Speech of Honourable Ramakrishna Sithanen, Deputy Prime Minister, Minister of Finance and Economic Development at the First Meeting of the Monetary Policy Committee of the Bank of Mauritius at Bank of Mauritius New Building on Monday 23rd April, 2007

Mr Rundheersing Bheenick, Governor Bank of Mauritius,

Ex Governors of the Bank of Mauritius,

Distinguished guests,

Ladies and gentlemen,

It is indeed a great pleasure to be with all of you to launch the Monetary Policy Committee of the Bank of Mauritius. Let me say a very special and warm welcome to Mr Mario Blejer, ex Governor of the Bank of Argentina and presently a member of the Monetary Policy of the Bank of England. We are very happy to have you in Mauritius Mr Blejer and we are indeed very grateful that you have agreed to help us with monetary policy. Let me also thank all the members I have nominated, in particular, Mr Stefan Gerlach from the Bank of International Settlement, Mr Jacques Li Wan Po, Mr Shyam Seebun, Mr Pierre Dinan, and Mr Jaganaden Coopamah, for their prompt and positive response to serve on the Committee.

I am confident, that this pool of expertise and knowledge that makes up the Committee, will, under the Chairmanship of the Governor of the BOM, execute the functions and objectives of the Committee to the expectations of all stakeholders. It is important to stress that the members of the MPC are not here as representatives of any interest group. They are here as experts to participate in rigorous debate around the issues of monetary policy formulation and implementation. Every member must ensure he has his say. At the same time we do not want to end up in situations where there can be 'paralysis by analysis'. I am convinced that the debates will be well focused and practical – and that every meeting of the Committee will end with implementable and effective solutions.

The Modus Operandi and communications policy of the MPC will be discussed today and I leave it to the experts to decide on the best mode of operation.

Your choice should not be difficult as there are a number of models, ranging from the individualistic committee of the Bank of England to the collegial MPC of the European System of Central Banks. For your communication policy also you will be able to draw on the experience of other central banks. There are a number of items that any central bank might think about disclosing or keeping confidential. These are the monetary policy decision, the statement that accompanies the decision, the vote if any, the inputs to and reasons for the decisions, the minutes of the meeting and plans for the future. I am confident that your communication policy will make monetary policy decisions as transparent as is possible in practice.

Speaking about transparency, let me here welcome the decision of the Governor to invite the press for the launching of this first Meeting of the MPC. Monetary policy has a fundamental role to play in the nation's development endeavour and the public should have a better insight of what monetary policy is, what it can do and what to expect from it. May be in the case of monetary policy it is also important to know what should not be expected from it.

One question that must be on the mind of many is why a committee to determine monetary policy? This is a world wide trend that has resulted from the spread of central bank independence. It is said that even before economic theorists had a chance to fully turn their attention to the choice between an individual and a committee to make monetary policy, central banks across the world have chosen to switch to group decision making. There are now more than 80 central banks that make monetary policy by committee. Today, the Bank of Mauritius is connecting to that trend.

But the most important reason for setting up the MPC is the conviction that it will strengthen capacity for formulating monetary policy. The speculative attack that our currency suffered last year is a prominent example of the need for stronger mechanisms to identify and deal with problems on the money and foreign exchange markets promptly. The MPC will be a powerful forum to formulate right solutions. But, we should recognise that monetary policy is only one aspect of macroeconomic policies and it has a particularly focused role to play in the economy.

In the past three decades a lot of empirical evidence has emerged to support the view that while monetary policy can influence many macroeconomic variables over short periods of time, including real GDP, employment and investment, it can have a sustained influence only on the rate of inflation. Today, this view dominates monetary policy world wide. More recently this postulate has been supported by other empirical evidence based on the experiences of many countries over many years, showing that significant differences in inflation rates had more to do with differences in monetary policy than with any other single macroeconomic variable or policy.

It has therefore become widely accepted that central banks should adopt a long-run target for the rate of inflation which is the only variable that they can reasonably expect to influence over the long run. Thus many central banks around the world have chosen to focus monetary policy actions on maintaining prices low and stable.

On the other hand, while monetary policy cannot have a sustained impact on other macroeconomic variables than the inflation rate, it can nevertheless influence them in the short run. Thus monetary policy can also have a role to reducing short-run fluctuations in aggregate output and influence investment and employment.

This dual role of Monetary policy is fully captured in the Bank of Mauritius Act which states that the primary objective of monetary policy is to "maintain price stability and to promote orderly and balanced economic development".

However, notwithstanding the operational independence of Central Banks, they stay alive and responsive to the broader economic goals of Government and of what fiscal authorities are doing. Monetary and fiscal policies must be coordinated and aligned on the same national economic goals. Such coordination is provided for in the Bank of Mauritius Act, which states that the Bank, with the concurrence of the Minister, will determine the accepted range of the rate of inflation during a given period, consistent with the pursuit of the price stability objective.

A good coordination is even more crucial now in a period when fiscal policy is being totally reengineered. The new fiscal policy stance of Government is clear. We are moving towards more rules and less discretion. Back in August 2005, in the Statement on Setting the Stage for Robust Growth, I announced that fiscal policy will be guided by the Golden Rule that government must borrow only to finance its investment and the Sustainable Investment Rule that debt be put on a downward track to a sustainable level. In last year's budget I reinforced these two principles with the Constant Expenditure Rule that requires that total expenditure remains constant after adjusting for inflation.

In a similar vein, I have removed the discretion of the Minister to remit duties and taxes. We are implementing the same policy in the area of business facilitation with the Silent Agreement Principle.

The Medium Term Expenditure Framework within which Government budget is now cast and the adoption for the coming fiscal year of programmatic and performance based budgeting will increasingly limit the scope for discretion on the expenditure side of fiscal policy.

On the revenue side, our approach to clean the system of tax expenditures, to rationalize incentive schemes and to apply a single tax rate, reduces significantly the discretion of Government.

A new Debt Strategy is also being put in place focusing on clear targets for Debt-GDP ratio and for maturity and currency composition of the debt portfolio as well as for various risk ratios.

Thus in all three areas of fiscal policy – i.e. revenue, expenditure and borrowing- the approach is to set rules, targets and indicators. It is our conviction that adhering to rules will most likely deliver desired outcomes. There is therefore a convergence in terms of approaches between fiscal and monetary policies as monetary policy also is guided by rules, especially if its long run focus is on price stability. We must now make this convergence work to maximise the effectiveness of macroeconomic policies through earlier and smoother policy response to emerging problems.

I should like to end by wishing the Chairman and members of the Monetary Policy Committee success and fruitful deliberations in this first meeting. Both monetary and fiscal authorities have a challenging task ahead. With well coordinated policies and well-thought out and timely solutions we will meet the challenges and achieve our goals. We are seeing very encouraging signs of succeeding the transition of our economy. Let these be a source of inspiration to continue our journey.

I thank you for your attention.