CSR) has caught on in the general climate of opinion. It holds the view that a business enterprise has economic, environmental and social dimensions, and it should therefore practise multiple stakeholder engagement to meet society's expectations. The CSR approach regards profits as a vehicle for virtuous conduct rather than as an indicator of an enterprise's contribution to the welfare of people.

Officially favoured by the Mauritian government, CSR has been embodied in the Finance Act 2009. All onshore companies are now legally bound to endorse CSR and give effect to it by setting up in every year a CSR Fund equivalent to 2% of their book profit derived during their preceding year. Even a micro enterprise that makes a profit of some thousand rupees is a contributor. More worryingly, the general adoption of CSR by businesses has undesirable implications on their role, aims and conduct, thus heralding a change in the relations between government and the private sector.

Since CSR contribution is an income tax, it is not deductible. In effect, the corporate tax rate has been raised from 15% to 16.7%. Given that the personal income tax rate remains at 15%, this will give rise again to tax planning at best and will impair the signalling function of profits at worst. While liberalisation is advancing with conspicuous success in developing and transition economies, it matters that Mauritius does not get perceived as moving one step backward.

#### Profits are moral

Running a business, like other forms of activity, has a moral dimension. The ethics of business does not imply that enterprises should do more harm than good to themselves, but rather that they should be more effective and efficient in the performance of their primary role as agents of economic progress. Profits are moral in that they are earned by providing consumers with products and services that they want. In so far as the CSR doctrine betrays a fixation on the purity of business motives and the unwarranted suspicion of profits, it downgrades the claims to legitimacy and recognition of profit-oriented private business.

Admittedly, businesses cannot ignore social and environmental pressures: they have little choice but to embrace CSR, in the interests of survival. There is not much cause for concern as long as firms are able, on their own initiative and commercial judgement, to devise their codes and practices, to determine their goals and strategies, and to change them at will. Only then could the adoption of CSR be part of a competitive

strategy based on the premise that people would prefer to buy from, invest in or work for a socially responsible firm.

#### CSR is neither costless nor riskless

In so far as firms are denied the freedom to choose, because of their legal obligations, their performance will instead be weakened, market opportunities curtailed, and competitive pressures reduced. Adoption of the CSR approach by businesses everywhere rather than just by vanguard firms will have an economy-wide impact. Clearly, a genuine commitment to CSR will entail additional costs and hence narrow prospective profitability. It is ill-timed precisely when all firms are engaged into a cost-cutting exercise to ward off the economic slowdown.

To take up the role of vanguard firm is not costless, and it is not riskless either. Three main sources of enterprise risk can be identified. One relates to the performance of management. CSR extends managerial tasks and responsibilities to take account of problems external to the enterprise. Alongside this dilution of energies, managers are called on in time-consuming consultations with outside groups that are unconcerned with the commercial success of firms, let alone hostile to private business.

A second source of risk is that CSR requires developing new systems for recording, monitoring, reporting and evaluating the firm's performance against a set of environmental and social goals. To operate such systems can be costly.

The third one is that firms are supposed to insist on the observance of the same norms and standards by their suppliers and contractors, with the result that all compliance costs will be passed on to the final customers. This may preclude mutually advantageous deals, contracts and working arrangements. Since circumstances vary among enterprises, insistence on common company practice may limit the scope for mutually beneficial market-based transactions.

It cannot be taken for granted that CSR actions undertaken by businesses would outweigh these costs and have a positive balance on the general welfare. Social goals that are voluntarily chosen by the enterprise or imposed by the government may not necessarily reflect public opinion at large. The interests of big firms in showing that they act fairly may not be representative of the population.

#### CSR can work on a voluntary basis only within a competitive market economy

In spite of the outcry of private sector representatives against the mandatory nature of the CSR Fund, Mauritian businesses have to share the blame for contributing in their own account to the further regulation of economic life. They have become so dependent on handouts from the state that they have lost their bargaining power. As they have been at times obsequious to the political masters, their influence over determining policy-making has waned.

In the face of the global financial crisis, the government is dishing out billions of rupees for the benefit of enterprises. This money could have been used for social targets. In return for the stimulus package, businesses are expected to be socially responsible. It is a tacit and unwritten deal, one among many others witnessed under the heading of "public-private collaboration".

Mauritian businesses now pay a high price for failing to draw a distinction between profits that are related to performance and those that are not. For too long, some corporates have enjoyed a monopoly rent that is not linked to performance. Abnormal profits have created a misleading disjunction between the core activities of a business and its contribution to the public welfare.

To build a business case for voluntary CSR, our corporate sector must depart from the age-old anti-market mentality of the socialisation of losses coupled with the privatisation of gains. There is only one condition for making enterprises free to decide on CSR: that they operate within a competitive market economy. Market distortions could then serve as a trigger to enforce CSR on the firm punished by the Competition Commission. The sole norm that can be applied uniformly is true and dynamic competition.



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