

## THE ECONOMIST'S VIEWPOINT

### **In search of capital**

Our leaders must think outside the box to hammer out good policies.

By Eric Ng Ping Cheun

**T**his is not the time to indulge in utter alarmism. Still, the day of reckoning has come as the Prime Minister has avowed that the Mauritian economy is in a “*dramatic situation*”, indeed in a “*state of emergency*”. One cannot blame it all on external factors when, in fact, the seeds of gloom and doom were sown by our policy makers. Bad policies, gross mismanagement and lack of strategic thinking have taken a heavy toll of local business environment. As Minister of Finance, Mr Paul Bérenger was definitely not good in economics. Now let us hope that he is good in democracy.

A government respectful of every citizen's democratic rights has to submit to decisions of employers within the purview of the rule of law. No one, whether he is a minister or a trade unionist, gets away with insulting employers for whatever reasons. Certainly, no sensible person can remain unmoved by the plight of workers who receive a redundancy notice after several years of service. But in a liberal democracy, it is a fundamental right of employers to lay off workers. If such a right cannot be exercised, we will be living in a totalitarian state.

Always anxious to repeat what the political masters of the day are saying, the Joint Economic Council went so far as to assert that “*the worst is behind us*”. Actually, the situation has turned from bad to worse, and the worst will come when the business community at large will have absolutely no trust in our democratic institutions. Suspicions and fears have already crept over the economic agents, who deem it not worthy to play by the rules of the game. Till the next general elections, the Mauritian economy will keep tottering on stilts across the mists of uncertainty and unpredictability.

**I**n a bid to make our business environment less unfriendly, the Board of Investment has introduced a Declared Projects System which allows the approval of projects under the ICT, EEC and ESZ investment schemes within 24 hours. An Investment Tracking System has also been set up to enable a proper tracking and follow-up of investment projects submitted to the BOI. Furthermore, the BOI has launched an Administrative Barrier Survey to identify obstacles, bottlenecks and rigidities in the investment process.

These initiatives, however laudable they may be, are unlikely to bring a significant improvement in our investment and business climate. If the problem were strictly of an administrative nature, its solution would not be difficult to find

out. Government can facilitate all procedures, but an investment decision boils down to risks and returns. While the bottom line remains profit, investment involves multiple risks – business, economic, political, social and institutional. And the most reliable gauge of risks is confidence.

As John Maynard Keynes put it: *“The state of confidence, as they term it, is a matter to which practical men pay the closest and most anxious attention.”* Confidence is the essential link between perception and action. Nothing can be more pernicious to economic agents than perceptions of government interference in the functioning of institutions that embody the laws of the country. Super-committees cannot replace institutions. Regulators cannot be dependent on government. Attempts from the political authorities to bend the rules can only beget inaction and indecision from would-be investors. Politicians must have the decency to refrain from trying to make capital out of human frailties and institutional shortcomings. Alas, as things stand, political capital is chasing away capital investment.

**W**e badly need capital, not the kind searched by politicians, but capital investment. On the one hand, public infrastructure projects on a large scale have severely crowded out private investment, which is currently at a low ebb, with the result that the ratio of gross domestic fixed capital formation has been stuck below 23 per cent of GDP during the last four years. On the other hand, despite numerous road shows, Mauritius continues to receive a trickle of foreign direct investment (FDI), which explains the considerable delay in the development of modern industries.

Our economic situation is frightful, but it makes no use for the government to pile on the agony. The last straw would be to see a panic-stricken government, in tacit collusion with the traditional private sector, proceed by irrational thinking and by crisis management. In the first instance, it is irrational to think that our economy is replete with “capital” just because commercial banks are awash with liquidity! The concept of capital is related to the equipment used by enterprises and to the technological methods employed.

What is lacking to make Mauritius as prosperous as any high-income country is only one thing: capital. We must accumulate domestic capital and we must attract foreign capital. When an economy increases capital, it raises the marginal productivity of labour, and real wages will rise. With better and more efficient tools, a worker can perform in one hour much more than someone who works one hour with less efficient instruments. Better equipment makes enterprises more profitable, and employers would then like to build more and better factories. The only thing that prevents them from doing it is the shortage of capital.

**I**t is also irrational to think that workers and employees in Mauritius are inferior to those in China or India. Rather, it is our equipment and technological methods

that are inferior. This is not due to the ignorance of our entrepreneurs whose role is to know everything about technology. They know very well that the factories in China are much better equipped.

It is not the worker's personal qualities but the conditions in the country that make it possible for him to perform better and to earn higher wages. The thing is, an employer cannot pay a worker more than the amount added by his work to the value of the product. The employer cannot pay the worker more than the customers are prepared to pay for his *additional* work. If the employer pays him more, he will incur losses and go bankrupt.

The difference between Mauritius and China is not personal inferiority or ignorance. The difference is the supply of capital, the amount of capital invested, the quantity of capital goods available. In this respect, it is not surprising that China has superseded the United States as the biggest recipient of FDI. Since 1978, China has received over \$500 billion in FDI, and the US alone has invested \$40 billion in 40,000 projects in this country.

**I**n the second instance, by way of crisis management, the government might just yield to sirens from certain quarters of the private sector demanding protection as well as an overtly deep depreciation of the rupee. But tariffs, inflation and unstable rupee are precisely the means to prevent the importation of capital and industrialization into the country. Protectionism does not add anything to the capital of an economy as it can only divert investments from one branch of business to another branch. To start a new factory or to improve an already existing factory, one needs capital, and not a tariff.

Some bulwarks of rupee depreciation are hinting a 50 per cent devaluation of our currency at one go! Anyone with even a modicum of common sense can imagine the disastrous economic and social consequences of such a folly. First, we are not dealing with a stable monetary unit per se: the rupee has already depreciated by 50 per cent against the Euro over the past four years. Second, business and households will be unable to sustain a severe blow on their costs and to withstand recurrent hikes in oil prices at the same time. Third, the widening of the inflation rate and interest rate differentials with respect to our main trading partners is already putting immense pressure on the rupee. And fourth, it is absurd to imperil the whole economy just for the sake of keeping under artificial respiration one sunset industry (sugar) and one declining sector (textile) that together account for only 13 per cent of GDP.

**O**ur old-fashioned policies based on state protection and rupee depreciation will not work anymore. So long as our leaders think inside the box, the Mauritian economy will remain in the doldrums. A change in their mindset is prerequisite to moving the country forward. While the government must overcome their denial

syndrome and stop manipulating perceptions, the private sector must be proactive instead of being reactive.

It will be a big strategic mistake on the part of the government to support the sugar and textile sectors at the expense of the other economic activities. Policy makers must instead focus on how to allow the tourism, wholesale and retail trade, information and communication technology, real estate, finance and other services sectors to survive and to cater for new jobs in replacement of lost jobs in the traditional sectors. Give the economy a breathing space rather than throttling it with tariffs, regulations, price hikes and taxes.

More importantly, the government should have no qualms about accepting foreign capital even if new enterprises with foreign equity partners pose a serious challenge to incumbents. It is a fact that established big Mauritian business just pay lip service to FDI because they are worried about maintaining their own grip over customers and over small local competitors. Protecting Mauritius is not about patriotism.

We used to tailor policies specifically to attract foreign investment and to offer low-cost labour as well as good infrastructure to compete with other developing countries. While targeted policies can lure investors, political and macroeconomic stability and structural reforms are key factors in attracting FDI to Mauritius. Sound fiscal and monetary policies, supported by an appropriate exchange rate policy, are vital. Finally, foreign investors will respond positively to policies that reduce the state's role in the economy, shift government spending priorities to improve the quality and availability of physical and human capital, embrace market-oriented reforms that help create a flourishing private sector, and remove impediments to foreign investments.