SUMMARY

“Sentence first – verdict afterwards,” shouts the Queen of Hearts. So readers who share the Gryphon’s priorities can read the book from the end to the beginning, for they will not get lost in the flow of ideas. Or they can follow the instructions of the King of Hearts: *“Begin at the beginning… and go on till you come to the end: then stop.”*

The book comprises thirty-three essays that cannot be separated into neat categories. In some cases, it was not possible to eliminate the overlap between essays without disrupting the flow of the exposition. Nevertheless, the book is divided into seven parts for expository purposes.

Part I elaborates on economic growth, a concept which remains unclear to many non-specialists. The opening chapter sets the Mauritian economy in historical perspective. Part II focuses on public finance, critically evaluating our fiscal policy and state pension system. Part III consists of four essays pertaining to monetary policy, the first one elaborating on the true status of inflation. Part IV is a natural extension of the previous section as it dwells on the banking industry, the stock market, the real estate sector and the economic cycle.

Part V deals with international trade, takes position against protectionism and demystifies the notion of competitiveness based on rupee devaluation. One chapter in this section explains in detail the balance of payments, a concept largely misunderstood, even by economists. Part VI contains essays that challenge the conventional wisdom on poverty, state-managed natural disasters, corporate social responsibility and risk management. Part VII concludes on economic freedom, innovation, capital investment and entrepreneurship.

We summarise the main ideas of the book in the same order as the essays are numbered.

Part I

1. A stopover for traders long ago and now a highly open small economy, Mauritius is poised to become a regional hub of trade, tourism, financial and professional services.
2. Economics is not about gross domestic product but about human action. It is a science of the means to be applied to attain chosen ends.
3. The sources of economic growth come not only from labour and capital but also from institutional rules that dictate the actions of economic agents. Thus, growth should be seen as the result of an endogenous process.
4. Fiscal and monetary policies must complement each other well in order to put the economy on a long-run non-inflationary growth trajectory.

Part II

5. Business people are motivated by tax incentives. Under a flat tax regime, the more income you earn, the more tax you pay. This proportionality principle brings revenues to the state coffers while doing justice to the taxpayer.

6. It is preferable that public deficit finances capital projects rather than consumption. It remains that any public expenditure that increases the budget deficit crowds out private investment. The more the government borrows, the less is left for the financing of private projects.

7. A current account deficit fuelled by a high budget deficit, on the back of a consumer-led growth, is harmful to the economy. The deficit in the external balance is reflected in the widening of the saving-investment gap as additional domestic consumption and investment goods are imported.

8. Our ageing population problem calls for an overhaul of the state pension system. The existing funded defined-benefits arrangement with some components financed on a pay-as-you-go basis is not financially viable compared to a private actuarial scheme of capitalization. Besides, the latter produces a favourable effect on overall savings.

Part III

9. Inflation is everywhere and always a monetary phenomenon. Inflation is truly defined as an expansion in the quantity of money, not as a general rise in prices.

10. While economics is about money, a currency is not really a proxy for the state of an economy. The price of the rupee is set by supply and demand on the domestic foreign exchange market where intervention of the central bank may smooth out excess volatility. On the other hand, monetary easing lowers down confidence in the local currency.

11. A policy of inflation targeting cannot ignore asset price inflation. A growth target is not better than an inflation target. The most reliable indicator, and a good early-warning signal, is money supply.

12. A loose monetary policy causes a swell of currency in circulation, thereby creating imbalances in the banking system. These distortions, if left unchecked, could throw the economy out of kilter. To mop up excess liquidities on the money market, the Bank of Mauritius must carry out reverse repo transactions regularly with banks.

Part IV

13. A banking system based on fractional reserve, in which banks lend a large fraction of their deposits, is the root cause of inflation by virtue of the money multiplier effect. The best way to control creation of credit money is to establish a one hundred per cent reserve of demand deposits.

14. Small depositors need to be protected by a deposit insurance scheme that is explicit, not implicit. Capital-to-asset ratio is a better measure than capital adequacy ratio to assess whether banks are well capitalised.

15. A financial bubble occurs when the value of assets moves out of line with their fundamental worth. If the stock exchange is inflated by investors flush with cash, overheating of the market should become a concern for the central bank.

16. Prices in the banking sector, judged by the large interest rate spread and by the wide bid/ask spread for currency, are not really competitive. Financial services providers can structure their professional advice in so far as consumers accept the notion of paid service.

17. Interest rate defined as the relative price between consumption goods and capital goods is what makes the construction business a speculative activity. Strong credit expansion creates a real estate bubble in a negative real interest rate environment.

18. The Mauritian economic cycle has remained quite flat since 1984 with expansions stretching over several years. The economy is likely to stay on an even keel as it is powered by the services industries. Nevertheless, the importance of a prudent monetary policy and of well-regulated capital markets cannot be overemphasised.

Part V

19. The World Trade Organisation cannot promote free and fair trade at the same time. Developing countries like Mauritius need proper market access in developed economies. Industries must root out their own inefficiencies to be able to participate in the positive sum game of free international trade.

20. Protective tariffs are supposed to counteract “dumping”, to help “infant” industries and to secure jobs. Such policies are ineffective in practice. Mandatory minimum wage and equal pay are impediments to job creation.

21. The island turns out to be a regional trade hub thanks to preferential access to the United States under the African Growth and Opportunity Act. However, Mauritian industrialists are competing against resourceful Chinese investors to find some niche markets in Africa, a continent still mired in political instability and uncertainty of law.

22. A full-fledged Duty Free Island will take shape through a well-paced import liberalisation.

23. The current account of the balance of payments is balanced by its capital account through a change in reserves. A current account deficit implies a net sale of domestic assets to foreigners. It exerts downward pressure on the value of the rupee unless it is financed by capital inflows or by the Bank of Mauritius digging into the official foreign exchange reserves.

24. Movements in Mauritius' terms of trade often contradict those who intone the mantra that the country's export competitiveness hinges crucially on a weak rupee. The high import content and the price inelasticity of our exports explain this.

Part VI

25. Income gap is not a yardstick of absolute poverty. From this view, one is always the other's poor. The war on poverty can best be won by less state intervention in the economy.

26. Public policies can alleviate poverty mainly through their influence on economic growth. They should form part of an active "pull-up" strategy instead of a passive "trickle-down" strategy. Financial sector development can be more effective than micro-finance in providing credit to potential small entrepreneurs.

27. Economic development protects people against natural catastrophes better than government programmes. The former increases the value of life and of property whereas the latter aim to get political mileage through media coverage.

28. While transparency and accountability are an absolute must in the governance of a company, corporate social responsibility should be voluntary but within a competitive market economy. Businesses would act in their enlightened interests in so far as the benefits outweigh the costs.

29. A corporate governance premium is risk management. Risk governance is at the heart of a banking organisation. It helps burnish the market credibility of the bank without necessarily eating up its profitability.

Part VII

30. For want of natural resources, the Mauritian economy can only be on course for individual freedom to stay as a front-runner in the race for growth despite a burden of remaining controls. The country's institutional memory of property rights is a repository of trust. It shall be the launching pad for a higher plane of economic development.

31. How to make innovation happen depends on how top corporate managers and civil servants are willing to ignite new ideas. Government and private sector together must foster a risk-taking culture within a flat organisation. Time and money are of the essence to allow for the emergence of in-house innovators, known as intrapreneurs.

32. The concept of capital refers to the equipment used by enterprises and to the technological methods employed. What differentiate countries are the supply of capital, the amount of capital invested and the quantity of capital goods available. Mauritius badly needs capital investment.

33. Investments per se do not guarantee prosperity. They are pure waste in an economy run by people lacking entrepreneurial qualities. A country

driven by entrepreneurs is capable of adapting to the forces of globalisation.