Mauritius

key figures

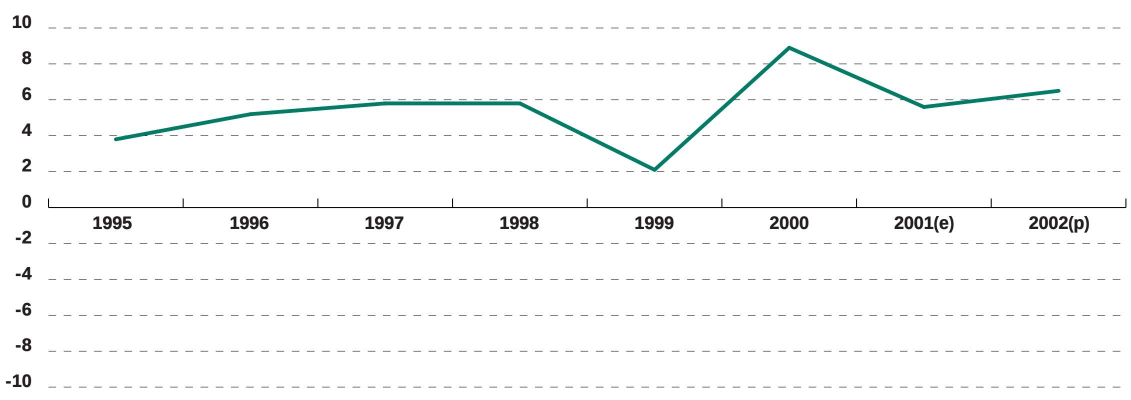
- Land area, thousands of km²: 2
- Population, thousands (2000): 1 161
- GDP per capita, $ (2000): 3 987
- Life expectancy (1995-2000): 70.7
- Illiteracy rate (2001): 15.0

Mauritius

MAURITIUS CAN BE CONSIDERED one of the most successful stories in the African continent. In the last two decades real GDP growth has increased by 5.7 per cent on average and educational attainment is among the highest in developing countries. After the severe drought that hit the country in 1999 with a great impact on the sugar sector, the economy rebounded and in 2000 it grew by 8.9 per cent. GDP growth — with an average rate of 6.1 per cent — will continue its usual high pace in 2001 and 2002. Once heavily dependent on sugar exports, Mauritius has been able to diversify its economy with the development of the garment manufacturing industry through the Export Processing Zones (EPZs). Despite its remarkable performance, the country is facing severe economic challenges since the bases on which it has built its development path are rapidly changing. Labour cost rises in recent years have eroded its competitiveness in the textile industry, and preferential market access, that has been critical for the development of the sugar sector and garment industry, will phase out over the next few years.

Mauritius has been able to diversify its economy through the Export Processing Zones

Figure 1 - Real GDP Growth



Source: Authors' estimates and predictions based on domestic authorities' data.

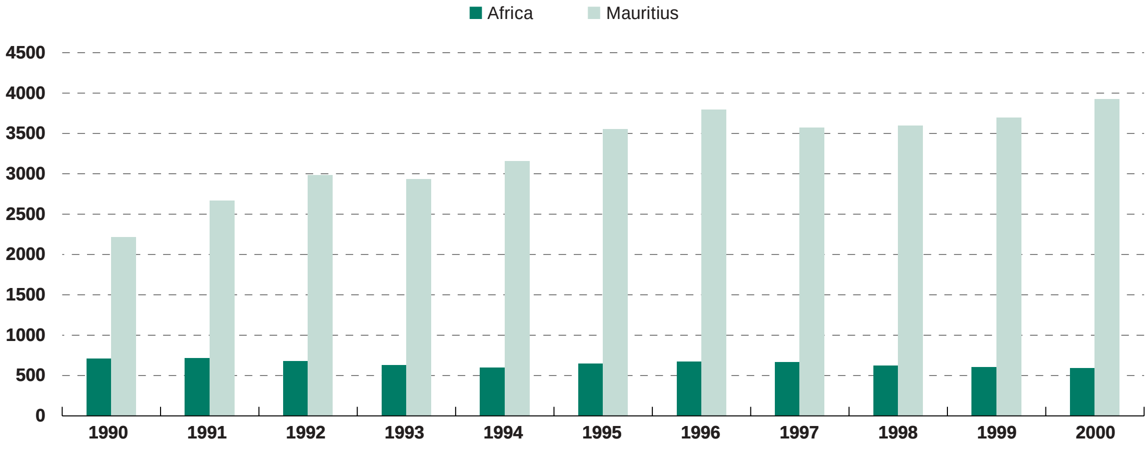
Recent Economic Developments

In the last six years (1996-2001) Mauritius has grown on average by 6 per cent rooting its development on its growth engines: EPZs, the sugar sector, tourism and the emerging financial services sector.

The consolidated penetration in the French, UK and US markets of the garment industry — by far the largest production in the EPZs — has allowed the sector to expand at a sustained level in the recent past. Accounting for 12 per cent of GDP and bringing in almost three-quarters of export earnings, the EPZs industry has grown by around 6 per cent in recent years. Nevertheless, the changing economic environment could jeopardise the near future of the industry. The end of the quota and duty free access to the European market starting by December 2004 coupled with increasing labour costs in the EPZs incurred in the last decade could require a drastic change within the EPZs industry.

The sugar sector — which consists of sugarcane production and to a lesser extent the sugar industry — has largely rebounded in 2000 after the 1999 drought,

Figure 2 - GDP Per Capita in Mauritius and in Africa ($ current)



Source: Authors' estimates based on IMF and domestic authorities' data.

one of the most severe that the country has known. The sector expanded by 52.5 per cent in 2000 and in 2001 is expected to recover at its pre-drought production level. Following the sector's boom during the 1970s, the sugar sector has expanded steadily over the last two decades mainly due to the Sugar Protocol and Special Preferential Sugar (SPS) Agreement with the EU which allowed exports at a guaranteed price three times higher than the world price. As a result, almost the entire production is sold to the EU. The likely reduction in the guaranteed EU sugar price could hamper the future developments of this sector.

The tertiary sector has expanded remarkably in the last few years (11.1 per cent in 2000) and represents 62 per cent of the entire economy. In the last five years, Mauritius has carved a comfortable niche in the world of international financial services thanks to its expanding tax treaty network, a reputable offshore jurisdiction, its strategic location, and its membership in major regional trading blocs. Financial services now represent the third pillar of the economy, after the EPZs manufacturing sector and agriculture. The introduction of new legislation related to anti-money laundering has reinforced confidence in the regulatory, institutional and operational frameworks boosting the sector's growth by 11.1 per cent in 2000.

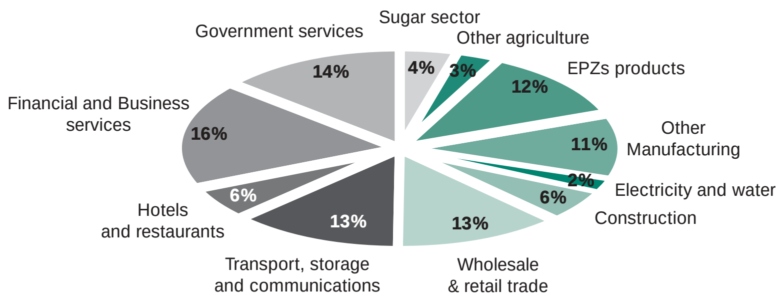
Alongside financial intermediation, tourism contributes significantly to economic growth and has been a key factor in the overall development of Mauritius. In the past two decades tourist arrivals increased at an average annual rate of 9 per cent. In 2000, the sector expanded at a higher pace.

Table 1 - Demand Composition (percentage of GDP)

	1995	1998	1999	2000	2001 (e)	2002 (p)
Gross capital formation	**25.8**	**25.3**	**26.0**	**25.6**	**22.5**	**25.8**
Public	8.0	6.0	6.6	6.5	5.7	8.5
Private	17.8	19.3	19.4	19.1	16.8	17.3
Consumption	**76.7**	**75.5**	**77.5**	**76.4**	**75.2**	**77.9**
Public	12.1	12.5	12.8	12.4	11.4	11.6
Private	64.6	63.0	64.7	64.0	63.7	66.4
External sector	**-2.5**	**-0.8**	**-3.5**	**-2.0**	**2.3**	**-3.7**
Exports	59.6	65.6	63.5	60.8	58.6	55.9
Imports	-62.1	-66.4	-67.0	-62.8	-56.3	-59.6

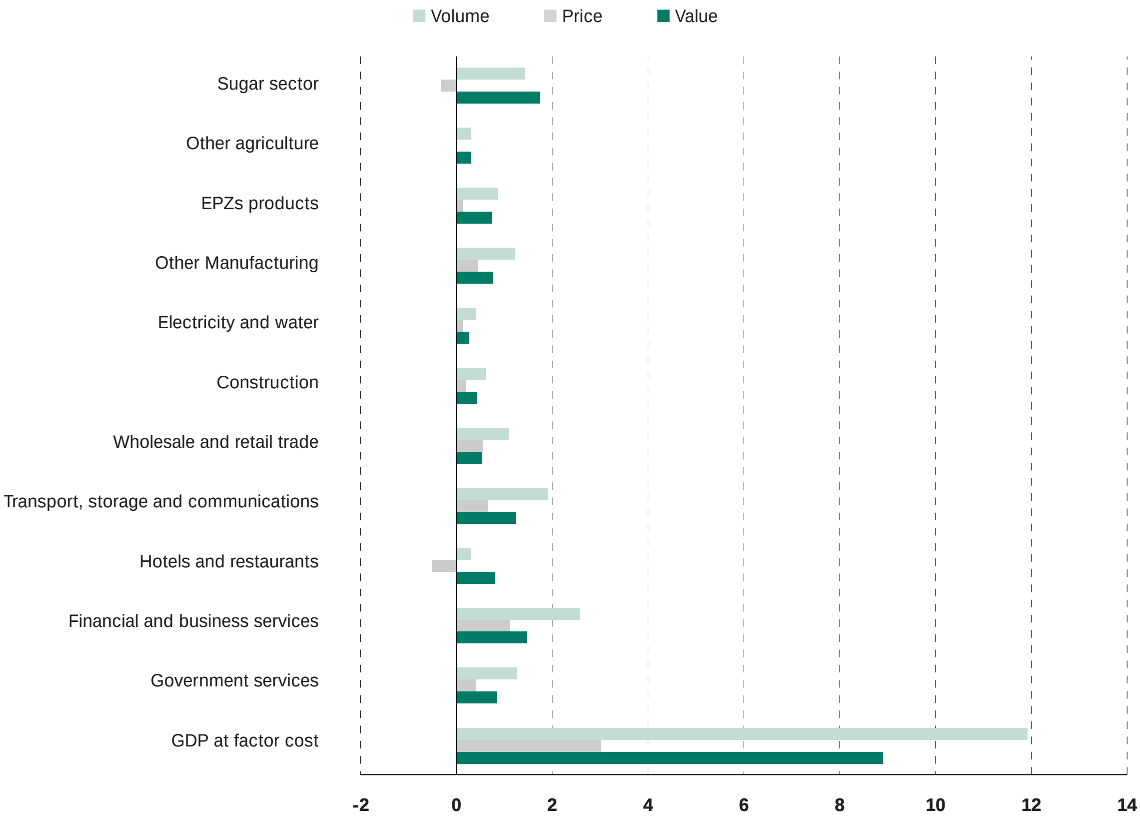
Source: Authors' estimates and predictions based on domestic authorities' data.

Figure 3 - GDP by Sector in 2000



Source: : Authors' estimates based on Central Statistical Office data.

Figure 4 - Sectoral Contribution to GDP Growth in 2000



Source: Authors' estimates based on Central Statistical Office data.

The composition of demand has remained nearly stable over the last years with investment accounting for a quarter of domestic demand and exports and imports accounting altogether for more than 120 per cent of GDP. The fluctuation of gross fixed capital formation can be explained as the result of the large impact of investments of air and land transport in the transport sector. Similar trends are expected in 2001 and 2002 although public investment will grow following the new fiscal policy stance in fiscal year 2001/02.

Macroeconomic Policy

Fiscal and Monetary Policies

Despite the fact that the principal aim of recent budgetary policy has been the reduction of fiscal deficit, over the last five years (fiscal years 1996/97 to 2000/01) Mauritius has registered an average overall fiscal deficit of 4.9 per cent of GDP. The situation has worsened particularly in 2000/01 owing to the losses experienced by large parastatals and to some revenue reductions. After consolidating the central government budget deficit with those of the State Trading Corporation (STC) and the Central Electricity Board (CEB), the revised estimate for the 2000/01 budget deficit rose to 7.6 per cent to be compared with a target of 2.9 per cent of GDP. Losses incurred by the STC and the CEB are mostly attributable to higher energy prices which have not been passed on to consumers. On the revenue side, significant reductions in external tariffs as well as some income tax and indirect tax reductions have contributed to the current large fiscal deficit.

Because of repeated and large budget deficits, public debt — mainly domestic debt — has expanded notably in the recent past. From a level of $1.2 billion in June 1995 domestic debt reached $1.8 billion in June 2000, equivalent to 39 per cent of GDP. Added to external public debt, the ratio of total public debt stood at 47 per cent relative to GDP.

Notwithstanding increasing concerns related to the rising public debt, the current government has prioritised the financing of a vast public investment programme in its 2001/02 budget. The need for a highly skilled labour force and good infrastructure, necessary to face the rising labour costs and the end of preferential market access, has been the main concern of the current government. Consequently, capital expenditure will increase by 58 per cent to finance investment in education and training, ITC and infrastructure, environment and health, as well as for various social sectors. Therefore, the budget primary deficit for 2001/02 is expected to reach 5 per cent in spite of an increase in value-added tax from 10 per cent to 12 per cent. The government has announced its intention to bring down the overall budget deficit gradually, over the next five years, to 3 per cent of GDP. Nevertheless, the ambitious four-year public investment programme launched in the last budget poses concerns over its sustainability in the coming years as the widening of the primary deficit for 2001/02 suggests.

Table 2 - Public Finances[a] (percentage of GDP)

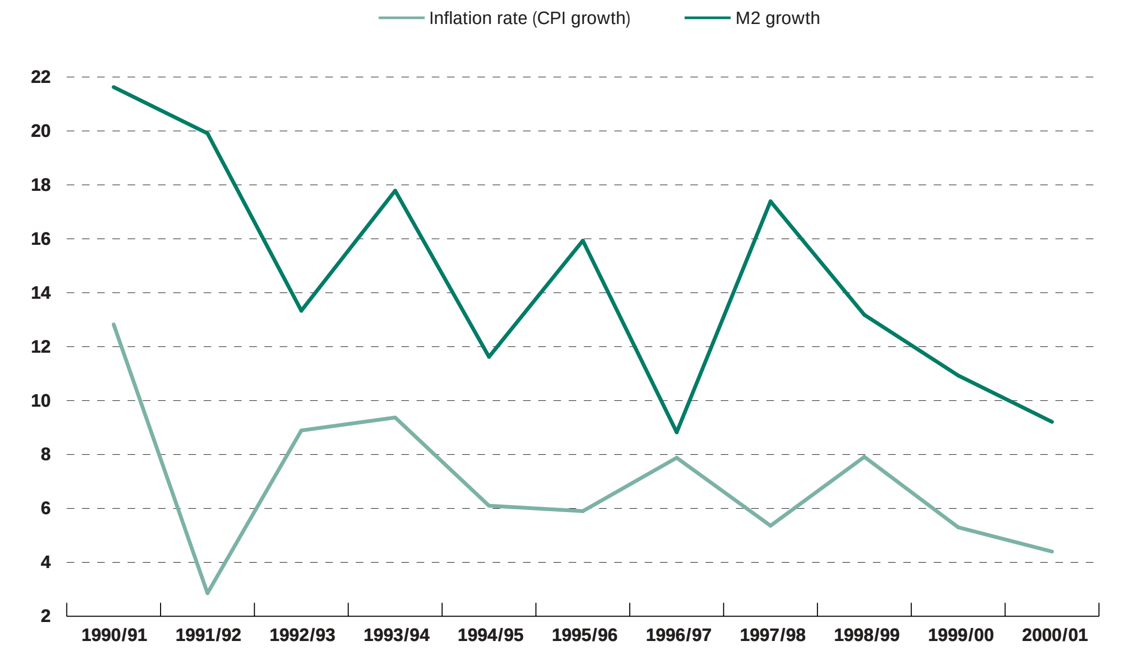
	1994/95	1997/98	1998/99	1999/00	2000/01(e)	2001/02(p)
Total revenue and grants[b]	**20.0**	**20.2**	**20.6**	**21.4**	**17.3**	**17.6**
Tax revenue	16.9	17.2	17.3	18.8	15.4	15.8
Total expenditure and net lending[b]	**23.7**	**24.2**	**24.0**	**25.4**	**23.6**	
Current expenditure	20.0	21.1	21.1	21.3	20.0	
Excluding interest	*16.9*	*17.2*	*17.6*	*17.8*	*16.2*	*16.2*
Wages and salaries	7.6	7.1	7.2	7.1	6.2	6.0
Interest on public debt	3.1	3.8	3.5	3.5	3.8	
Capital expenditure[c]	3.8	3.0	2.1	3.2	3.1	4.4
Primary balance	**-0.6**	**-0.1**	**0.1**	**-0.4**	**-2.5**	**-5.0**
Overall balance	**-3.7**	**-4.0**	**-3.4**	**-3.9**	**-6.3**	

a. Fiscal year begins 1 July.
b. Only major items are reported.
c. Including net lending.
Source: Authors' estimates and predictions based on IMF and domestic authorities' data.

The mandate of monetary and exchange rate policy, under the authority of the Central Bank, the Bank of Mauritius, is to sustain growth through stable prices and exchange rates. The Central Bank has pursued this objective in the recent past through a mix of policies. In the domestic market, a tightening in monetary policy followed the elections in September 2000. Money growth has been targeted consistently with a growth in GDP of 5.5-6 per cent and inflation of 4.5-5 per cent. The Lombard rate, introduced in December 1999, was raised accordingly from 11 per cent as of June 2000 to 12.5 per cent until April 2001. As a result, despite the strong recovery of the economy after the drought that hit the sugar sector in 1999, inflation has remained subdued and passed from a level of 5.3 per cent in the year 1999/2000 to a level of 4.4 per cent over the following fiscal year. For 2001, with expected inflation of 4.1 per cent, the monetary stance of stable prices will be followed.

On the exchange rate market, a large real appreciation of the Mauritian rupee occurred during 1999 and much of 2000 as a result of inflation differentials with trading partners and owing to the depreciation of the euro *vis-à-vis* the US dollar. In response to demands of the sugar sector the Bank of Mauritius reintroduced a 50 per cent surrender requirement on the export proceeds of the Mauritius Sugar Syndicate. Since October 2000, in response to market pressures, the Mauritian rupee depreciated in real effective terms by 7.5 per cent, reversing much of the previous loss in competitiveness.

Figure 5 - Inflation Rate and Broad Money Growth



Source: Central Statistical Office data.

External Position

Mauritius is one of the most open economies in Africa and its trade relationships have been mainly shaped by preferential market access. Therefore, while sugar exports are essentially shipped to European countries under preferential access schemes and at guaranteed prices, the main export markets for garment manufacturing industry are France, the United Kingdom and the United States where Mauritius' products also enter duty free. On the imports side, trade relationships are more diversified. Indeed, beside high-income countries such as France (which is the second largest supplier), other EU countries, the United States and Hong Kong, other significant partners include India and South Africa. Imports consist mainly of manufactured materials (textile yarns and cotton fabrics), machinery and transport equipment, and to a lesser extent food and live animals.

Mauritius' external position is structurally characterised by the trade balance deficit offset by net exports in services (principally borrowing) and current transfers. Indeed, over the last five years, an average trade balance deficit of 9 per cent of GDP has been consistent with a current account deficit averaging only 0.9 per cent of GDP. As a result of increasing — mainly public — investment in 2001/02, imports will be at 44.2 per cent of GDP in 2001/02 widening the trade deficit by 40 per cent.

In fiscal year 1999/2000, despite the impact of the drought on sugar exports, the current account balance passed from a 1.6 per cent deficit to a surplus of 0.5 per cent thanks to growing tourism receipts.

With a 10-year average of 1 per cent of GDP, foreign direct investments are not significant determinants of the overall balance of payments. More importantly, the flows of FDI do not contribute significantly to productive capacity expansion since it represents, on average, less than 4 per cent of gross investment. Nevertheless, the acquisition by France Telecom of 40 per cent of Mauritius Telecom shares in November 2000, has produced exceptionally high FDI inflows, equal to 6 per cent of GDP and 25 per cent of total gross investment.

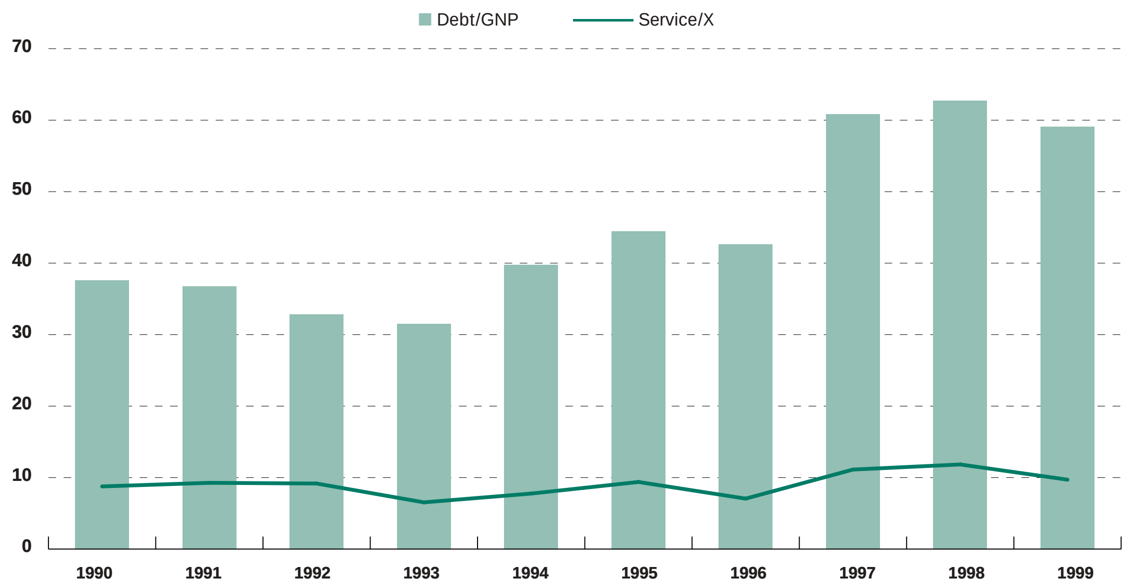
In the last ten years Mauritius' external debt has increased remarkably from below $1 billion in 1990 to $2.5 billion in 1999. Long-term debt, which represents three-quarters of the total, is largely owed to private creditors representing 73 per cent of total

Table 3 - Current Account (percentage of GDP)

	1994/95	1997/98	1998/99	1999/00	2000/01(e)	2001/02(p)
Trade balance	-10.3	-10.1	-8.8	-10.5	-9.5	-13.6
Exports of goods (f.o.b.)	38.6	39.6	40.3	35.5	32.1	30.6
Imports of goods (f.o.b.)	-48.9	-49.8	-49.1	-46.0	-41.6	-44.2
Services	2.9	4.8	5.6	9.8		
Factor income	-0.5	-0.5	-0.6	-0.8		
Current transfers	2.7	3.0	2.2	2.0		
Current account balance	**-5.2**	**-2.9**	**-1.6**	**0.5**		

Source: Authors' estimates and predictions based on IMF and domestic authorities' data.

Figure 6 - Stock of Total External Debt (percentage of GNP) and Debt Service (percentage of exports of goods and services)



Source: World Bank (2001), *Global Development Finance.*

creditors in 1999. Nevertheless, the external debt service has remained stable (8.8 per cent of exports of goods and services in 1990, to 9.7 per cent in 1999).

Structural Issues

The comparative advantages which had been crucial for the sustained economic growth of Mauritius in the last few decades are now changing and in the near future the country will face important new challenges. The transformation of the trade environment will require a rethinking of the current economic model based mainly on low-end garment production and on a strong sugar industry. On the internal side, the ageing of the population due to demographic changes will affect the population dependency ratio, with implications on the growth potential and putting pressure on public finances.

On the external side, the major changes are related to the ending of non-reciprocal preferential market accesses. The elimination of global quotas on clothing — under the Multifibre Arrangement (MFA) — by the EU and the United States by the end of 2004 will reduce preferential access enjoyed by the garment industry, exposing the country to world competition. Moreover, the gradual phasing out of the EU guaranteed sugar price in the next few years will definitely hamper the current profitability of the sugar sector. On the other hand, the African Growth and Opportunity Act (AGOA) enacted by the United States in 2000 could have a significant impact on Mauritius especially for the garment industry. The duty-free access in apparel to the US market in force until 2008, subject to the rule of origin requirement, could outweigh the negative impact of the MFA elimination phasing out. In addition, regional trade could be enhanced through a boosting of Mauritius' FDI in neighbouring African countries, such as Madagascar and Mozambique, which are exempted from the rule of origin requirement for a period of four years.

On the internal side, the relatively long period of sustained growth which occurred in the country in the last three decades has influenced demographic trends. The decline in the fertility rate from 3.25 in 1970 to 1.90 in 1998, coupled with an increase in life expectancy from 63 to 72 years, is changing the population structure. Indeed, over the next ten years, labour force growth will decline to less than 1 per cent per year with a consequent ageing of population. This will add considerable pressure on pension funds and on public finance, with an increasing weight of the current transfers, as well as on the economy's growth potential.

Changes in current regulatory framework and developments of infrastructure are currently implemented to adapt the country to those structural changes and to allow it to reach a new stage of development.

The regulatory framework related to FDI has been reformed in the last year in order to attract new potential investors. So far, top-heavy bureaucratic procedures in issuing FDI permits and work permits for expatriates have acted as a disincentive for attracting FDI. From a fragmented institutional framework with responsibilities given to various institutions and ministries, the government has created a new institution called the Board of Investment (BOI). This is responsible for the whole set of procedures required of foreign investors to settle new investment projects. Moreover, a new strategy is currently being put into place based on selective targeting of potential foreign investors instead of the usual road shows exposing the investment potential of the country to a broad category of foreign investors.

By African standards, Mauritius has well-developed basic infrastructure**.** The large government investment projects of the recent past have markedly improved the island's road transport and road network with 1 880 km of tarred roads. Sea transport is also well developed with the main harbour, Port Louis, which has been recently been expanded and modernised to cater for bigger vessels. Under the control of the Mauritius Freeport Authority (MFA), a parastatal body created in 1992, the country has substantially increased its port facility. The establishment of a Freeport considered as the logistics platform for warehousing, distribution and marketing of the region is in line with the government policy to develop the services sector and help Mauritius to become a regional trading hub. Mauritius also has a well developed infrastructure related to air transport with the state-owned international airport, through which 15 international airlines operate, handling about 150 flights a week.

In addition to the development of basic infrastructure, Mauritius is taking steps towards achieving its ambition to become a telecommunications and ITC hub. With a tele-density of 250 lines per thousand inhabitants Mauritius has the most developed telecommunications network in Africa. Nevertheless, the ambitious plan of developing Mauritius as a world-class ITC hub still faces constraints related to the present telecommunications environment. The costs of basic telephony are still high and Internet access prices as well as the number of Internet host per 10 000 inhabitants is still lagging relative to competitors such as Malaysia, Korea or Singapore. The tele-communications market is still dominated by the monopoly of Mauritius Telecom which is the only fixed line operator and Internet service provider and is likely to remain so until the end of 2003. On the other hand, the completion — scheduled for the end of 2001 — of the new SAFE (South Africa Far East) undersea fibre-optic cable, which will link the island to Malaysia, South Africa and then onwards to West Africa and Europe, will boost the island's high capacity bandwidth. Beside that, a large infrastructure ITC project — Cybercity — with the technical and financial co-operation of India, is likely to attract national and international investors to relocate their activities on the island.

The banking sector is one of the most developed in sub-Saharan Africa and Mauritius is rapidly achieving a remarkable position in the international market for financial intermediation**.** Offshore banking took off in the 1990s primarily thanks to liberalisation of the Indian economy and Mauritius enjoys bilateral tax conventions signed in the last ten years with several Asian countries. Mauritius is now considered to be the fourth largest foreign investor in India through large portfolio investment. The total number of offshore entities on register has reached 10 561 as at November 1999 in the form of national and international companies, and trusts. Off-shore banking — dominated by Barclays, HSBC and South Africa Investec — comprises 11 offshore banks and total assets have stood at $2.6 billion, while non-bank deposits were $1.1 billion. On the other hand, the ten onshore commercial banks operating in Mauritius can be considered as profitable. The banking system is well capitalised enjoying an average capital adequacy ratio in the range of 12-13 per cent in the past three years, above the Basel requirement of 8 per cent. This sector — which is still dominated by Mauritius Commercial Bank and the State Bank of Mauritius — has been able to raise markedly private sector credit which has increased on average by 30 per cent in the last three years, with a parallel evolution of deposits. Financial supervision has followed the pace of development of the entire sector. The supervision of the offshore sector has been recently strengthened with the introduction of the Financial Services Development Bill which will bring under one umbrella the regulation and supervision of the non-bank financial sector. Moreover, the National Assembly has ratified the Economic Crime and anti-Money Laundering Act — which led to the setting-up of the Economic and Crime Office. The supervision of onshore activities has been enhanced as well through closer monitoring of the central bank.

Political and Social Context

Mauritius enjoys one of the most stable political systems in Africa, based on a multiparty democratic republic. Legislative power lies in the hand of the elected National Assembly which comprises 60 elected representatives. The last general elections were held in September 2000 opposing two main alliances: the Mauritian Militant Movement and the *Mouvement Socialiste Militant* (MMM-MSM) alliance on one side and the Mauritian Labour Party and *Parti Mauricien Social Démocrate* (MLP-PMSD) alliance on the other. The MMM-MSM alliance won 54 of the 60 parliamentary seats. Such landslide victories are not unusual in Mauritian elections — in 1995 an MLP-MMM alliance won all 60 seats, and in 1992 an MMM-MSM alliance won 56 seats.

The MSM-MMM alliance has a pre-electoral agreement to share the post of Prime Minister. Sir Anerood Jugnauth, leader of the MSM, will hold the post of Prime Minister for the first three years and will then become President of the Republic. For the remaining two years in the five-year mandate, Paul Berenger, leader of the MMM party, will be Prime Minister. This will be the first time that Mauritius has experienced a sharing of power between two parties in one mandate. When Mr Berenger accedes to the post of Prime Minister, he will be the first Prime Minister of Mauritius coming from a non-Hindu minority community.

The strong ties that exist between Mauritius and the West are due to Mauritius' political heritage and dependence on Western markets. Mauritius has sought to establish close links with the European Union and its member states, particularly the United Kingdom and France, which exercises sovereignty over the neighbouring island of Réunion. In the last decade, Mauritius' foreign policy emphasis has gradually moved towards the strengthening of its ties with the African continent, with steady integration within SADC, COMESA and IOC (Indian Ocean Commission) regional blocs and by pursuing closer economic and political ties with South Africa. Finally, India and Mauritius share close relations based on cultural and ethnic links.

Within the African context Mauritius can be considered as a successful case of sustained economic growth associated with a substantial welfare improvement of the entire population. The achievements of the universality of access to primary health care as well as universal primary education are unambiguous signs of great advances in the social services. Nevertheless, the changing socio-economic environment has not been accompanied by a revision of the education system. As a result the labour market in Mauritius is facing an increasing skills mismatch and a rise in unemployment.

With an adult literacy rate of 85 per cent, free education until university level, and universal primary education, the education standards of Mauritius are remarkable within the African context. Nevertheless, enrolment rates fall from 100 per cent in the primary sector to just 60 per cent in the secondary level, as a result of the high drop-out and failure rates at the end of the primary level. The causes of this drop are related to the inequalities which persist in society itself and the inability of the primary school system to overcome them. Regions with higher incomes have better schools and there parents are prepared to pay for private tuition for their children to pass the competitive Certificate of Primary Education (CPE) examination at the end of the primary level. Moreover, the system is lagging behind the changing socio-economic environment: Mauritius ranks 95 in terms of the percentage of population enrolled in science, computing and engineering, significantly less than its world competitors such as East Asian countries and other African countries such as Botswana, Cameroon, Côte d'Ivoire, Egypt, Nigeria, and Zimbabwe.

Despite sustained economic growth, the employment situation has markedly deteriorated over the last five years. The unemployment rate went up to 8 per cent in 2000 from a level of 2.8 per cent in 1990, and preliminary estimates for 2001 suggest a level above 9 per cent. The pace of this rise has been remarkable in the last two years, when the rate of unemployment increased by 18.4 per cent. The evolution from a low-skilled/low-technology economy towards a service economy accounts for this pattern. Indeed, the labour force is still highly characterised by semi-skilled and low-skilled workers who account for 97 per cent of employment. On the other hand, there are specialised jobs in the economy that cannot be filled by the current unemployed because of a lack of related skills. Another important factor to be reckoned is women's participation rate which increased from 30 per cent in the 1980s to 40 per cent in 2000.