Mauritius

key figures

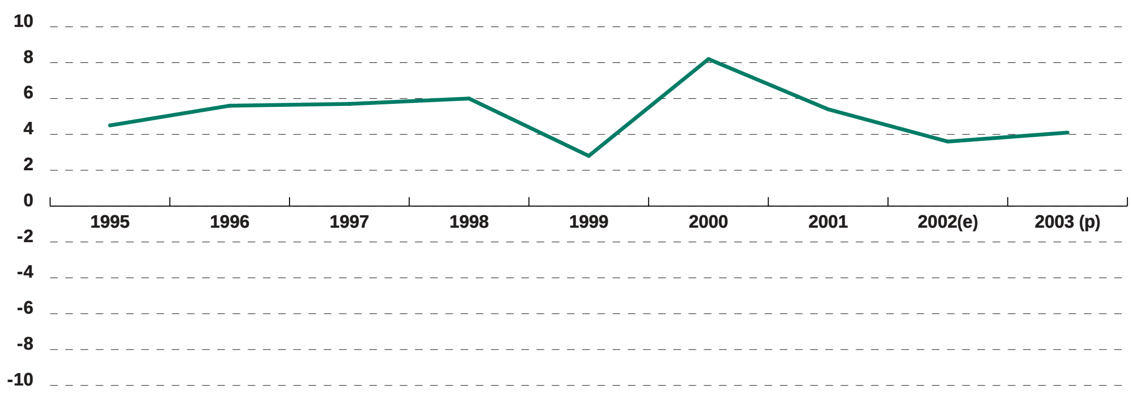
- Land area, thousands of km² 2
- Population, thousands (2001) 1 171
- GDP per capita, $ (2001) 3 866
- Life expectancy (2000-2005) 72.0
- Illiteracy rate (2001) 15.0

Mauritius

MAURITIUS CAN BE CONSIDERED one of the most successful stories in the context of the African continent. However, despite its remarkable performance, the country is facing severe economic challenges as the bases of its development are rapidly changing. Increasing labour costs in recent years have eroded the competitiveness of the textile industry, and preferential market access, which was critical for the development of the sugar sector and garment industry, will phase out over the next few years. The country operators - the public as well as the private sector - are aware of these structural changes and are showing a great deal of adaptability and creativity in facing the new challenges. Consequently, despite going through a difficult transition period, Mauritius is displaying relatively good economic performance. After the severe drought which had a major impact on the sugar sector in 1999, the economy rebounded and grew by 8.9 per cent in 2000 and 5.8 per cent in 2001. In 2002, however, the growth rate was lowered to an estimated 3.6 per cent due to the negative impact of cyclone Dina on sugar output, the aftermath of 11 September and the political crisis in Madagascar. In the medium term, the economic recovery will depend on the credibility of the structural changes undertaken by the country and the subsequent renewed confidence of private investors.

Labour costs have eroded the competitiveness of the textile industry in recent years, but Mauritius is adapting to new challenges

Figure 1 - Real GDP Growth



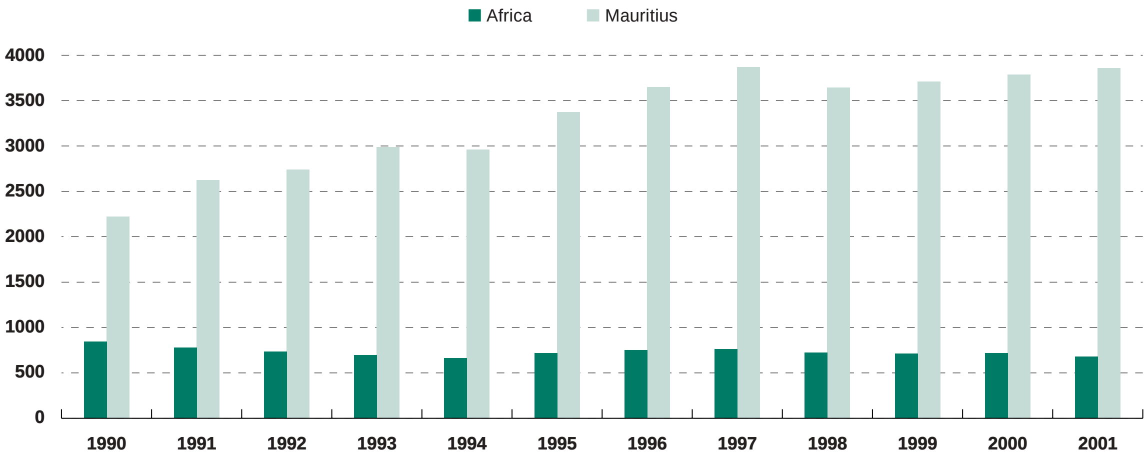
Source: Authors' estimates and prospects based on Central Statistical Office data.

Recent Economic Developments

In the last six years (1996-2001), Mauritius has grown on average by 6 per cent, relying on several growth engines: export processing zone (EPZ), the sugar sector, tourism and the emerging financial services sector. In 2001, all sectors contributed positively to growth. However, despite a growth rate of 5.8 per cent, Mauritius suffered in 2001 from adverse external conditions – related to a significant slowdown in Europe and the US – as well as from the difficult transition of the economy due to changing comparative advantages.

The sugar sector – which consists of sugarcane production and the sugar industry – has largely rebounded in 2000 following the 1999 drought, one of the severest the country has known. In 2001, the production of sugarcane increased by 13.4 per cent (from 5 109 521 tonnes in 2000 to 5 792 326 in 2001) thanks to favourable weather conditions (which resulted in an improvement of 13 per cent in the yield per

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



Source: Authors' estimates based on IMF.

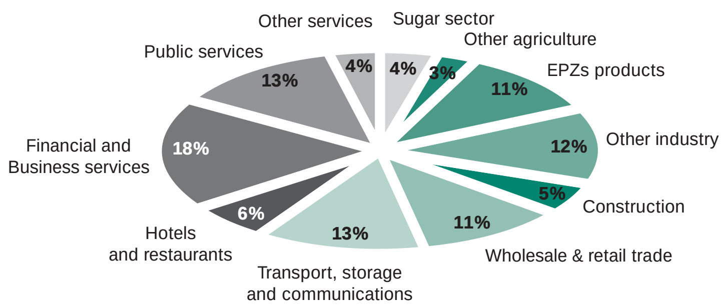
hectare). Meanwhile, sugar milling increased from 569 289 to 645 598 tonnes. In January 2002, the sugar crop suffered from cyclone Dina, which led to a 2002 level of sugar production and milling 13 per cent lower than in 2001. Over the longer term, the milling target is set at 620 000 tonnes so as to be in line with the phasing out of the preferential trade agreements and to satisfy a better allocation of land resources.

In view of meeting the challenges of increasing competition, which Mauritius is expected to experience over the coming years, the sugar sector is undertaking a series of reforms[1] in order to reduce production costs (from 18 cents / lb to 12 cents by 2008). Concerning the labour force, a programme is currently being implemented with the aim of reducing the manpower by one third. A voluntary retirement scheme is currently in place (and will end in 2003) allowing female agricultural workers above 50 and males above 55 to withdraw from the activity with cash and land compensation. By mid-2002, the target had almost been met – as 7 000 out of the envisaged 8 000 workers had already agreed to the scheme - albeit at a very high cost (estimated at 3 billion rupees). The second aspect of the reform involves a higher concentration in the milling sub-sector, the number of sugar factories being reduced from 14 to 8 by 2008. So far this has been successfully implemented throughout the country except for the South where the sugar industry is more fragmented. Thirdly, mechanisation and irrigation have become the priorities with a land target of 60 000 ha over 77 000 to be mechanised and 32 000 to be irrigated by 2010. This should be boosted by the operationalisation of the Midlands Dam in September 2002. The reform programme also includes more intensive use of electricity produced from the bagasse as well as an amendment to the Labour Act, which will bring more flexibility to employment policy.

The consolidated penetration into the European and US markets of the garment industry - which represents around 80 per cent of the EPZ activity - has recently enabled the sector to expand at a sustained level. Accounting for 12 per cent of GDP and bringing in almost three-quarters of export earnings, the EPZ industry has grown around 6 per cent up until 2000. In 2001, however, the EPZ industry grew only by 4 per cent, due to a 14.5 per cent drop in the US market following the 11 September shock. This occurred despite a strong growth rate attaining 11 per cent during the first nine months of 2001. Beyond the short-term effect of 11 September, the changing economic environment could jeopardise the near future of the industry. Already, the increasing world-wide competition associated with the political crisis in Madagascar, which began in December 2001 with the

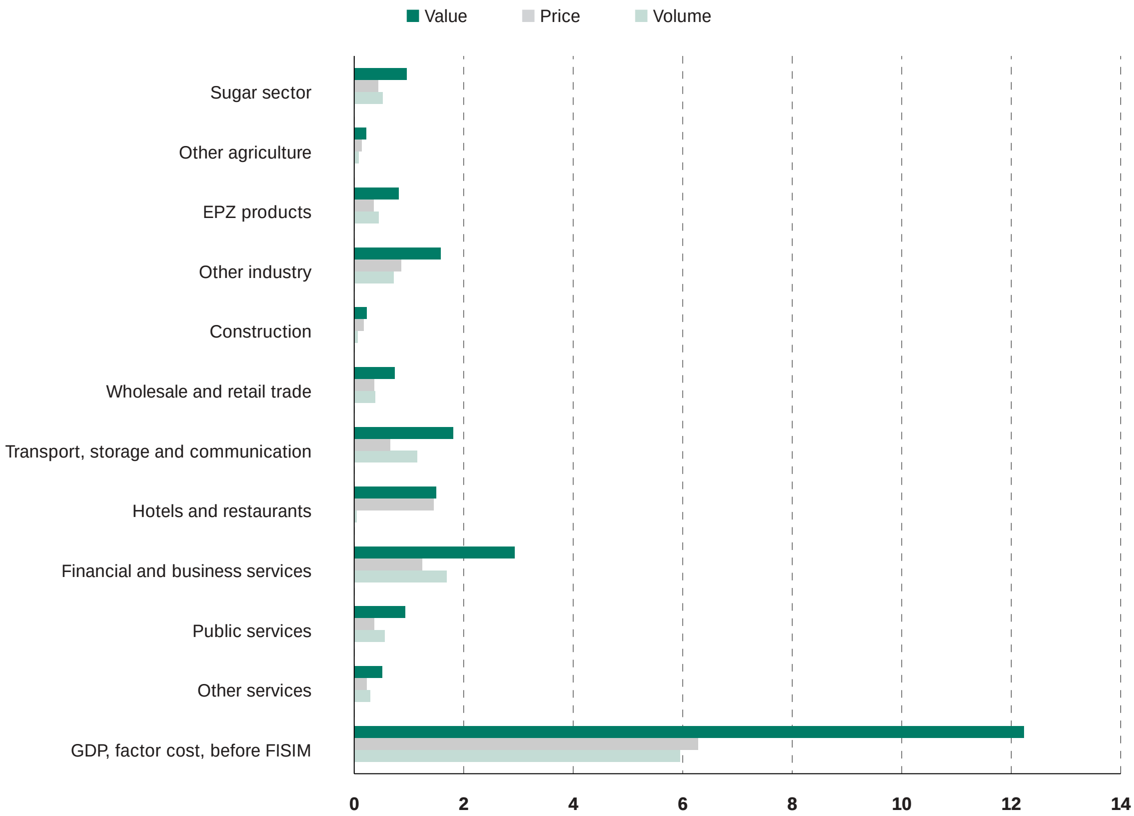
1. Developed in the Sugar Sector Strategic Plan 2001-2005, issued in June 2001.

Figure 3 - GDP by Sector in 2001 (at factor cost before FISIM)



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

Figure 4 - Sectoral Contribution to GDP Growth in 2001



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

presidential elections, has led several big textile companies to close down, generating 742 job losses in the first quarter of 2002. Many Mauritian textile companies have established branches in the Malagasy EPZ in order to reduce their costs through outsourcing parts of their production there. As a consequence, the future of the Mauritian textile industry will depend in part on the political normalisation process in Madagascar.

The end of the quota and duty-free access to the European market due to start by December 2004 coupled with the increasing labour costs, which have occurred in the EPZ in the last decade, as well as security issues in Madagascar, require a drastic change within the EPZ industry. The strategy adopted by the sector is threefold. First, the objective is to develop both quality and transformation within the textile industry so as to take advantage of the comparative advantages of Mauritius in terms of service (respect of timing), location (between the producers of raw cotton and end users) and to comply with the rule of origin requirement of the AGOA (African Growth and Opportunity Act) initiative. Several spinning projects are already under way, among which is the Tianli Spinning Mill financed by Chinese investors. The second objective is to develop product and market diversification drawing on the duty-free access that AGOA is granting for some 1 800 products (other than textile). The operators are experimenting in several sub-sectors more or less successfully. Electronics has been largely disappointing owing to high competition from Asian markets. The shoe industry is limited by problems of quality but could be developed to fulfil regional demand. Some better prospects are expected from jewellery, clock industry and printing work that could be exported to the EU and the US. The medical products market is also currently being investigated with Mauritius hoping to extend the Doha agreement on generics at regional level. Lastly, the country is largely counting on its SMEs, which are more flexible and contribute more to job creation than big companies, to ensure the dynamism of its economy.

It is worth noting that Mauritius also has a substantial manufacturing sector outside the EPZ, which accounts for 12 per cent of GDP and generates 50 000 jobs. This sector comprises industries processing soap, sodas, flour, candles and shoes. It supplies the domestic market as opposed to the EPZ sector. It is suffering from the preferential treatment that benefits the EPZ (concerning tax but also lower electricity prices...) and also from the harsh competition imposed on it by imports. However taxation is currently being harmonised.

The tertiary sector has expanded remarkably in the last few years to represent around 60 per cent of GDP in 2001. Over the last five years, Mauritius has carved out a comfortable niche in the world of international financial services thanks to its expanding tax treaty network[2], a reputable offshore jurisdiction, its strategic location between the Far East and the European time zones, and its membership of major regional trading blocs. Financial services now represent a substantial pillar of the economy at 9.4 per cent of GDP. The introduction of new legislation related to anti-money laundering has even further reinforced confidence in the regulatory, institutional and operational frameworks boosting the sector's growth by 14.6 per cent in 2000 and 13.5 per cent in 2001. Alongside financial intermediation, tourism continues to be 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 by 13.6 per cent before receding in 2001 to a growth rate of 0.6 per cent owing to the general context of morosity in Europe and the US and internal factors such as the limited capacity of Air Mauritius. September 11 had a tangible but time-limited impact on tourism in Mauritius as the destination is generally considered to be safe. Consequently, signs of a pick-up were noticeable from the first quarter of 2002 on. In the longer run, the authorities are planning to emphasise quality of service in order to favour high-income as opposed to mass tourism. Whereas the number of tourists was stagnating at 0.6 per cent in 2001, tourism receipts increased by more than 27 per cent, reflecting the higher purchasing power of the visitors. In view of the need to diversify the sector, the authorities also intend to develop integrated resort zones offering all facilities to rich retired foreigners.

In 2001, Mauritius registered a significant slowdown in private consumption and private investment growth rates. The slowdown in consumption growth is a consequence of the rise in unemployment, external shocks such as the appreciation of the rupee and the unsustainability of the previous consumption path (relying on the boom in the EPZ sector and leading

2. Since 1978, Mauritius has been building up a network of double taxation treaties with more than 30 countries in Africa, Asia and Europe allowing significant bilateral cuts in dividends, interest and royalties.

Table 1 - Demand Composition (percentage of GDP)

	1995	1999	2000	2001	2002 (e)	2003 (p)
Gross capital formation	**25.8**	**26.3**	**25.7**	**20.9**	**22.3**	**25.6**
Public	8.0	6.6	6.3	6.5	7.7	8.6
Private	17.8	19.7	19.4	14.5	14.6	16.9
Consumption	**76.7**	**77.2**	**74.9**	**73.4**	**71.8**	**71.7**
Public	12.1	13.2	13.0	12.6	12.4	12.2
Private	64.6	63.9	61.9	60.8	59.4	59.5
External demand	**-2.5**	**-3.5**	**-0.6**	**5.7**	**5.9**	**2.7**
Exports	59.6	64.3	61.8	68.6	68.3	67.4
Imports	-62.1	-67.8	-62.3	-62.9	-62.5	-64.7

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

to high household indebtedness). The general morosity in the former leading sectors also explains the slowdown in the development of private investment, driving the share of private investment in total investment and in GDP to decline constantly. Meanwhile, public investment recorded significant growth. However, it did not compensate for the loss in private investment. Consequently, the investment ratio decreased to 21 per cent of GDP, the lowest rate in the past 15 years. These trends are unlikely to be altered in the short run even though signs of a pick-up in private investment might appear in 2003 following renewed confidence in projects such as Cyber City.

Macroeconomic Policy

Fiscal and Monetary Policy

Despite the fact that the principal aim of recent fiscal policy has been the reduction of the fiscal deficit, Mauritius has registered an average overall fiscal deficit of 4.9 per cent of GDP over the last five years (fiscal years 1996/97 to 2000/01). The situation has worsened particularly in the last two fiscal years owing mainly to the losses experienced by large parastatals[3], and to the active policy of public investment led by the authorities. Consequently, the budget deficit rose to 6 per cent (compared with a target of 2.9 per cent) in 2000/01 and to 6.5 per cent of GDP in 2001/02. In 2002/03, the overall deficit is likely to reach 7.1 per cent of GDP due to a significant slowdown in GDP growth and a very ambitious investment policy, though it was initially programmed at 6 per cent of GDP. The government has announced its intention to bring it down gradually to 3 per cent of GDP by 2005/06.

Concerning fiscal revenue, Mauritius is facing several constraints. In 2001/02, the country faced a shortfall of 1.75 billion rupees in VAT and receipts from customs duties. Customs duties are steadily decreasing due to regional agreements and the extension of EPZ activities. However, taxing profits or corporate finance is a risky strategy as investment is highly volatile and low direct tax is one of Mauritius' comparative advantages (at present, corporate tax is at 15 per cent). Moreover, the government has already increased VAT twice in two years (from 10 to 12 per cent in the 2001/02 budget and to 15 per cent in the 2002/03 budget), which makes it politically difficult to re-use as a tool for increasing revenue. In order to raise the fiscal revenue, the authorities are adopting a new strategy based on broadening the fiscal base of VAT and income tax by lowering the number of exemptions and attempting to capture the informal sector. As a matter of fact, the informal sector is estimated to amount to 20 to 25 per cent of the value added of tourism. In order to fiscalise the sector, the government enforced a tourism bill in June 2002 imposing registration to the Ministry of Tourism as a prerequisite to all activities in the sector.

3. Namely the State Trading Corporation (STC) and the Central Electricity Board (CEB), the deficits of which are due to government regulated prices for petroleum products and electricity.

More generally, the authorities are planning to impose a business registration number on all activities.

Notwithstanding increasing concerns related to the erosion of fiscal revenues, the government has prioritised the financing of a vast public investment programme starting in fiscal year 2001/02. The need for a highly skilled labour force and good infrastructure, necessary to face rising labour costs, and the end of preferential market access, have been the main concerns of the current government. Consequently, despite a shortfall of almost 2 billion rupees compared with the target due to procedural delays and implementation bottlenecks, capital expenditure increased by 38 per cent from 2000/01 to 2001/02. In 2002/03, the investment programme remains the priority of the authorities, bringing the share of capital expenditure to 5.2 per cent of GDP. The objective is to complete the infrastructure development initiated in 2001/02 in the following fields: education, information and communication technology (ICT), infrastructure and environment. To that purpose, the total budget for education has been increased to 6 billion rupees (the increase includes both construction of new sites and recruitment of staff) and amounts to 25 per cent of total budgetary allocations, excluding payment of interest on public debt. The ICT budget comprises the Cyber City project, which should be completed by September 2003 and is estimated at 1.5 billion rupees. Concerning infrastructure, the government is focusing on three priorities: supply of water, road network and public transport. On environment, particular attention is being paid to the wastewater sector, in which the government plans to invest 10 billion rupees over the next 10 years, on the premise that 80 per cent of the population is not connected to the sewerage system. Overall, these four priorities require in 2002/03 the mobilisation of 8 billion rupees. It is also worth noting that the government is putting health next on its agenda of investment after education and is planning to undertake the necessary reforms – highlighted in the forthcoming White Paper on health sector reform - from 2004/05 onwards.

The government is also trying to encourage private investment through the creation of a one billion-rupee equity fund. This fund is intended to help settle new industries in cotton spinning and ICT but also to restructure existing enterprises of the textile sector. It is seen as a tool designed to make up for the lack of private investment, but of limited duration, as the government will eventually withdraw to make place for private shareholders. The private sector is meanwhile highly encouraged to set up a similar equity fund.

Because of repeated large budget deficits, public debt – domestic at 89 per cent – has expanded notably in recent years increasing from 27.4 billion rupees in 1995 to 65 billion in December 2001 (i.e. more than 49 per cent of GDP). On top of this government debt, the external debt of public corporations reached 18.7 billion rupees bringing the overall debt of the public sector to 63.3 per cent of GDP in December 2001. As a result, 6.3 billion rupees have been devoted

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

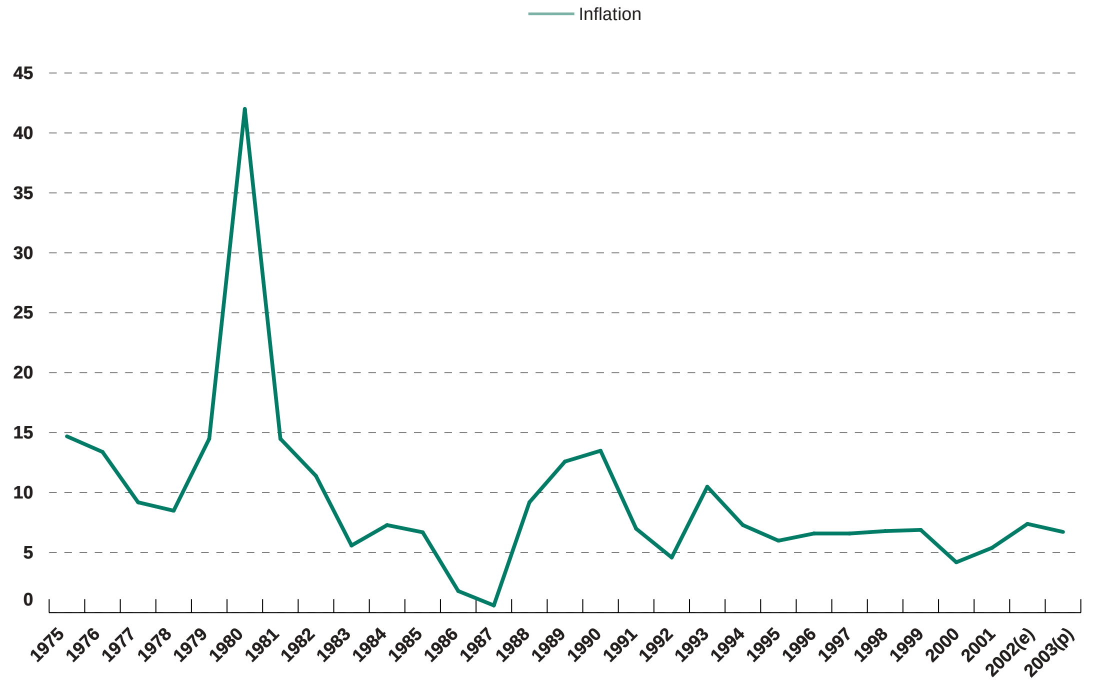
	1994/95	1998/99	1999/00	2000/01	2001/02(e)	2002/03(p)
Total revenue and grants[b]	**19.7**	**20.3**	**20.8**	**18.3**	**18.0**	**17.9**
Tax revenue	16.6	17.3	18.2	16.2	15.3	15.8
Total expenditure and net lending[b]	**23.3**	**23.8**	**24.1**	**24.4**	**24.5**	**25.1**
Current expenditure	19.6	21.2	20.7	21.2	20.2	20.1
Excluding interests	*16.6*	*17.6*	*17.3*	*17.1*	*16.9*	*16.5*
Wages and salaries	7.5	7.0	6.7	6.6	6.3	6.3
Interest	3.0	3.6	3.5	4.1	3.3	3.6
Capital expenditure	3.7	3.3	3.2	3.1	3.9	4.5
Primary balance	**-0.6**	**0.1**	**0.1**	**-2.1**	**-3.2**	**-3.6**
Overall balance	**-3.6**	**-3.6**	**-3.3**	**-6.1**	**-6.5**	**-7.1**

a. Fiscal year begins July 1st.
b. Only major items are reported.
Source: Authors' estimates and predictions based on Ministry of Finance and IMF

to interest servicing in fiscal year 2001/02, which amounts to a third of fiscal revenue and to a quarter of current expenditure.

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 tight monetary policy. 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 dropped from a level of 6.9 per cent in 1999 to 4.2 per cent in 2000. In 2001, however, several factors pushed the inflation rate upwards again. VAT was increased from 10 to 12 per cent whilst bus fares, food prices, alcohol, beer, cooking gas and medicinal products rose. Consequently, the inflation rate reached 5.4 per cent. The new VAT increase from 12 to 15 per cent adopted in July 2002 is again expected to increase inflation, so that it could reach 7 per cent in 2002, before receding slightly to 6.4 per cent in 2003.

Figure 5 - . Inflation Rate



Source: Central Statistics Office.

On the exchange-rate market, the Mauritian rupee has implicitly been anchored to the US dollar since 1999, following a speculative attack against the rupee in 1998. A large real appreciation of the currency occurred during 1999 and much of 2000 as a result of inflation differentials with trading partners and of the depreciation of the euro *vis-à-vis* the US dollar. Consequently, the real effective exchange rate appreciated by 8.9 per cent. However, since October 2000, the trend has been reversed in response to market pressures, allowing the country to recover much of the previous loss in competitiveness. Between June 2001 and April 2002, the real effective exchange rate depreciated by 3.7 per cent owing to the strengthening of the euro against the dollar.

External Position

Mauritius is one of the most open economies in Africa thanks to its trade preferential agreements and the subsequent development of its EPZ. Mauritius' trade relationships have been mainly shaped by preferential market access. As a result of the Sugar Protocol and Special Preferential Sugar (SPS) agreement which authorises exports to the EU at a guaranteed price three times higher than the world price, most of the sugar production is sold to the EU. Garment products are exported to France, the UK and the US where they enter duty free according to the EU-ACP agreement and the US AGOA. The exports are relatively little diversified in terms of products – even though Mauritius remains one of the most diversified exporters in Africa, after Morocco, South Africa and Tunisia - as EPZ exports (textile at 83 per cent) and sugar exports together amount to 90 per cent of total exports. In terms of destination of trade, Mauritius has so far largely favoured the EU and the US markets. It is however changing its strategy towards greater diversification of destinations, as these markets are becoming increasingly competitive. Along with the continued deepening of trade relationships with the US through the AGOA initiative, Mauritius is today trying to develop intra-regional trade links (within Africa with the SADC and COMESA, but also with Asia through the Indian Ocean Rim). In this context, the political instability displayed by Zimbabwe and Madagascar represents a significant limiting factor.

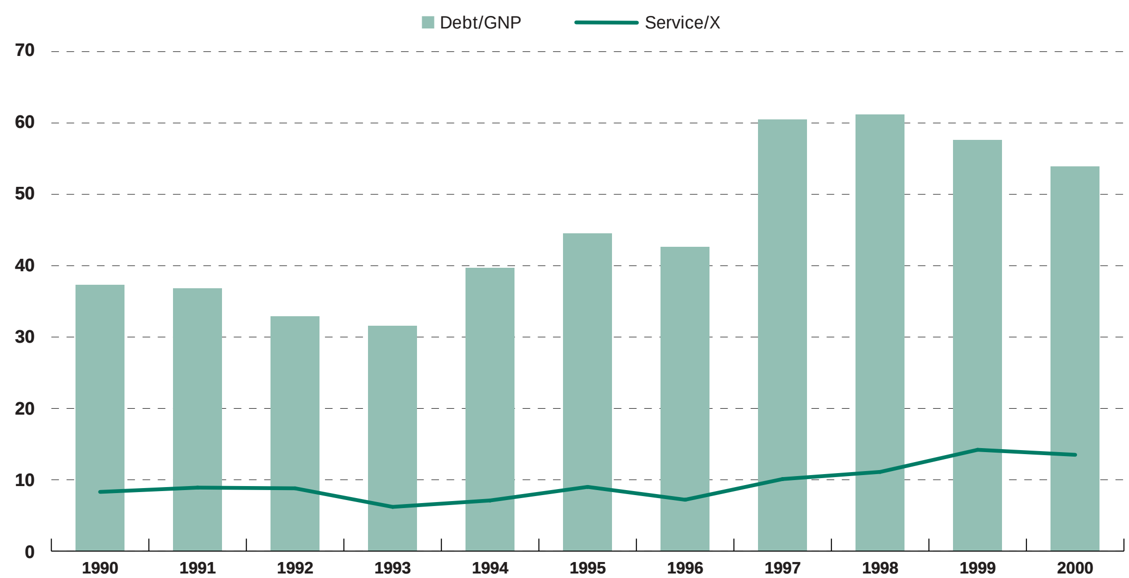
On the imports side, trade relationships are more diversified. Besides high-income countries, such as EU countries (accounting for 27 per cent of total imports in 2001), the US and Hong Kong, other significant

Table 3 - Current Account (percentage of GDP)

	1994/95	1998/99	1999/00	2000/01	2001/02(e)	2002/03(p)
Trade balance	-10.3	-8.6	-10.9	-6.2	-6.6	-5.0
Exports of goods (f.o.b.)	38.6	39.6	34.2	36.1	35.2	36.1
Imports of goods (f.o.b.)	-48.9	-48.2	-45.1	-42.3	-41.9	-41.1
Services	2.9	5.5	8.0	7.3	9.5	
Factor income	-0.5	-0.6	-0.8	0.1	-0.1	
Current transfers	2.7	2.2	2.2	1.4	1.5	
Balance on current account	**-5.2**	**-1.5**	**-1.5**	**2.5**	**4.3**	

Source: Authors' estimates and predictions based on Bank of Mauritius and Central Statistical Office data.

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



Source: World Bank.

partners include India and South Africa. In 2001, imports consisted mainly of manufactured materials such as textile yarns and cotton fabrics (30 per cent), machinery and transport equipment (23 per cent), and to a lesser extent of food and live animals (14 per cent).

Mauritius' external position is structurally characterised by a trade balance deficit offset by net exports in services and current transfers. For the second consecutive year, Mauritius has registered in 2001/02 a current account surplus owing to a net slowdown in the growth of imports and good performance of services exports, both consecutive to the depreciation of the currency. These trends are expected to last in 2002/03 as a result of the strengthening of the euro against the US dollar, although the difficulties experienced in the sugar sector following cyclone Dina lower significantly the volume of exports.

In the last ten years, Mauritius' external debt has increased from below 37 per cent of GNP in 1990 to 61 per cent in 1998 before decreasing to 54 per cent in 2000. Nevertheless, the external debt service has remained relatively stable and low (8.3 per cent of exports of goods and services in 1990, to 13.5 per cent in 2000).

Structural Issues

The structural issues faced by Mauritius pertain essentially to the drastic change of comparative advantages, which the country is experiencing. As regards privatisation, the authorities do not have a programme and are therefore tackling the issue on a case-by-case basis.

The trade agreements, which had been crucial for the sustained economic growth of Mauritius are now coming to an end, requiring a rethinking of the current economic model based mainly on low-end garment production and on a strong sugar industry. These major changes are related to the ending of non-reciprocal preferential market accesses. On the one hand, the elimination of global quotas on clothing – under the Multifibre Arrangement – by the end of 2004 will reduce the preferential access enjoyed by the garment industry, exposing the country to world competition. On the other hand, the gradual phasing out of the EU guaranteed sugar price will definitely hamper the current profitability of the sugar sector.

In this context of trade agreement restructuring, Mauritius is showing much dynamism. Internally, the country is adopting a multiple-direction strategy, trying to diversify its trading partners as well as production itself. As far as product diversification is concerned, the authorities have decided not to concentrate investment on one industry only but to develop several sectors simultaneously based on the idea that the country cannot rely on a single engine of growth. They also chose to develop diversification within the traditional sectors (sugar and textiles) promoting higher value-added activities. Externally, Mauritius is also very active taking the lead in negotiations and promoting regional co-operation whenever possible. For instance, the country is taking the leadership in the negotiations of the Cotonou Agreement, putting forward solidarity within the ACP as the main strategy for discussing the crosscutting issues with the EU. Within the WTO negotiations, Mauritius is advocating the recognition of a new category of countries comprising the small developing economies based on the trade specificities of those entities (their necessary trade openness coupled with their vulnerability to external shocks and the narrowness of their domestic market). Mauritius is also at the front line of the AGOA discussions, having played a significant role in the enactment of the initiative by the US and hosting the coming forum on the subject in January 2003.

Both the authorities and the private sector are showing a great deal of optimism regarding the impact of the AGOA initiative on the economy. They are expecting significant effects not only on the garment industry but also on the diversification process, which should be boosted by the 1 800 products to which the US is allowing duty-free access until 2008. More generally, the country acknowledges the beneficial consequences of an initiative that forces the private sector to comply with very strict rules of quality and service. In the textile industry, Mauritius is constrained by the stringent rule of origin requirement, which obliges the country to use raw cotton coming either from Africa or from the US. It should, however, help enhance regional trade 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[4]. It has also led the country to approach West African economies, such as Senegal and Côte d'Ivoire, which produce cotton and could therefore provide the raw materials to Mauritius for transformation. Already, the US is working on a new version of AGOA (called AGOA II) that will loosen some of the constraints imposed in the first initiative (such as the cap on textile exports). Mauritius is also advocating an extension of the duty-free access beyond 2008.

Changes in the current regulatory framework and developments of infrastructure are currently being implemented to adapt the country to these structural changes and to allow it to reach a new stage of development. The regulatory framework related to FDI has been reformed in order to attract new potential investors. From a fragmented institutional framework with responsibilities given to various institutions and ministries, the government has created a new institution (the Board of Investment, BOI), in charge of the whole set of procedures required of foreign investors to settle new investment projects. Another institution, the MIDA (Mauritius Industrial Development Authority) is in charge of promoting exports, identifying profitable markets for exporters.

By African standards, Mauritius has a well-developed basic infrastructure**.** The large government investment projects of the recent past have improved markedly the island's road transport and network with 1 880 km of tarred roads. Under the control of the Mauritius Freeport Authority (MFA), a parastatal body created in 1992, the country has also 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 government policy to develop the services sector and help Mauritius become a regional trading hub, drawing on the strategic location of the country between Asia and Africa. However, the Freeport has so far had only limited success due to the competition of already existing similar facilities (such as Djebel Ali in Dubaï), the relatively high facility cost – linked to the narrowness of the market and the cost of inputs – and political instability in the region. In order to improve the Freeport, the authorities adopted in July 2001 a new institutional framework, the "Freeport Act" and a strategic plan, with the objective of linking more closely the EPZ and the Freeport, to develop synergies with the airport as well as to attract multinationals. Mauritius also has a well-developed air transport infrastructure by way of the state-owned international airport through which 15 international airlines handle about 150 flights a week.

Mauritius is also taking steps towards achieving its ambition to become a telecommunications and IT hub. With a tele-density of 235 lines per thousand inhabitants, Mauritius has the most developed telecommunications network in Africa (with Seychelles). Nevertheless, the ambitious plan of developing Mauritius as a world-class IT hub still faces constraints related to the present telecommunications environment. The costs of basic telephony are high and internet access prices as well as the number of internet hosts per 10 000 inhabitants is still lagging compared to competitors such as Malaysia, Korea, or Singapore. On the other hand, the completion in June 2002 of the South Africa Far East (SAFE) undersea fibre-optic cable, which links the island to Malaysia, South Africa and then onwards to West Africa and Europe, will boost the island's high capacity bandwidth. Moreover, the government has decided to bring forward the termination of Mauritius Telecom monopoly on fixed-line services to December 2002 instead of December 2003, displaying clearly its will to move forward in the reforms of the telecommunication sector. In addition, the authorities are investing massively in a large

4. Even though those two countries experienced big shocks in 2001/02 – political troubles in Madagascar and heavy floods in Mozambique - that led Mauritius to withdraw its investments from Madagascar and to decrease its interest in Mozambique. This situation should, however, improve as political instability recedes in Madagascar and Mozambique enters a reconstruction phase.

infrastructure ITC project – the Cyber City - with the technical and financial co-operation of India in order to attract national and international investors to relocate their activities to the island. The objective is to develop high value-added ITC activities such as software development and e-education so as to move the comparative advantages of the country up in quality and to create new job opportunities. The project is developed in close technical and financial co-operation with India, which is interested in penetrating the francophone market through the bilingual Mauritian platform. The Cyber City infrastructure should be finished by the end of 2003. As of now, around 40 per cent of the available space has already been sold to companies. However, some Mauritian operators are showing scepticism concerning the project, criticising the lack of clarity and pointing out the scarcity of qualified labour from which the country suffers (the Cyber City requires the training of 7 000 professionals and 13 000 support staff by 2005) as a major limit to the impact of the Cyber City on the economy. In order to meet this challenge, several partnerships, in particular with India, have been set up to offer professional training courses.

The banking sector is one of the most developed in sub-Saharan Africa and Mauritius has achieved a remarkable position in the international market for financial intermediation. As at June 2001, offshore banking – dominated by Barclays, HSBC and South Africa Investec – comprised 12 offshore banks and total assets stood at $3.8 billion, while non-bank deposits were $1.6 billion. Onshore banking comprised 10 commercial banks with the Mauritius Commercial Bank and the State Bank of Mauritius holding about 70 per cent of banking assets. Domestic banking 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, above the Basel requirement of 8 per cent. The ratio of non-performing loans has been lowered to the OECD level (under 5 per cent). Along with the banking sector, the non-bank financial sector is taking off at a high pace, comprising 19 349 companies at end-June 2002 (from a level of 3 272 in December 1995). Overall, the financial and business services account for 18 per cent of total value-added. Financial supervision has followed the pace of development of the entire sector. The supervision of the offshore sector was strengthened in December 2001 with the introduction of the Financial Services Development Act which brings under one umbrella the regulation and supervision of the non-bank financial sector. Moreover, the Economic Crime and Anti-Money Laundering Act came into force in June 2002 and led to the establishment of the Economic and Crime Office. In June 2000, Mauritius was also one of the first countries to comply with the OECD request to commit to the elimination of harmful tax practices by the end of 2005. It includes a commitment to exchange information on tax matters and transparency.

Political and Social Context

Mauritius enjoys a very stable political system based on a multiparty democratic republic. Legislative power lies in the hands of the elected National Assembly, which comprises 62 elected representatives, 60 from Mauritius and two from the island of Rodrigues. The last general elections were held in September 2000 opposing two main alliances: the *Mouvement Militant Mauricien* and the *Mouvement Socialiste Mauricien* (MMM-MSM) alliance on one side and the Labour Party and *Parti Mauricien Social Democrate* (LP-PMSD) alliance on the other. The MMM-MSM alliance won 54 of the 62 parliamentary seats. The alliance had a pre-electoral agreement to share the post of Prime Minister. Sir Anerood Jugnauth, leader of the MSM, was to hold the post of Prime Minister for the first three years and then become President of the Republic. For the remaining two years of the five-year mandate, Paul Berenger, leader of the MMM party would be Prime Minister. This is the first time that Mauritius is experiencing a sharing of power between two parties in one mandate. In 2003, when Paul Berenger accedes to the post of Prime Minister, he will be the first non-Hindu Prime Minister of Mauritius.

Within the African context, Mauritius can be considered a successful case of sustained economic growth associated with a substantial welfare improvement of the entire population as shown by the statistics. Life expectancy is the highest in sub-Saharan Africa, reaching over 70 years (68.3 years for males, 75.4 for females) in 2001. The infant mortality rate is the lowest, at 14.3 per 1 000 live births and has largely improved from the rate of 22 recorded in 1996. However, the ageing of the population due to the decline of the fertility rate from 3.25 in 1970 to 1.90 in 1998, coupled with the increase in life expectancy deeply affects the population dependency ratio, with implications on the growth potential and heavy pressure on public finances. Over the next ten years, labour force growth is expected to decline to less than 1 per cent per year, adding considerable pressure on pension funds.

With an adult literacy rate of 85 per cent in 2001 (88.1 per cent for males, 81.8 for females), free education until university level, and universal primary education, the education standards of Mauritius are remarkable within the African context. Nevertheless, gross enrolment rates drop from 104 per cent in the primary sector to just 63 per cent in the secondary level, as a result of the high dropout and failure rates at the end of the primary level. The causes of this drop are related to the inequalities which persist in the society itself and the organisation of the education system which pushes the pupils to compete fiercely to enter the few star secondary schools and to repeat a year in the event of failure. The consequences of dropping out after primary school are very detrimental to the pupils as it is officially forbidden to work before the age of 15 and failing children are not channelled towards more appropriate paths. However, the authorities are making reforms towards less competition at such an early stage by decentralising the school system and linking secondary school attendance with the place of residence.

The changing socio-economic environment has not been accompanied by a revision of the education system, which still counts few pupils enrolled in science, computing and engineering. As a result, the labour market in Mauritius is facing an increasing skills mismatch and a consequent rise in unemployment despite sustained economic growth. The unemployment rate increased to 8.8 per cent in 2000 (8.3 per cent for males, 9.6 per cent for females) from 2.8 per cent in 1990, and estimates for 2001 suggest a level of 9.2 per cent (8.8 per cent for males, 10.1 for females). The current unemployment issue derives from the evolution of the country from a low-skilled/low-technology economy towards a service economy. Consequently, while the labour force is still highly characterised by semi-skilled and low-skilled workers who account for 97 per cent of employment, many specialised jobs cannot be filled by the current unemployed because of a lack of related skills. Another important factor to be reckoned with is the women's participation rate, which increased from 30 per cent in the 1980s to 40 per cent in 2000. Given the nature of the unemployment problem, the government has decided to lead a threefold policy. First, as the small- and medium-enterprise sector contributes the most to job creation, the authorities are taking measures to promote SMEs by allowing them lower interest rates on loans, exemption from customs duties... Secondly, in order to reduce the mismatch between required skills and available human capital, massive investments in education are to be undertaken during 2001/02 and 2002/03 involving the construction of new secondary schools, tertiary level infrastructure, hiring of new staff and awarding of scholarships in IT and biotechnology. Finally, in order to facilitate the integration of job seekers in labour market, large-scale training will also be undertaken.

