FOR AGENDA

SM/84/196

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August 14, 1984

To: Members of the Executive Board

From: The Secretary

Subject: Mauritius - Staff Report for the 1984 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1984 Article IV consultation with Mauritius. A draft decision appears on page 26.

This subject will be brought to the agenda for discussion on a date to be announced.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Stillson (ext. 72917).

Att: (1)

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INTERNATIONAL MONETARY FUND

MAURITIUS

Staff Report for the 1984 Article IV Consultation

Prepared by the Staff Representatives for the
1984 Consultation with Mauritius

(In consultation with the Fiscal Affairs, Legal,
and Treasurer's Departments)

Approved by J. B. Zulu and Eduard H. Brau

August 10, 1984

I. Introduction

The 1984 Article IV consultation discussions with Mauritius were held in Port Louis June 5-22, 1984. The principal Mauritian representatives were Mr. S. Lutchmeenaraidoo, Minister of Finance, Mr. N. Deerpalsingh, Minister of Agriculture, and Mr. I. Ramphul, Governor of the Bank of Mauritius. The staff representatives were Messrs. Abu-zobaa (head), Stillson, Niebling, and Mortimer-Lee (all AFR), Ms. Flug (ETR), and Ms. Buggs (secretary-AFR).

Since 1979 Mauritius has made extensive use of Fund resources under four consecutive stand-by arrangements. The latest arrangement, approved by the Executive Board on May 18, 1983, was for a period of 15 months in an amount equivalent to SDR 49.5 million (92.4 percent of quota). As of July 31, 1984 Fund holdings of Mauritian rupees subject to repurchase amounted to SDR 172.6 million, equivalent to 322.1 percent of quota. Of this amount, SDR 39.0 million (72.8 percent of quota) was in respect of compensatory financing and buffer stock facilities. Mauritius continues to avail itself of the transitional arrangements of Article XIV. Mauritius has maintained a reliable and generally timely flow of economic and financial data to the Fund. Appendix I contains additional information on Fund relations with Mauritius.

The World Bank has played an active role in Mauritius and has approved two structural adjustment loans (SAL), in May 1981 for US$15 million and in December 1983 for US$40 million. The first was fully disbursed, and the first tranche (US$20 million) of the second has already been disbursed. The Bank's supervision reports have concluded that implementation under SAL II has been satisfactory. Overall, as of March 31, 1984 the World Bank had committed US$20.4 million in IDA credits, which were fully disbursed, and US$185.3 million in IBRD loans, of which US$80.7 million had been disbursed. Additional information concerning World Bank Group activity in Mauritius is contained in Appendix II.

II. Background

1. Economic structure

Mauritius is a small and densely populated country. The island of Mauritius has a population of about 970,000, growing at 1.4 percent per year, with a population density of about 510 per square kilometer, more than twice as high as any other country in Africa; a smaller island (Rodrigues) has a population of about 32,000, growing at an annual rate of 3 percent. GDP per capita in 1983 is estimated at SDR 970, the level of a middle-income developing country. The World Bank estimates that adult literacy is over 80 percent, life expectancy is about 65 years, and basic needs are extensively covered.

The largest industry in Mauritius is sugar, which in 1982/83 (July-June) contributed about 14 percent to GDP, employed about one fourth of the labor force, accounted for about 60 percent of merchandise exports, and contributed directly 17 percent to tax revenue. Also, sugarcane occupies about 90 percent of cultivated land. Mauritius is the tenth largest net exporter of sugar in the world and accounts for about 2 percent of world sugarcane exports; during the period 1972-83 output averaged about 635,000 tons per year. Mauritius has a quota in the protected markets of the European Community (EC) of 500,000 tons (38 percent of the quota allocated to ACP countries) and of the United States of 28,000 tons. 1/

Mauritius has made considerable progress toward export diversification and the creation of employment. The Export Processing Zone (EPZ) comprises firms (half of which are in textile manufacturing) that have been granted special tax relief as an incentive to invest and export. 2/ In 1983 employment in EPZ firms amounted to 25,000 persons, and the share of EPZ exports in the total reached 33 percent. Tourism has provided another major source of foreign exchange earnings

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1/ In 1983/84 the average prices received by Mauritius in respect of sugar exports to the EC and the United States were 16.5 US cents and 20.5 US cents per pound, respectively, compared with the average export price to the free market of 10.9 US cents. In July 1984 the free market price was less than 5 US cents per pound.

2/ The most important tax relief is exemption from all taxes on imports and a 10-year holiday from corporate income tax.

and employment, and there has been a moderate growth in other domestic manufacturing. Notwithstanding the successful efforts at diversification, the pre-eminence of the sugar industry in providing foreign exchange earnings and employment is likely to continue for many years to come.

2. Overview of economic developments

a. The sugar boom and its immediate aftermath

The current economic and financial situation is largely a result of the authorities' reactions to wide swings in world sugar prices and fluctuations in domestic output. After a decade of slow increases, sugar prices received by Mauritius more than doubled in 1974 (Chart 1). 1/ Buoyed by these developments the Government embarked on expansionary policies, which continued during the second half of the 1970s notwithstanding the fluctuations in sugar output and a drop in prices. During the four-year period 1976-79 real domestic demand grew by about 25 percent as indicated by higher fiscal deficits, which reached 10.7 percent of GDP in 1979/80, and in pronounced increases in domestic credit and in broad money (Chart 2). Imports grew at more than twice the rate of the increase in exports. As a result, the external current deficit rose to about 11 percent of GDP and was financed by recourse to external borrowings (US$87 million from the Eurocurrency market) and a drawdown of reserves. Meanwhile, the rate of inflation remained modest during this period, as the increase in domestic demand was mainly reflected in the external accounts. Gross domestic savings, which increased rapidly during the sugar boom years, declined in the late 1970s to below the average levels prior to the sugar boom.

b. Adjustment under Fund-supported programs, 1979-1982/83

In October 1979 the Mauritian authorities embarked on a comprehensive program to reduce the financial imbalances. The rupee was devalued by 23 percent in foreign currency terms; measures were adopted to reduce the fiscal deficit, including increasing the retail prices of subsidized rice and flour; interest rates were raised; and the rate of credit expansion was reduced. However, in late 1979 and early 1980 severe cyclones hit Mauritius and caused a decline in sugar production of 31 percent and in real GDP of 9 percent. The economic impact of the cyclones was felt particularly in 1980/81, which also coincided with the full effects of the second oil price increase. As a result, in 1980/81 the external current account deficit and the overall fiscal

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1/ Sugar prices in Chart 1 are SDR equivalent of unit values averaged over calendar years. The broad trend is similar to that of world prices, but the timing of the peaks and trough and the magnitude of changes in any one year may differ from the world market.

deficit peaked at 15.5 and 14 percent of GDP, respectively, and there was a large increase in external borrowing, particularly from the Eurocurrency market. By end-1980 total disbursed Eurocurrency borrowing had risen to US$132 million, or about 44 percent of total external debt outstanding.

It was only in 1981/82 that a major adjustment was undertaken. The rupee was devalued again, by 17 percent in foreign currency terms, in September 1981. The 1981/82 budget provided for increases in taxes on imports, as well as for a substantial reduction in capital expenditure and net lending. Moreover, the rate of credit expansion was curtailed, and wage increases were held below the inflation rate of the preceding year. As a result of these measures and a partial recovery in sugar output, the current account deficit declined to 5.7 percent of GDP, and the overall balance of payments position improved dramatically. Also, the overall fiscal deficit declined by one percentage point to 12.9 percent of GDP.

In 1982/83 the adjustment process continued, with emphasis on the budget. Taxes on imports were raised substantially, and in January 1983 a sales tax was introduced with Fund technical assistance. The overall fiscal deficit dropped by 3.5 percentage points to 9.4 percent of GDP. The balance of payments continued to improve; the current account deficit remained about constant in SDR terms and thus declined to 5.2 percent of GDP. However, unemployment continued to climb, reaching 16 percent of the labor force by end-1982.

c. Performance under the 18-month program, January 1983-June 1984

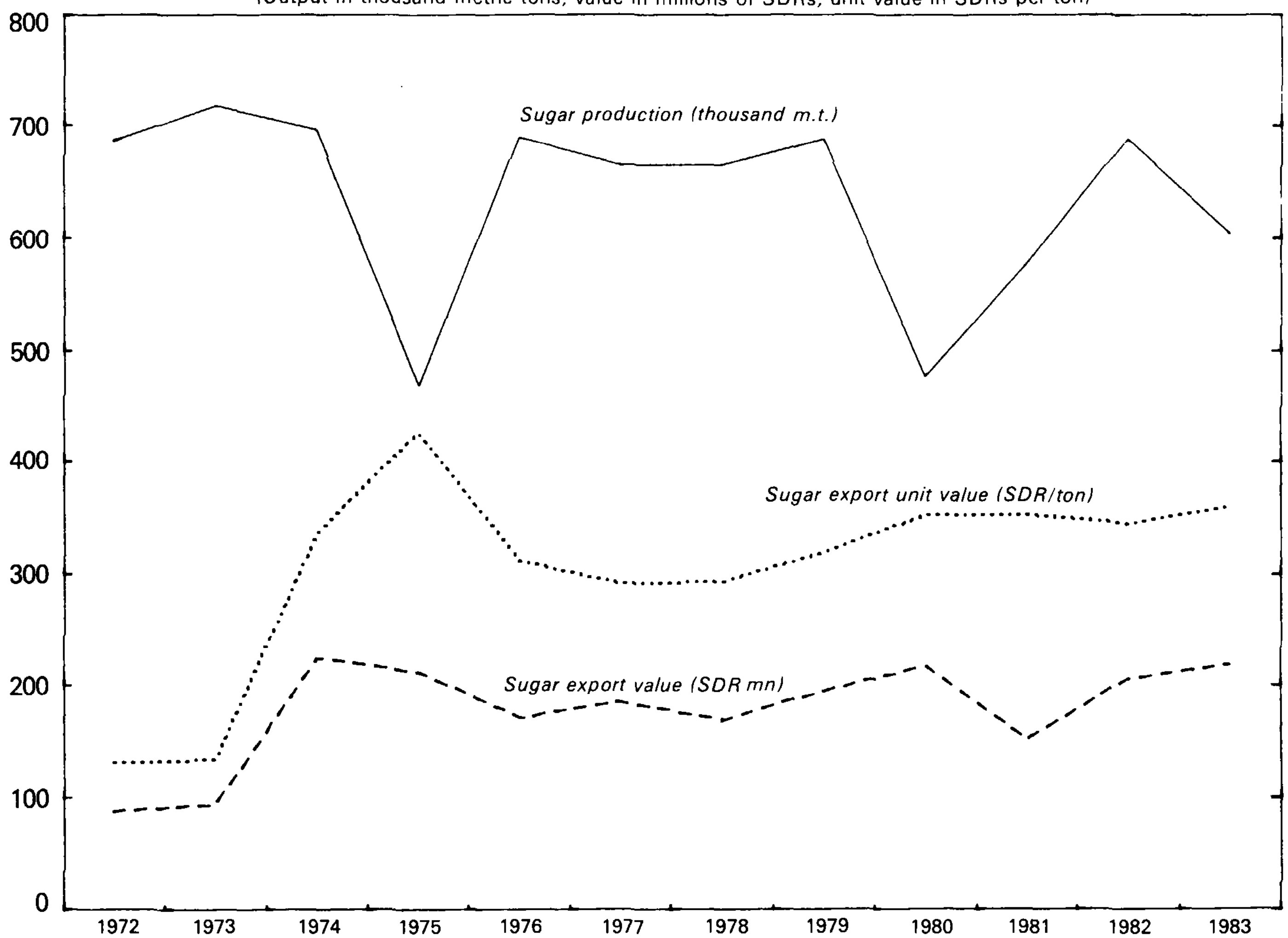
On May 18, 1983, the Executive Board approved Mauritius' request for a 15-month stand-by arrangement (the fourth in a series) in an amount equivalent to SDR 49.5 million (92.4 percent of quota). A first review of the arrangement was completed on November 23, 1983, and a second review was completed on May 7, 1984. All of the performance criteria have been observed, and the total amount of the arrangement was purchased (Table 1). Virtually all of the major policy actions were implemented, and most of the targets had been achieved or surpassed (Table 2 and Appendix III). Under the program certain pricing and institutional measures were taken that should have an impact well beyond 1983/84. Specifically, the system of price controls is being liberalized; subsidized consumer prices of wheat flour and rice were raised; the domestic price of sugar was increased; utility rates were adjusted upward; wage increases were kept below the rate of inflation of the previous year; institutional improvements in tax administration were implemented; exemptions from import taxes were reduced; a flexible exchange rate policy was pursued; and quantitative restrictions

CHART 1

MAURITIUS

SUGAR OUTPUT AND EXPORTS, 1972-83

(Output in thousand metric tons, value in millions of SDRs, unit value in SDRs per ton)



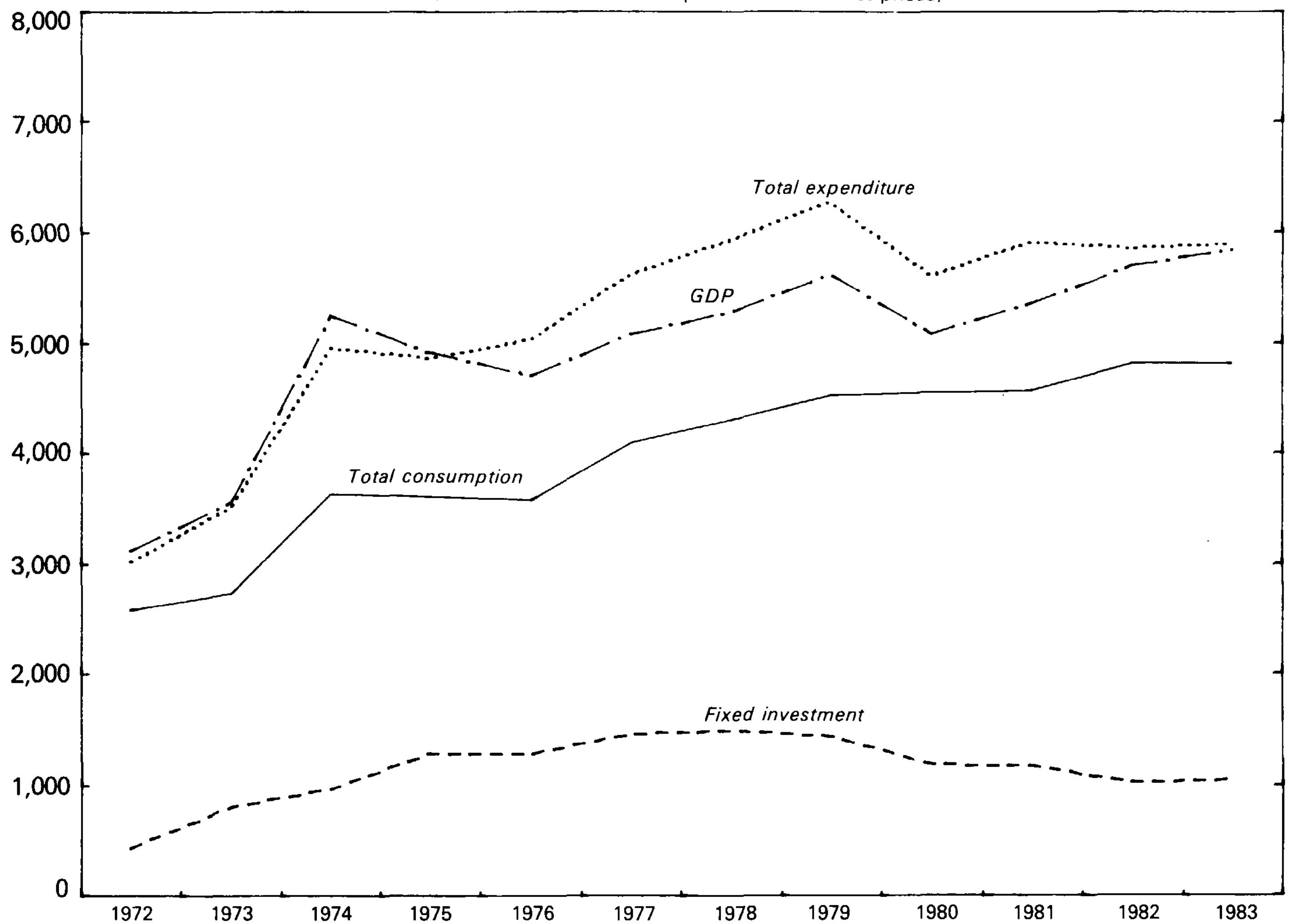
Source: Bank of Mauritius.

CHART 2

MAURITIUS

EXPENDITURE ON GDP, 1972-83

(In millions of Mauritian rupees at 1976 market prices)



Source: Central Statistical Office.

Table 1. Mauritius: Quantitative Performance Criteria

	1982	1983				1984	
	Dec.	March	June	Oct.	Dec.	March	June
		(In millions of Mauritian rupees; end of period)					
Credit to Government (net) 1/							
Ceiling	...	4,900 2/	5,084	5,030	5,530	5,330	5,627
Actual	4,760	4,445	4,877	4,951	5,347	5,132	5,382
Total domestic credit 3/							
Ceiling	...	7,495 2/	7,870	7,830	8,380	8,265	8,710
Actual	7,221	6,970	7,560	7,698	8,144	8,026	8,535
			(In millions of U.S. dollars)				
New external borrowing commitments (cumulative) during program period							
1-10 years' maturity 4/							
Ceiling	...	...	50	50	50	50	50
Actual	...	...	--	--	--	--	--
1-5 years' maturity							
Ceiling	...	...	--	--	--	--	--
Actual	...	...	--	--	--	--	--
Drawdown on new external borrowing (cumulative in program period)							
Ceiling	...	...	20	40	40	40	40
Actual	...	...	--	--	--	--	--

Sources: EBS/83/234; and data provided by the Mauritian authorities.

1/ Defined as credit to the Government from the banking system less government deposits plus any budgetary use of new nonconcessionary loans (net) of 1-10 years' maturity.
2/ Indicative target, not performance criterion.
3/ Defined as net credit to the Government plus credit extended by the banking system to the private sector.
4/ Defined as new external borrowing on nonconcessionary terms contracted or guaranteed by the Government. This ceiling applies for the entire period of the stand-by arrangement.

Table 2. Mauritius: Selected Economic and Financial Indicators, 1979/80-1983/84

Fiscal years (July-June)	1979/80	1980/81	1981/82	1982/83 Prov.	1983/84 Program 1/	1983/84 Revised program 2/	1983/84 Prov. actual
	(Annual percentage changes, unless otherwise specified)						
National income and prices							
GDP at constant market prices 3/	3.8	-6.1	4.3	7.8	3.1	1.6	2.0
GDP deflator 3/	20.8	16.8	11.5	6.9	7.8	6.9	6.2
Consumer prices (average)	33.0	26.5	13.4	7.4	9.0	7.4	5.6
External sector (in terms of SDRs)							
Exports, f.o.b.	7.6	-8.0	16.3	-5.1	4.5	1.3	8.5
Imports, c.i.f.	8.6	10.2	-13.7	-3.2	5.0	-0.7	1.0
Non-oil imports, c.i.f.	3.7	10.8	-18.3	-3.6	7.6	0.9	2.7
Terms of trade (deterioration -)	-6.0	-6.4	-4.5	3.6	-0.3	4.3	3.4
Effective exchange rates 4/							
Nominal	-18.8	-6.0	-8.3	0.7	-3.9	-4.2	-4.1
Real	-5.0	7.8	-5.9	1.1	-1.4	-3.9	-4.6
Government budget (revised GFS basis)							
Revenue, excluding grants	27.8	13.7	7.9	26.0	13.5	11.4	10.3
Total expenditure and net lending	17.8	24.3	9.2	8.4	12.4	5.0	5.0
Money and credit							
Domestic credit 5/	26.5	20.1	14.5	19.5	15.8	11.1	16.0
Government (net) 5/	38.6	21.0	15.3	26.5	16.3	8.6	15.0
Private sector	13.6	18.9	13.4	10.0	14.9	14.9	17.5
Money and quasi-money	14.3	8.6	18.0	20.9	15.0	11.3	6.6
Interest rate (annual rate - one-year time deposit)	10.0	10.0	12.25	12.0	11.5	10.5	10.25
	(In percent of GDP, at market prices, as revised)						
Central Government (revised GFS basis)							
Savings (current balance)	-1.9	-4.3	-5.6	-3.2	-2.1	-2.2	-2.4
Overall balance							
Excluding grants	-10.7	-14.2	-13.5	-9.6	-9.7	-8.8	-8.2
Including grants	-10.7	-14.0	-12.9	-9.4	-9.0	-8.2	-7.7
Domestic bank financing 5/	7.8	5.4	4.1	7.1	5.0	2.7	4.7
Foreign financing (net) 5/	2.6	7.7	7.4	-1.4	2.3	3.8	-0.4
Gross domestic investment 6/	26.0	23.0	21.7	18.3	21.5	18.5	18.6
Gross domestic savings 6/	15.0	12.6	15.1	16.4	17.8	16.7	17.5
External current deficit 7/							
Excluding transfers	12.1	17.6	7.9	7.6	7.3	6.7	4.8
Including transfers	10.7	15.5	5.7	5.2	4.6	4.4	2.6
External debt (year-end) 7/							
Excluding Fund credit	23.0	30.1	39.2	34.8	37.3	38.3	34.0
Including Fund credit	30.1	42.6	54.3	50.5	53.8	55.0	50.7
	(In units indicated)						
Debt service ratio (percent) 8/	7.6	15.8	14.7	21.7	25.2	25.8	23.6
Interest payments	5.0	9.3	9.2	9.8	8.9	8.6	7.5
Overall balance of payments deficit (-) (millions of SDRs)	-45.0	-60.0	-9.0	-28.0	-20.0	-3.0	-36.0
Gross central bank reserves (months of imports)	0.9	0.7	1.1	1.0	0.7	1.1	0.3

Sources: Ministry of Finance; Bank of Mauritius; and staff estimates.

1/ EBS/83/234 of October 31, 1983 (First Review of Stand-By). Program figures slightly different from budget.
2/ EBS/84/77 of April 20, 1984 (Second Review of Stand-By).
3/ Sugar crops and milling included in fiscal year harvested; otherwise averages of calendar-year data.
4/ Trade-weighted annual averages of end-of-month rates; negative indicates depreciation
5/ Eurocurrency loans included in foreign financing; for performance criteria purposes, they are added to domestic bank financing.
6/ Based on averages of calendar year data.
7/ Program figures for 1983/84 valued at revised exchange rate.
8/ Including the Fund.

on imports were reduced. 1/ As a result of these policy actions, the external current account deficit has been reduced to 2.6 percent of GDP, compared with the original program target of 4.6 percent; the overall fiscal deficit has been reduced to 7.7 percent of GDP, compared with the original program target of 9.0 percent; and the inflation rate has been reduced to 5.6 percent, compared with 9.0 percent originally envisaged. Also, there are signs of a substantial increase in investment and employment in the EPZ. This is due, in part, to a recovery in world demand for textiles and an increased interest by certain Hong Kong firms, some of which already operate in Mauritius. Current estimates are that as many as 5,000 new jobs (about 20 percent of total EPZ employment) may be created during calendar 1984 as a result of the new investment. This should contribute to easing somewhat the rate of unemployment, which in mid-1983 reached almost 20 percent of the labor force.

The degree of adjustment from the substantial internal and external imbalances, which peaked in 1980/81, can be summarized in the following table:

	Year ending June			
	1980/81	1981/82	1982/83	1983/84
	(In percent of GDP)			
External current account deficit	15.5	5.7	5.2	2.6
Overall fiscal deficit	14.0	12.9	9.4	7.7
Gross domestic savings	12.6	15.1	16.4	17.5
	(In percent)			
Inflation rate	26.5	13.4	7.4	5.6

Despite the progress made thus far, two key areas need to be tackled in the period ahead, namely the financial position of the sugar industry and the burden of external debt servicing. Concerning the sugar industry, 3 out of 21 firms registered a cash deficit (i.e., before depreciation) in 1982, and the number rose to 12 in 1983. After taking account of depreciation allowances, the number of firms with losses rose from 9 in 1982 to 15 in 1983. In regard to external

1/ Detailed descriptions of the program measures and their implementation are given in EBS/83/78 of April 20, 1983 and in the first and second reviews of the stand-by arrangement (EBS/83/234, October 31, 1983 and EBS/84/77, April 4, 1984).

debt, there are large service payments bunching in 1984/85 and 1985/86, much of which are to the Fund and commercial banks. The debt service ratio, based on currently contracted debt, will peak in 1984/85 at 27 percent of exports of goods and nonfactor services. Charges and repurchases to the Fund are the largest component and represent 45 percent of the total debt service in that year. The situation is particularly acute; in the last two years Mauritius has refrained from recourse to commercial borrowings, and has financed the overall balance of payments deficit by purchases from the Fund and a rundown of reserves to a very low level. While the overall balance of payments is projected to register substantial improvement in 1984/85, a large financing gap is currently envisaged as Mauritius is scheduled to repurchase SDR 44 million to the Fund. It was against this background that the consultation discussions were carried out.

III. Report on the Discussions

The Mauritian authorities, while pleased with the progress made thus far, are fully aware of the problems lying ahead and the need for perseverance in the adjustment effort. This point was stressed in the 1984/85 budget speech to the Legislative Assembly, given on June 12, 1984. In presenting their policies, the Mauritian authorities stated that, given the small domestic market and meager resource base, the creation of new employment and the maintenance of the high standard of living in Mauritius could be achieved only through export-led growth. In view of the current outlook for the world sugar market, export growth must be centered on the EPZ. Parallel with this, it is crucial to improve the productivity of the sugar sector to free scarce resources, particularly land, to make nonsugar agricultural growth possible. The authorities also foresee a diminished public sector role that will be essentially confined to providing the needed infrastrcture, without being the main source of economic growth or new employment. The main objectives of economic policy would be to influence aggregate demand and the allocation of resources through fiscal, credit, and interest rate policies. Domestic enterprises should be able to compete with imports, and inefficient enterprises, including parastatals, should be closed.

1. External sector

The substantial reduction in the external current account deficit in 1983/84 is attributable mainly to a stagnation in imports in nominal terms, combined with an estimated 9 percent increase in exports (Table 3). Although sugar output fell from 688,000 tons in 1982/83 to 605,000 tons in 1983/84, export proceeds increased because of large sales to the EC in respect of the 1984/85 quota. There was a small net public capital inflow (compared to a net outflow in 1982/83), notwithstanding the increased amortization of Eurocurrency loans.

Table 3. Mauritius: Balance of Payments, 1981/82-1984/85

(In millions of SDRs)

	1981/82	1982/83	1983/84 Est.	1984/85 Proj.
Current account	-54	-53	-27	-43
Merchandise	-35	-43	-20	-35
Exports, f.o.b.	335	318	345	349
Sugar	(201)	(196)	(202)	(193)
EPZ	(109)	(100)	(112)	(129)
Other	(25)	(22)	(31)	(27)
Imports, f.o.b.	-370	-361	-365	-384
Imports, c.i.f.	433	-418	-422	-441
Rice and flour	(-42)	(-36)	(-32)	(-31)
Petroleum	(-83)	(-81)	(-76)	(-76)
EPZ	(-64)	(-62)	(-73)	(-84)
Other	(-244)	(-238)	(-241)	(-250)
Services (net)	-39	-35	-29	-33
Of which:				
gross tourist receipts	(38)	(39)	(42)	(45)
Transfers	20	25	22	25
Public sector capital	74	-5	1	31
Eurocurrency loans	29	-32	-40	-24
Disbursements	(36)	(--)	(--)	(--)
Amortization	(-7)	(-32)	(-40)	(-24)
Concessionary loans	45	26	41	55
Disbursements	(54)	(39)	(57)	(72) 1/
Amortization	(-9)	(-12)	(-16)	(-17)
Private capital flows and errors and omissions 2/	-29	30	-10	4
Overall balance	-9	-28	-36	-8
Financed by:				
IMF	20	22	13	-36
Purchases	(26)	(27)	(33)	(8) 3/
Repurchases	(-6)	(-5)	(-20)	(-44)
Reserves (increase -)	-11	6	23	...
Financing gap	...	...	...	44 4/
Memorandum items:				
End-year net reserves in months of imports, c.i.f. 5/	1.1	1.0	0.3	...
Merchandise terms of trade (percent change)	-4.5	3.6	3.4	...
Current account/GDP (percent)	-5.7	-5.2	-2.6	-3.9

Sources: Data provided by the Mauritian authorities; and staff estimates.

1/ Assuming SAL II disbursements of SDR 19 million in 1983/84 and 1984/85 and an ADB structural adjustment loan of SDR 8 million in 1984/85.

2/ Including commercial banks.

3/ The final purchase effected under the 1983/84 stand-by arrangement.

4/ The gap could rise to SDR 47.6 million if Mauritius is required to repurchase the outstanding amount under the buffer stock facility.

5/ Net of short-term foreign borrowing, i.e., foreign bank deposits.

This reflected large increases in disbursements of concessionary loans, including SDR 19 million under SAL II. On the other hand, there was a sizable net outflow of private capital (including errors and omissions), as the sugar syndicate repaid short-term loans of SDR 13 million borrowed in 1982/83. The overall balance is estimated to have registered a deficit of SDR 36 million, financed by net purchases from the Fund (SDR 13 million) and a rundown of reserves (SDR 23 million), to the equivalent of one week's imports. 1/

In 1984/85 the sugar crop is likely to be even lower than in 1983/84 owing mainly to drought, and the value of sugar exports is likely to decrease by almost 5 percent. This reduction will be more than offset by a strong rise (15 percent) in EPZ exports, resulting in about 1 percent increase in total exports. Imports, however, should increase by about 5 percent, due primarily to higher EPZ imports of inputs and capital equipment. The public sector capital account should improve again by a large amount, as amortization payments due to commercial banks are scheduled to decline substantially and disbursements on concessionary loans already contracted should continue to increase with the second tranche of the SAL II and a new structural adjustment loan from the African Development Bank. As a result, a sharp reduction in the overall deficit to SDR 8 million is projected. However, given net repurchases to the Fund (after the final purchase effected in July 1984 under the 1983/84 stand-by arrangement), an unfinanced gap of SDR 44 million is projected. 2/

The Mauritian representatives recognized that both additional financing and continuation of the adjustment path would be required. In March 1984 the authorities approached the Eurocurrency market for a fifth loan to fill a part of the gap. They also intend to request a fifth stand-by arrangement with the Fund and a possible purchase under the compensatory financing facility. They stated that further commercial borrowing could be justified in light of the adjustment that has occurred and the bunching of debt service payments. On the basis of currently contracted debt, and the assumption of the maintenance of the 1984/85 nominal level of gross concessionary capital flows, total debt service payments (including charges and repurchases to the Fund) are expected to peak in 1984/85 (27 percent of exports of goods and nonfactor services) and to decline thereafter (Tables 4 and 7). By financing part of the gap in 1984/85, the authorities felt they would be able to smooth debt service payments and prevent a too extreme short-term adjustment from compromising their medium-term goals. The authorities recognize that, parallel with the financing, continuation of adjustment would be required in order to avoid in the future a situation in which the debt service would be unsustainable. The mission

1/ Net of a buildup of short-term reserve liabilities in the form of commercial bank deposits in foreign exchange at the Bank of Mauritius.

2/ The gap would rise to SDR 47.6 million if Mauritius were required to repurchase the outstanding amount under the buffer stock facility.

Table 4. Mauritius: Debt Service Payments on Medium- and Long-Term Debt 1981/82-1989/90 1/

(In millions of SDRs)

	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90
Eurocurrency	26	51	52	33	23	13	12	11	10
Principal	7	32	40	24	17	9	9	9	9
Interest	19	19	12	9	6	4	3	2	1
Other public 2/	19	24	28	36	46	54	64	72	75
Principal	9	13	16	17	22	26	33	36	36
Interest and charges	10	11	12	19	24	28	31	36	39
Private	5	4	5	3	2	2	2	3	3
Principal	4	4	4	2	1	1	1	2	2
Interest	1	1	1	1	1	1	1	1	1
IMF	19	18	33	59	57	37	30	19	16
Repurchases	6	5	20	44	44	28	23	15	13
Charges	13	13	13	15	13	9	7	4	3
Total (incl. IMF)	69	97	117	131	128	106	108	105	104
Principal and repurchases	26	54	80	87	84	64	66	62	60
Interest and charges	43	44	37	44	44	42	42	43	44

Sources: Data provided by the Mauritian authorities; and staff estimates.

1/ For Eurocurrency and private, on the basis of debt outstanding as of June 30, 1984. For other public on the basis of currently contracted debt, and on the assumption that disbursements of concessionary loans will remain at the 1984/85 level of SDR 72 million.

2/ Excludes repurchases and charges on IMF drawings except for Trust Fund.

felt that, besides filling the projected gap, there is a need to reconstitute reserves. Because of Mauritius' vulnerability to cyclones and changes in world markets, the mission suggested that reserves equivalent to one month's imports should be restored as soon as possible but a higher level would be necessary over the medium-term. In view of these factors, a careful balance between adjustment and financing would be required. Although the authorities had not yet formulated their po¿5cies, they stated that they were considering several options, including continued flexibility in the exchange rate, price and other measures to reduce consumption of gasoline, restrictions on credit for imports of consumer goods, and further increases in customs tariffs on consumer goods.

Since the rupee was unlinked from the SDR on February 28, 1983, the Mauritian authorities have been pursuing a flexible exchange rate policy. Between February 1983 and June 1984 the nominal and real trade-weighted exchange rate indices depreciated by 7.9 percent and 8.7 percent, respectively (Chart 3). This has almost completely reversed the appreciation of the rupee that occurred between September 1981 (when the rupee was last devalued) and February 1983. The exchange rate of the rupee against the SDR has depreciated from SDR 1 = Mau Rs 12 at endFebruary 1983 to SDR 1 = Mau Rs 14.24 at end-July 1984, with the depreciation being most pronounced in the last few months, reflecting the appreciation of the U.S. dollar.

The Mauritian authorities were very concerned about the protectionist stance of countries that are principal markets for their manufactured goods. They stated that if protectionism were tightened further it would jeopardize their plans for export diversification. Since October 1981 there has been an annual quota of 1.3 million pieces of knitware to the U.S. market; the quota represents about one tenth of Mauritius' current production of 12 million pieces. The authorities felt that if the quota were to be removed, there would be a likely market for Mauritian products in the United States of 5-6 million pieces. In May 1984 Canada imposed a quota for 1985 of 417,000 pieces, which the authorities felt constrained a potential market for Mauritian products in that country of about 1.5 million pieces. 1/ Although there are no quotas in the European Community under the terms of the Lomé II Convention, the authorities stated that the complicated "rules of origin" and the threat of possible quotas under the market disruption clause in the Lomé II Agreement acted as a brake to expansion in these markets.

2. The sugar sector

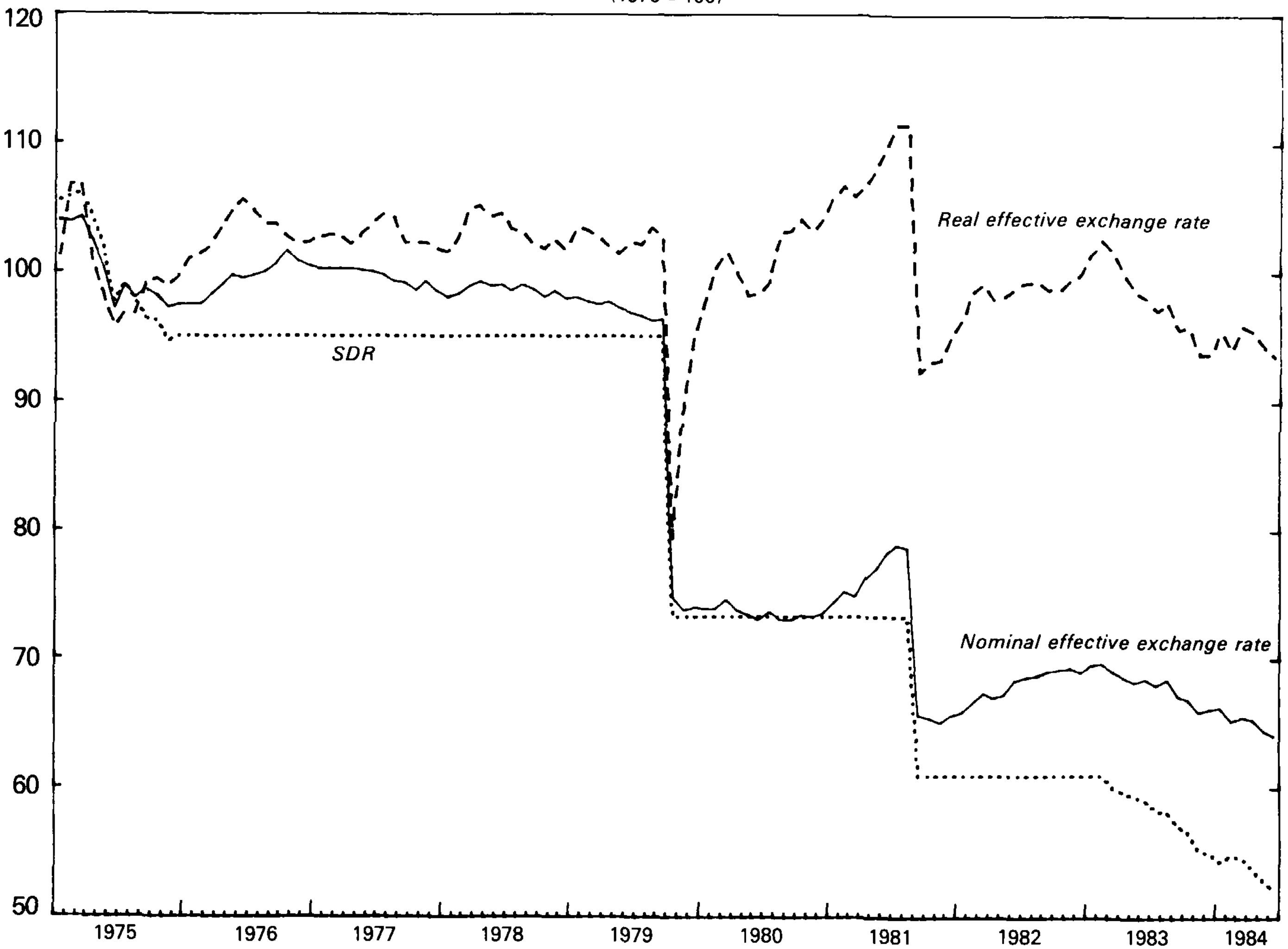
The sugar sector in Mauritius is dominated by 21 miller-planters (estates that operate mills), which account for over 60 percent of the cane output; the remainder is produced by about 33,000 small planters,

1/ Canada is allowing the sale of 1 million pieces in 1984 on the basis of existing contracts.

MAURITIUS

INDICES OF NOMINAL AND REAL EFFECTIVE EXCHANGE RATES, AND SDR, 1975-84

(1975 = 100)



Source: Staff calculations; decline indicates depreciation.

including both owners and tenants. Sugar is marketed through the Mauritius Sugar Syndicate, which contracts with importers, arranges transportation, deducts the export duty and other charges, and reimburses producers. Sugar exported to the EC is regulated by a Protocol under the Lomé II Convention. The volume of sugar exported to the United States market has been sharply curtailed by the imposition of a quota in 1982.

The financial situation of the sugar industry has been deteriorating since 1979 due to poor crops, caused in part by cyclones and droughts, a continued rise in costs, weakening world prices, and an increased level of taxation. 1/ In 1983 six firms were in a particularly difficult financial situation, and in April 1984 three of them were unable to meet their immediate needs except after the authorities intervened with the state-owned commercial bank to grant them credit. There is concern that these and probably other firms will not be able to survive 1984/85 without financial relief. This is due partly to the reduction in the 1984/85 crop to an estimated 580,000 tons, a 4 percent decline following the 12 percent fall in 1983/84. For the entire industry, the financial squeeze has resulted in a decline in investment; in 1982 and 1983 additions to fixed assets of the miller-planters were about two thirds of the average amount in 1977-79.

The Government is aware of the problems of the industry, and structural reform as well as short-term relief are major policy concerns. Most proposals for reform have been politically controversial because they involve (1) closing certain mills, with the resulting loss of employment and disruption to nearby villages; 2/ and (2) providing financial relief to the industry with implications for the distribution of income. The Government established a Commission of Enquiry in December 1982 to study the problems and propose solutions, but the commission was unable to agree on a set of proposals, and two separate reports were presented. The chairman focused on the current financial difficulties of the industry and recommended, inter alia, replacing the export duty by an excess profits tax. The two other members of the commission recommended institutional changes. There were, however, some common elements in the two reports; foremost among these was a recommendation to establish a Sugar Authority.

1/ A preliminary report of a June 1984 IBRD sugar subsector mission indicates that the financial returns of miller-planters varied widely, with returns on net capital employed during 1980-83 ranging from 4.4 percent to -12.7 percent.

2/ In the past four years two mills requested the Government that they be allowed to close or consolidate with larger firms nearby. These requests were not approved pending the outcome of the Commission of Enquiry and the development of a more comprehensive plan for the industry.

In June 1984 the Government established the Sugar Authority to advise on policy and coordinate changes within the industry. The act creating the authority provides it with wide powers and responsibilities. Its first priority, however, will be to propose to the Government a "restructuration" plan for the industry, including, if necessary, the closure of certain mills and the provision of financial relief. Other aspects are measures designed to improve the productivity of smallholders, a review of the land tenure system, a review of the sharing of sugar and by-products between millers and planters, and a plan of agricultural research. In regard to financial relief, two actions have already been taken: eliminating the brokerage fee, and raising the domestic price of sugar, on average, by 22 percent. These two actions are projected to provide relief to the industry of about Mau Rs 20 million. The Mauritian representatives stated that the Sugar Authority would consult with the various interested parties during July-August 1984 and would submit proposals to the Government by September 1984. These proposals would be discussed with the World Bank before they are announced. They added that the financial relief would be made retroactive to July 1, 1984 in order to coincide with the beginning of the export season.

3. Fiscal policy

Revised estimates on the outturn of the 1983/84 budget indicate an overall deficit of Mau Rs 1,032 million, equivalent to 7.7 percent of GDP, well below the budget (Table 5). The main reason for the lower than envisaged deficit was a large shortfall in capital expenditure and net lending. Since 1980/81 capital spending and net lending have taken the brunt of the fiscal adjustment, declining in nominal and real terms by 21 percent and about 40 percent, respectively. This reduction is partly attributable to delays in project implementation, unavailability of foreign financing, and a trimming, in agreement with the World Bank, of the Public Sector Investment Program (PSIP). There are, however, indications of a lack of co-ordination between the capital budget and the PSIP, with some projects in the PSIP not fully funded while some spending ministries have been able to implement projects not included in the PSIP.

Revenue and grants in 1983/84 increased by 12 percent from the outturn in 1982/83 but were lower than budgeted due mainly to shortfalls in import duties. The largest increase came from the sales tax, while other tax revenue rose at a lower rate than nominal GDP. Recurrent expenditure increased by 8 percent in 1983/84, but was lower than budgeted. About half the rise in recurrent expenditure was due to higher wages and salaries, which increased by about 11 percent in spite of an average wage settlement of only 4.5 percent for central government employees. Interest on the public debt, accounting for 25 percent of total recurrent expenditure, also increased by 11 percent. Total subsidies and current transfers are estimated to have risen by

Table 5. Mauritius: Central Government Operations, 1980/81-1984/85

	1980/81	1981/82	1982/83	1983/84 Budget	1983/84 Prov.	1984/85 Budget
	(In millions of Mauritian rupees)					
Revenue and grants	2,073	2,289	2,822	3,285	3,152	3,474
Tax revenue	1,797	1,950	2,407	2,814	2,721	2,934
Nontax revenue	262	272	392	368	366	420
Grants	14	68	23	103	65	120
Expenditure and net lending	3,366	3,677	3,985	4,466	4,184	4,469
Current	2,471	2,892	3,223	3,542	3,480	3,717
Capital	483	444	360	531	440	635
Net lending	413	341	402	393	264	117
Overall deficit (-)	-1,293	-1,388	-1,163	-1,182 1/	-1,032	-995
External financing	707	794	-176	205	-58	381
Disbursements	807	944	313	811	594	859
Amortization	-100	-150	-489	-606	-652	-478
Domestic financing	586	594	1,339	977	1,090	614
Banking system (net)	496	438	875	754	624	...
Nonbank (net)	90	156	464	223	466	...
Memorandum items:						
Bank financing on a performance criterion basis	850	853	816	750	505	...
	(In percent of revised GDP)					
Total revenue and grants	22.4	21.3	22.8	24.5	23.5	23.5
Total expenditure	36.4	34.2	32.2	33.3	31.2	30.2
Current	26.8	26.9	26.0	26.4	26.0	25.1
Capital	5.2	4.1	2.9	4.0	3.3	4.3
Net lending	4.5	3.2	3.2	2.9	2.0	0.8
Overall deficit	14.0	12.9	9.4	8.8 1/	7.7	6.7

Sources: Ministry of Finance, Central Statistical Office; and staff estimates.

1/ The program provided for an overall fiscal deficit of Mau Rs 1,200 million, or 9.0 percent of revised GDP; the budget therefore provided for a small safety margin.

only 5 percent, as increases in some items were partly offset by a reduction in subsidies for rice and flour. With the increase in retail prices of these two items, the subsidies on them were reduced from Mau Rs 190 million in 1982/83 to Mau Rs 110 million in 1983/84.

The 1984/85 budget, as approved by the Legislative Assembly, envisages an overall deficit of Mau Rs 995 million, equivalent to 6.7 percent of projected GDP. The Mauritian representatives stated that the budget was formulated, with a view, inter alia, to providing some room for the introduction of the above-mentioned "restructuration" package for the sugar industry without the need to introduce new fiscal measures or to change the overall deficit. The principal new revenue measure introduced in 1984/85 is a 10 percent surcharge on import taxes (customs and stamp duties) which yielded Mau Rs 1.1 billion in 1983/84. Also budgeted in 1984/85 is a near doubling of grants, reflecting additional aid from European sources.

There were no new major expenditure measures announced with the 1984/85 budget. The Mauritian representatives expressed their intention to continue the policy of expenditure restraint shown in the past three years. Recurrent expenditures are budgeted to increase by 7 percent, or less than the expected rate of inflation. The annual wage awards, effective from July 1, provided for increases ranging from 5.7 percent for the lowest paid workers (the rate of inflation in 1983/84 was then projected at 5.7 percent) to 0.8 percent for the highest paid; this implies an average increase of about 3 percent in the public sector. The Government also intends to limit employment and wage drift so that the wage bill is budgeted to increase by 5.6 percent, compared with 11 percent in 1983/84. Total subsidies and current transfers will remain virtually stable, as slight increases in subsidies to local governments, education, and pensions are expected to be offset by a further decline in subsidies for rice and wheat flour.

On June 1, 1984 a Unified Revenue Board was established with Fund technical assistance. The purpose of the board is to coordinate and supervise the activities of revenue departments and to reduce tax evasion and fraud. To these ends, the board will endeavor to promote close coordination and an exchange of information between the various revenue departments and will work with a Tax Appeals Tribunal that has been newly established to speed the adjudication of tax cases. Although the authorities were not able to estimate the effect on revenue in 1984/85, they were confident that the operation of the board and the tribunal would improve the buoyancy of the tax system over the medium term.

Another structural reform implemented in 1984/85 is a change in the company tax. The tax, which had previously been set at 55 percent for public companies and 66 percent for private companies, was calculated on net profits after dividend distribution. The Mauritian representatives stated that the structure of the tax encouraged an excessive distribution of dividends and discouraged capital formation. Therefore, in the 1984/85 budget, the deduction for dividend distribution was eliminated, and the tax rate was reduced to 35 percent for both public and private companies; this change is considered to be revenue neutral.

The structure of import taxes and the administration of the customs department are currently being studied, with the principal objectives of rationalizing the tariff and increasing revenue. Concurrently, in conformity with the IBRD SAL II, studies are under way to determine the level of tariffs that should provide protection for domestic industries to replace the quota restrictions on imports. In addition, UNIDO has sponsored a study on industrial policy to consider the effect of the tariff structure on local manufacturing and the possibility of providing rebates on duties to firms outside the EPZ scheme. Coordination of the various recommendations will be carried out by the Ministry of Finance.

4. Money and credit

During 1983/84 domestic credit and money supply grew at a slower pace than in the preceding year. Total domestic credit rose by 16 percent; net credit to the Government, increased by 15 percent while credit to the private sector rose by 18 percent (Table 6). 1/ Compared with 1982/83, there was an acceleration in the increase in private credit and a deceleration in the increase in net credit to the Government. The rate of monetary growth greatly fell to 8 percent in 1983/84 from 21 percent in 1982/83.

The Bank of Mauritius controls the volume of private sector credit by establishing a quarterly ceiling on credit expansion for each bank. The ceilings are determined by a formula that takes into account for each bank the increase in its lending to the priority sectors 2/ and its performance in mobilizing time and savings deposits, with a greater weight on the latter. Given the tight controls on credit expansion in recent years, and the progressive liberalization of interest rates in 1983, deposits, particularly time deposits, have grown by more than credit expansion, and the banking system as a whole has accumulated considerable excess liquidity. This situation has reduced the incentive for most banks to expand their deposit base further. The excess liquidity also resulted in a downward pressure on deposit rates in the first half of 1984, which has been reinforced by pressures from the authorities on banks to lower rates on credit to priority sectors. The

1/ On a performance criteria basis (i.e., including drawings by Government on Eurocurrency loans), total domestic credit increased in 1983/84 by 13 percent and net credit to the Government by 10 percent, compared with 16 percent and 20 percent, respectively, in 1982/83.

2/ Agriculture, EPZ, and Development Certificate companies.

Table 6. Mauritius: Monetary Survey, June 1981-June 1984

(In millions of Mauritian rupees; end of period)

	1981		1982		1983				1984		
	June	Dec.	June	Dec.	March	June	Oct.	Dec.	March	June	
										Prog. 1/	Actual
Foreign assets (net) 2/	-969	-940	-941	-1,001	-976	-1,205	-1,246	-1,521	-1,330	-1,239	-1,732
Bank of Mauritius 2/	-875	-900	-908	-1,119	-1,024	-1,240	-1,301	-1,635	-1,395	-1,303	-1,712
Commercial banks	-94	-40	-33	118	48	35	55	115	65	65	-20
Domestic credit	5,004	5,450	5,730	6,452	6,202	6,851	6,988	7,494	7,375	7,610	7,944
Net claims on Government	2,854	3,191	3,292	3,991	3,676	4,167	4,241	4,697	4,482	4,527	4,791
Bank of Mauritius	(2,139)	(2,490)	(2,517)	(2,865)	(2,537)	(2,826)	(2,944)	(3,500)	(3,159)	(...)	(3,505)
Commercial banks	(715)	(701)	(775)	(1,126)	(1,139)	(1,339)	(1,298)	(1,197)	(1,323)	(...)	(1,286)
Claims on private sector	2,150	2,259	2,438	2,461	2,525	2,683	2,747	2,797	2,893	3,083	3,153
Of which: sugar sector	(427)	(446)	(405)	(393)	(450)	(508)	(464)	(463)	(486)	(600)	(...)
Money (M_2)	3,655	3,993	4,313	4,927	4,775	5,213	5,244	5,428	5,400	5,800	5,559
Money (M_1)	1,391	1,534	1,513	1,742	1,586	1,772	1,683	1,805	1,686	...	1,725
Quasi-money	2,264	2,459	2,799	3,185	3,190	3,441	3,561	3,622	3,714	...	3,833
Other items (net)	380	517	477	524	450	432	497	545	645	570	653
Memorandum items:											
Monetary survey on a performance criteria basis											
Foreign assets (net) 2/	-1,323	-1,294	-1,710	-1,770	-1,745	-1,914	-1,956	-2,171	-1,981	-2,339	-2,323
Domestic credit	5,358	5,804	6,500	7,221	6,970	7,560	7,698	8,144	8,026	8,710	8,535
Of which: Net claims on Government	(3,208)	(3,545)	(4,061)	(4,760)	(4,445)	(4,877)	(4,951)	(5,347)	(5,132)	(5,627)	(5,382)
Eurocurrency loans outstanding 3/	354.3	354.3	768.6	768.6	768.6	709.6	709.6	650.5	650.5	1,100.0	591.5

Sources: Data provided by the Bank of Mauritius; and staff estimates.

1/ EBS/84/77 of April 4, 1984.
2/ Including valuation adjustment on liabilities to the Fund.
3/ Valued at the rate of exchange on the date of drawing; includes only loans drawn since 1980.

pressures reflected the authorities' concern regarding the widening of the spread between average lending and deposit rates since the start of the liberalization process. The Mauritian representatives stated that, despite the reduction in deposit rates, these have remained substantially positive in real terms. In regard to interest rates on credit, they said that there was a need to influence their level in general and between sectors in particular. This is in keeping with the objective of restricting the imports of consumer goods and encouraging investment and employment in export sectors.

The authorities, conscious of the rigidities of the current system of credit control, are considering a system of indirect credit controls, utilizing cash and liquidity ratios to keep credit expansion to the desired level. Parallel with the increase in investment in the EPZ, there has been an increase in demand for credit. The authorities are concerned that tight credit policies might have a negative effect on investment activity as the Government and the sugar industry absorb a large share of available resources, raising the possibility that credit to EPZ, where investment opportunites exist, might be crowded out. 1/

5. The exchange and trade system

Mauritius has a relatively liberal system of trade and payments. Imports subject to quantitative restrictions represented in 1981 (the year during which most of the restrictions were imposed) about 11 percent of the total value of imports. An important element of the 1983/84 program was the progressive reduction in these restrictions with the objective of an eventual complete liberalization of the system. At the time the program was formulated, there were three lists of restricted imports: (a) those that were completely prohibited to protect local industry; (b) those that were restricted by quota, also for the protection of the local industry; and (c) those restricted by quota for balance of payments reasons. In March 1984 all prohibited items under list (a) were made subject to quotas equivalent to 25 percent of the domestic market demand. However, import licenses are granted only to traders who can prove that they had imported these items before the ban was imposed. Thus far, no license has been granted. The Government hopes that all quotas under lists (a) and (b) will be removed by end-1984 and replaced by appropriate tariffs that will be progressively reduced. In regard to goods on list (c), those that are subject to tariffs of 30 percent or more have already been completely liberalized. The Mauritian representatives stated that so far about 70 percent of previously restricted imports had been liberalized. They added that goods subject to tariffs of less than 30 percent would be liberalized by end-1984.

1/ Commercial bank credit to the EPZ increased by 14 percent in the first quarter of 1984, after declining in real terms during 1982 and 1983.

Exports are subject to permits, which in general are issued freely. In the case of exports subject to quotas abroad the quota are distributed between local producers on the basis of performance prior to the imposition of quota. Exports of certain agricultural products are subject to restrictions in order to reduce price pressures in local markets.

Mauritius continues to maintain an exchange system that is virtually free of restrictions on payments and transfers for current international transactions. The Mauritian representatives stated that their objective of export-oriented growth requires an internationally competitive industry that, in turn, implies a relatively liberal system of trade and payments.

IV. The Medium-Term Balance of Payments Outlook

In conjunction with the Mauritian authorities, the mission prepared a simulation of the medium-term balance of payments outlook on the basis of current policies and trends (Table 7). The projections, covering the period 1985/86-1989/90, are based on the average volume of sugar output during the last few years and take into consideration the anticipated further sharp increase in the volume of EPZ imports and exports. As to prices, with the exception of sugar, the projections use the WEO assumptions for most items. Sugar prices on the free market are likely to be influenced in the coming few years by the current glut and by the relatively large stocks in producing countries. Both factors should, however, play a minor role in the case of Mauritius, given its share in the protected markets.

Sugar output is projected to remain at 625,000 tons, which is about the average during the past three years. No changes are envisaged in the export quotas to the protected markets, but export prices to these markets are assumed to rise by 2 percent per annum. On the other hand, free market prices are assumed to remain roughly constant at the 1983/84 level. 1/ The volume of EPZ exports is projected to rise in 1985/86 by 10 percent and to increase thereafter by 6 percent per year. EPZ export prices are assumed to rise by 4 percent per annum. Regarding other exports, it is assumed that their volume and price will increase annually by 2 percent and 4 percent, respectively. In all, the volume and price of exports are projected to rise annually by 2.7 percent and 2.9 percent, respectively.

As to imports, it is assumed that the volume of rice and flour will increase by 1.4 percent per year, which is the rate of growth of the population, and that their prices will rise by 4 percent a year.

1/ Price assumptions are provided by the Mauritian authorities. The Fund's Commodities Division does not project sugar prices beyond 1985. The World Bank does not project sugar prices in the EC and US markets.

Table 7. Mauritius: Medium-Term Balance of Payments and External Debt Outlook, 1983/84-1989/90

(In millions of SDRs)

	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90
Exports, f.o.b.	345	349	382	403	426	452	478
Imports, f.o.b.	-365	-384	-410	-443	-473	-508	-544
Trade balance	-20	-35	-28	-40	-47	-56	-66
Invisibles (net)	-7	-8	-7	--	7	12	22
Of which: investment income 1/	(-37)	(-44)	(-44)	(-42)	(-42)	(-43)	(-44)
Current account	-27	-43	-35	-40	-40	-44	-44
Capital (net) 1/	-9	35	37	41	35	32	32
Overall balance	-36	-8	2	1	-5	-12	-12
IMF (net)	13	-36	-44	-28	-23	-15	-13
Purchases	(33)	(8) 2/	(--)	(--)	(--)	(--)	(--)
Repurchases	(-20)	(-44)	(-44)	(-28)	(-23)	(-15)	(-13)
Reserves	23	...	...	...	...	...	...
Financing gap	--	44	42	27	28	27	25
Debt service							
1. On existing debt and assumed inflow of concessionary capital	117	131	128	106	108	105	104
2. On additional debt for financing the gap 3/	--	3	9	28	49	71	100
3. Total debt service (1+2)	117	135	137	134	157	176	204
Debt service ratio	24.6	27.8	25.8	23.7	26.0	28.7	29.7
of which: on existing debt and assumed inflow of concessionary capital	(24.6)	(27.0)	(24.1)	(18.8)	(17.9)	(17.1)	(15.1)

Source: Staff projections prepared jointly with the Mauritian authorities.

1/ On the basis of currently contracted debt, and assuming constant inflow of concessionary capital at the level projected for 1984/85. Investment income does not include interest on additional debt for financing the gap.
2/ The final purchase effected under the 1983/84 stand-by arrangement.
3/ Assuming that the gap is financed entirely on commercial terms.

The volume of petroleum imports is assumed to rise annually by about 3 percent beginning in 1985/86, owing mainly to large increases in industrial fuel imports; petroleum prices are projected to rise by 4 percent per year. The medium-term scenario envisages that EPZ imports will rise in line with the exports of this sector; therefore, to the extent that EPZ exports will fall short of the assumptions, EPZ imports will also decline. It is also assumed that the volume of other imports, which represent, on average, about 55 percent of the total, will rise by 2 percent per year, with prices rising by about 4 percent. It should be noted that in the past three years the value of other imports remained virtually stable, reflecting mainly the impact of the tight demand management policies pursued. In sum, the volume and price of imports are projected to increase annually by 3.2 percent and 4 percent, respectively. Given the projected evolution of export and import prices, Mauritius' terms of trade are projected to deteriorate by about one percent per annum beginning in 1985/86.

Service payments and receipts, excluding investment income, freight and insurance, and tourism, are projected to rise by 8 percent per annum. Freight and insurance payments are assumed to rise in line with the increase in the value of imports. Tourism receipts are anticipated to increase by 12 percent per year, owing mainly to the recent gains in Mauritian competitive edge over other tourism centers. In all, between 1984/85 and 1989/90 net receipts on services, excluding investment income, are projected to rise nearly threefold to SDR 25 million. Gross concessionary capital inflows are assumed to remain constant at the 1984/85 level of SDR 72 million. Given the amortization payments in respect of concessionary capital, the net inflow is projected to decline from SDR 55 million 1984/85 to SDR 36 million in 1989/90.

On the basis of the above assumptions, the medium-term balance of payments projections show that the overall balance will move from a deficit in 1984/85 to approximate equilibrium in each of the following two years, before changing again into a small deficit. Given repurchases to the Fund, a financing gap is projected in each year; the gap is, however, projected to decline from SDR 44 million in 1984/85 to about SDR 25 million by 1989/90. Under the hypothesis that the gap will be financed entirely on commercial terms, the debt service payments will increase beginning in 1987/88; the debt service ratio, after declining to 24 percent by 1986/87, will, therefore, increase again to about 30 percent by 1989/90. The Mauritian authorities stated that an increase in the debt service ratio would be unsustainable. They would like to formulate their policies with a view to lowering the debt service ratio to around 20 percent, a level they felt would be compatible with the objective of increasing the rate of economic growth and employment opportunities.

V. Staff Appraisal

Under four successive stand-by arrangements, Mauritius has made substantial progress in reducing the financial imbalances that emerged in the late 1970s. The adjustment process was pursued with considerable political courage and determination, notwithstanding particularly unfavorable external developments. As a result, between 1980/81 and 1983/84 the external current deficit was reduced from 15.5 percent of GDP to 2.6 percent and has reached a level that can be fully financed by net concessionary capital inflows. During the same period the overall fiscal deficit fell from 14 percent of GDP to 7.7 percent, and the inflation rate declined from 26.5 percent to 5.6 percent.

Despite the progress made thus far, the adjustment process has not yet been completed. Until mid-1982 the external imbalances were primarily financed by foreign borrowing, mostly on commercial terms, combined with substantial recourse to Fund resources. Although Mauritius did not contract or draw down any new commercial loans in the last two years, and in fact repaid nearly 50 percent of outstanding Eurocurrency credit, the debt service ratio is expected to peak in 1984/85 at 27 percent. Given the debt service payments, and the unfavorable outlook for sugar over the next few years, indications are that, on the basis of current policies, there will be a financing gap in each year over the next five years. Meanwhile, Mauritius' foreign exchange reserves are at a low level, and there is a pressing need to reconstitute them.

In regard to the productive sectors, the financial position of the sugar industry has been deteriorating in recent years due to poor crops caused, in part, by cyclones and droughts, a continued rise in costs, and a high level of taxation. As a result, the industry as a whole has not been able to maintain an adequate level of investment. If this situation were allowed to continue, there is a danger that production and exports would decline, with adverse consequences for growth, employment, and the balance of payments.

The problems that remain in the external sector and the sugar industry need to be tackled resolutely. Otherwise, the progress made thus far may be jeopardized and the objective of export-led growth may be undermined. Because the current account deficit has declined to a level that can be financed by net concessionary capital inflow, the solution to the difficulties facing Mauritius requires judicious debt management and a continuation on the adjustment path. It is necessary for Mauritius to seek new foreign financing to smooth the debt service payments and prevent a too extreme short-term adjustment from compromising the medium-term growth objectives. In regard to adjustment, there is a need to continue with the policies that have worked well in the past: demand management, market liberalization, and exchange rate policy. Concerning demand management, there is a need for some change of emphasis. Specifically while there is a need to provide sufficient credit to the rapidly expanding EPZ sector, the fiscal deficit is still high and should be progressively reduced.

Capital expenditure has, so far, taken the brunt of the fiscal adjustment. For the period ahead, tax increases and restraint on recurrent expenditure would be necessary; these policies were included in the 1984/85 budget, which shows an adjustment of about 1 percentage point of GDP in the overall fiscal deficit. In the medium term the initiatives taken on tax administration should improve tax buoyancy and allow further adjustment without substantial new discretionary measures. On the expenditure side, a careful buildup of capital expenditure to the level recommended by the World Bank would be desirable, given the large decline over the past three years, but restraint on recurrent expenditure should be maintained. A reduction in the fiscal deficit would help release credit to other sectors, particularly the export sectors.

The staff believes that emphasis should be given to market liberalization and continuation of a flexible exchange rate policy to provide stimulus to the export sectors. In the area of credit policy, the authorities are encouraged to introduce a system of indirect credit controls. Administrative measures to allocate credit among sectors or influence the interest rates to priority sectors will be counterproductive and may reduce the volume of credit available to the very sectors the Government wants to encourage. Although indications are that many firms in the EPZ are currently profitable, this sector has not so far been able to attract sufficient investment either to achieve sustainability in the balance of payments or to make a significant dent in unemployment.

Reform of the sugar industry is another area where policy action is needed. The Sugar Authority is reviewing various proposals for structural reform and financial relief and will make recommendations to the Government by September 1984. The Government, after consultation with the World Bank, should implement these recommendations without delay in order to improve the efficiency of the industry and ensure that the volumes of output and exports do not decline. The staff will be guided by the World Bank's views on matters relating to the sugar industry. From a macroeconomic point of view, it is important that the package of measures should not compromise the overall fiscal target set in the 1984/85 budget.

The maintenance of a liberal trade and exchange system is crucial to the achievement of sustainable export-led growth. The staff commends the authorities for the liberalization that has taken place in the trade system and urges the completion of this process. The authorities are also to be commended for the maintenance of an exchange system virtually free of restrictions. The staff hopes that the trading partners of Mauritius will be mindful of the effects of their protectionist measures on Mauritius' medium-term prospects; if these measures were tightened, it would seriously affect Mauritius' growth prospects and its ability to service its debt obligations.

Given the balance of payments prospects over the next few years, the consultation discussions will be held on a 12-month cycle.

VI. Proposed Decision

The following draft decision is proposed for adoption by the Executive Board:

1. The Fund takes this decision in concluding the 1984 Article XIV consultation with Mauritius, in the light of the 1984 Article IV consultation with Mauritius conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes with satisfaction that Mauritius continues to maintain an exchange system that is virtually free of restrictions on payments and transfers for current international transactions.

MAURITIUS - Fund Relations

(Amounts in millions of SDRs, as of end-July 1984, unless otherwise indicated)

I. Membership status

Date of membership:	September 23, 1968
Status:	Article XIV

A. Financial Relations

II. General Department	Millions of SDRs	Percent of quota
Quota:	53.6	100.0
Total Fund holdings of member's currency:	226.2	422.1
Fund credit:	172.6	322.1
Compensatory financing facility (exports)	35.4	66.1
Buffer stock financing facility	3.6	6.7
Credit tranches - ordinary resources	27.5	51.3
Credit tranches - SFF resources	59.2	110.5
Credit tranches - enlarged access resources	46.9	87.4
Reserve tranche position:	-- 1/	--
Current Operational Budget:	--	--
Lending to the Fund:	--	--

III. Stand-By Arrangements and Use of Special Facilities

Current stand-by

Duration:	May 18, 1983-August 17, 1984
Amount:	49.50
Utilization:	49.50
Undrawn balance:	--

Previous stand-by arrangements:

Dates	Duration	Amount	Utilized
February 1978	12 months	7.97	7.97
October 1979	12 months	73.03	40.00
September 1980	12 months	35.00	35.00
December 1981	12 months	30.00	30.00

Special facilities:

Compensatory financing facility (exports):	April 1981 - 40.50
Buffer stock financing facility:	January 1983 - 3.60

1/ The actual reserve tranche position is SDR 16,161.

IV. SDR Department

Net cumulative allocation:	15.74
Holdings: Amount	1.67
Percent of net cumulative allocation	(10.6)
Current designation plan:	--

V. Administered Accounts (amounts)

Trust Fund Loans	
Disbursed	9.1
Outstanding	7.3
SFF Subsidy Account	
Donations to Fund	--
Loans to Fund	--
Payments by Fund	3.5

VI. Overdue Obligations to the Fund: None

B. Nonfinancial Relations

VII. Exchange rate arrangement:

Since February 28, 1983 the Mauritian rupee, which previously was pegged to the SDR at Mau Rs 12 = SDR 1, has been pegged to a tailored basket of currencies. On July 31, 1984, SDR 1 was equivalent to Mau Rs 14.24.

VIII. Last Article IV consultation and stand-by review.

Last Article IV consultation May 18, 1983

Mauritius is on the standard 12-month cycle. The last Article IV consultation with Mauritius was held in January/February 1983. The staff report, along with Mauritius' request for use of Fund resources (EBS/83/78), was discussed by the Executive Board on May 18, 1983, and the decisions were:

(i) 1983 Consultation

1. The Fund takes this decision in concluding the 1983 Article XIV consultation with Mauritius, in the light of the 1983 Article IV consultation with Mauritius conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes with satisfaction that Mauritius continues to maintain an exchange system which is virtually free of restrictions on payments and transfers for current international transactions.

(ii) Stand-By Arrangement

1. The Government of Mauritius has requested a stand-by arrangement in an amount equivalent to SDR 49.5 million for a period of 15 months from May 18, 1983 through August 17, 1984.