EBS/83/78
Supplement 2

CONFIDENTIAL

May 19, 1983

To: Members of the Executive Board

From: The Secretary

Subject: Mauritius - Stand-By Arrangement

Attached for the records of the Executive Directors is the text of the stand-by arrangement for Mauritius agreed at Executive Board Meeting 83/71, May 18, 1983.

Att: (1)

Mauritius - Stand-By Arrangement

Attached hereto is a letter dated March 21, 1983 from the Minister of Finance and the Governor of the Bank of Mauritius requesting a stand-by arrangement and setting forth the objectives and policies that the authorities of Mauritius intend to pursue for the period of this stand-by arrangement. To support these objectives and policies, the International Monetary Fund grants this stand-by arrangement in accordance with the following provisions:

1. For the period of 15 months from May 18, 1983, Mauritius will have the right to make purchases from the Fund in an amount equivalent to SDR 49.5 million, subject to paragraphs 2, 3, 4, and 5 below, without further review by the Fund.

2. a. Purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 8.25 million until July 14, 1983, SDR 16.5 million until October 14, 1983, SDR 24.75 million until January 14, 1984, SDR 33.0 million until April 14, 1984, and SDR 41.25 million until July 14, 1984.

b. None of the limits in (a) above shall apply to a purchase under this stand-by arrangement that would not increase the Fund's holdings of Mauritius' currency in the credit tranches beyond 25 per cent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 per cent of quota.

3. Purchases under this stand-by arrangement shall be made from ordinary resources until purchases under the arrangement reach the equivalent of SDR 2,631,910, then each purchase shall be made from borrowed resources; provided that any modification by the Fund of the proportions of ordinary and borrowed resources shall apply to amounts that may be purchased after the date of modification.

4. Mauritius shall not make purchases under this stand-by arrangement that would increase the Fund's holdings of Mauritius' currency in the credit tranches beyond 25 per cent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 per cent of quota:

(a) during any period in which:

(i) the limit on total bank credit described in paragraph 10 of the attached letter; or

(ii) the limit on net credit to the Government described in paragraph 10 of the same letter; or

(iii) the limits on contracting, guaranteeing, and drawing down of government and government-guaranteed non-concessional foreign borrowing described in paragraph 10 of the same letter;

is not observed; or

(b) during any period after July 31, 1983, or January 31, 1984, respectively until suitable performance clauses with regard to total bank credit and net credit to the Government, and the drawdown on nonconcessional foreign borrowing, as defined in paragraph 10 of the letter, have been established in consultation with the Fund as contemplated in paragraph 12 of the attached letter, or if such clauses, having been established, are not observed; or

(c) during the entire period of this stand-by arrangement, if Mauritius

(i) imposes or intensifies restrictions on payments and transfers for current international transactions, or

(ii) introduces or modifies multiple currency practices, or

(iii) concludes bilateral payments agreements which are inconsistent with Article VIII, or

(iv) imposes or intensifies import restrictions for balance of payments reasons.

When Mauritius is prevented from purchasing under this stand-by arrangement because of this paragraph 4, purchases will be resumed only after consultation has taken place between the Fund and Mauritius and understandings have been reached regarding the circumstances in which such purchases can be resumed.

5. Mauritius' right to engage in the transactions covered by this arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of Mauritius. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 5, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and Mauritius and understandings have been reached regarding the circumstances in which such purchases can be resumed.

6. Purchases under this arrangement shall be made in the currencies of other members selected in accordance with the policies and procedures of the Fund, and may be made in SDRs if, on the request of Mauritius, the Fund agrees to provide them at the time of the purchase.

7. The value date of a purchase under this stand-by arrangement involving borrowed resources will be normally either the 15th day or the last day of the month, or the next business day if the selected day is not a business day. Mauritius will consult the Fund on the timing of purchases involving borrowed resources.

8. Mauritius shall pay a charge for this stand-by arrangement in accordance with the decisions of the Fund.

9. (a) Mauritius shall repurchase the amount of its currency that results from a purchase under this stand-by arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchases as Mauritius' balance of payments and reserve position improves.

(b) Any reductions in Mauritius' currency held by the Fund shall reduce the amounts subject to repurchase under (a) above in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

(c) The value date of a repurchase in respect of a purchase financed with borrowed resources under this stand-by arrangement will be normally either the 6th day or the 22nd day of the month, or the next business day if the selected day is not a business day, provided that repurchases will be completed not later than seven years from the date of purchase.

10. During the period of the stand-by arrangement, Mauritius shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Mauritius or of representatives of Mauritius to the Fund. Mauritius shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Mauritius in achieving the objectives and policies set forth in the attached letter.

11. In accordance with paragraph 12 of the attached letter, Mauritius will consult the Fund on the adoption of any measures that may be appropriate at the initiative of the Government whenever the Managing Director requests consultation because any of the criteria under paragraph 4 above have not been observed or because he considers that consultation on the program is desirable. In addition, after the period of the arrangement and while Mauritius has outstanding purchases in the upper credit tranches, the Government will consult with the Fund from time to time, at the initiative of the Government or at the request of the Managing Director, concerning Mauritius' balance of payments policies.

ATTACHMENT

Port Louis, Mauritius

March 21, 1983

Dear Mr. de Larosière:

1. Since the latter part of 1979 the Government of Mauritius has been implementing an adjustment program which has been supported by three successive stand-by arrangements with the Fund; the last one expired on December 20, 1982. The program has aimed at reducing the financial imbalances and putting the economy on a path of sustained economic growth. Despite adverse weather conditions, and a deterioration in the terms of trade, all policy measures contained in the program have been implemented, and the targets have been attained and, in some respects, surpassed. Hence in FY 1982/83 (July-June) the economy is expanding by about 6 per cent, and the rate of increase in domestic demand is moderating. Progress has also been achieved on the price front, and the rate of inflation has declined to about 11 per cent in 1982 compared with an average of 28 per cent in the preceding two years. Pressures on the balance of payments have been alleviated, and in FY 1982/83 the external current account deficit is expected to be of the order of 7 per cent of GDP as against an average of 11 per cent in the preceding two years. Moreover, the Government has begun to reduce its net indebtedness in the Eurodollar market. Central to the attainment of the above results was the adoption of a wide array of policies in the areas of exchange rate, reduction in consumer subsidies, wage restraint, restrictive credit and monetary policies, reduction in the overall fiscal deficit, and the maintenance of a liberal system of trade and payments for current international transactions.

2. Despite the progress thus far attained, much remains to be done. In particular, the overall fiscal deficit must be further reduced, and the rate of unemployment is unacceptably high. Therefore, the Government intends to persevere in its efforts to foster economic growth in the context of broad financial stability. To this end, in support of the policies which the Government intends to pursue for the remainder of 1982/83 and for 1983/84, we would like to request from the International Monetary Fund a 15-month stand-by arrangement in an amount of SDR 49.5 million. Discussions are also at an advanced stage with the World Bank for a second Structural Adjustment Loan in an amount of US$40 million. In the paragraphs below, we would like to outline the economic and financial policies which the Government intends to pursue in the period ahead.

3. The Government has formulated in cooperation with the World Bank the public sector investment program for the period 1983-85. The size of the program has been reduced in order to take into consideration financial constraints and implementation capacity. Furthermore, investments have been reoriented toward the productive sectors, while resources directed to housing, infrastructure, and social services have been scaled down. In view of our resource constraints, particularly the availability of land, in conformity with the World Bank's recommendations, the development of

the economy will have to be based on export-oriented industries and tourism. The key element in attracting the necessary foreign investment in these activities is the continual pursuit of macro-economic policies designed to reduce the financial imbalances and foster growth. Moreover, the Government, with the help of the World Bank, is in the process of identifying policies to restructure the economy and to remove obstacles that have hampered growth. We have not neglected the agricultural sector, but, as recognized by the World Bank, it would be difficult to formulate concrete policies in this area before the Sugar Enquiry Commission submits its report toward the end of 1983.

4. The Government is fully conscious of the need for following a policy of wage restraint in order to preserve our competitiveness and enable employment to expand. Consequently, with regard to the current fiscal year, the Government does not intend to grant any further wage increase. The Government's approach to wage policy in 1983/84 will be discussed in detail with the Fund staff next May and will be essentially guided by the need to link wage increases to productivity and ability to pay. In the context of our export drive, it is vital that the competitiveness of our industry is not eroded by unsustainable wage increases. It is also vital that Government should ensure the maintenance and promotion of harmonious industrial relations. In this context, the Government will repeal the Industrial Relations Act in the course of the year and will replace it by new legislation which will encourage a system of private sector wage settlements based on genuine bargaining between employees and employers at the level of the individual firm or industry. This legislation will strengthen the ability of the Government to ensure that wage developments are consistent with our economic situation and the economic and social objectives of the Government. In its effort to replace the present labor legislation and the mechanism for salary negotiations, which are cumbersome and which create wage inequity among various sectors and prevent labor mobility among the economic sectors, the Government, in its letter to the President of the World Bank, in connection with our request for a second Structural Adjustment Loan, has specifically requested World Bank technical assistance for this purpose. As regards the public sector, the need to reduce the overall budget deficit will be the key factor in determining the scope for wage awards in 1983/84. The preservation of our scarce financial resources for investment will, over time, expand employment and the income of all Mauritians. Wage settlements without regard to the availability of resources for investment can only increase inflationary pressures and weaken the balance of payments, thereby jeopardizing the competitiveness of the economy and the goal of expanding employment.

5. The budgetary performance in the first half of 1982/83 suggests that the fiscal target, established with the Fund staff in the context of the mid-term review of the expired stand-by arrangement, is attainable. However, the Government will not hesitate to take new revenue-raising or expenditure-saving measures in the event that data on fiscal developments during the first two months of 1983 suggest that the fiscal target may not be realized. The Government will communicate to the Fund staff by mid-

March 1983 the latest data on fiscal developments and, if warranted, details of measures that the Government is taking. In regard to the 1983/84 budget, the Government is currently formulating its policies, and several revenue and expenditure measures are under active consideration. The objective is to contain the 1983/84 overall budget deficit to no more than Mau Rs 1,200 million (about 8.5 per cent of estimated GDP) compared with Mau Rs 1,366 million (11 per cent of estimated GDP) in 1982/83. The fiscal adjustments in 1983/84 will be achieved from new measures over and above any expected benefit from improvements in tax administration. To the extent that this improvement is realized, the overall deficit will be further reduced. The Government will discuss the budget proposals for 1983/84 with the Fund staff before end-May 1983 to ensure that the budgetary policies are consistent with the objective of reducing the financial imbalances.

6. We have recently adopted a number of monetary policy measures which should make an important contribution to the allocation of financial resources and the efficiency of the banking system. All administrative ceilings on bank lending rates have now been removed. While maximum lending rates to priority sectors had been set with a view to helping these sectors, there was evidence that the effect of these limits was to impede the flow of credit to these sectors and squeeze bank profits; deposit rates have been freely determined for some time, and at present exceed the minimum rates fixed by the Bank of Mauritius. With a view to mitigating the upward pressure on lending rates as a result of the liberalization, the cash ratio has been reduced from 12 per cent to 10 per cent and the interest rate on Treasury bills, which together with government stocks will now comprise 20 per cent rather than 18 per cent of the liquidity ratio, has been raised from 9.9 per cent to 11 per cent. Whereas in the past the Bank of Mauritius allocated the expansion in credit to the private sector among commercial banks on the basis of their existing loan portfolios, this policy has now been changed. Such a policy, which benefited banks that held large portfolios, stifled competition and did not provide adequate incentives to mobilize deposits. Henceforth, the Bank of Mauritius will allocate the expansion of credit among banks on the basis of banks' deposit mobilization performance as well as their lending to priority sectors. The observance of the liquidity ratio will be strictly enforced, and penalties will be promptly imposed where such observance is not adhered to.

7. Despite the deterioration in the terms of trade, the balance of payments has strengthened in recent years, owing mainly to the restrictive demand management policies pursued by the Government. In 1982/83 the external current account deficit is expected to reach 7 per cent of GDP compared with 15 per cent and 6 per cent in 1980/81 and 1981/82, respectively. The small increase in the current account deficit in 1982/83 is attributable to a recovery of imports from their depressed level of the preceding year, brought about by uncertainties associated with the national election and a relatively slow growth of exports due partly to the world recession and growing protectionism in major markets. The current account deficit will be financed mainly by drawings on project-related concessionary foreign borrowing and by purchases from the Fund; no account has been taken of disbursements under the SAL II during the current fiscal year. During

1982/83 nonconcessionary foreign borrowing in the maturity range of 1-10 years will be less than the amortization payments falling due on previously disbursed Eurodollar loans. As a result, the external debt profile has improved, and in 1983/84 the debt service burden is expected to reach about 16 per cent of exports of goods and services. The medium-term balance of payments outlook is favorable. Barring severe adverse weather conditions, we expect the external current account deficit to decline in 1983/84 to less than 6 per cent of GDP, and in the context of the first review we will discuss with the Fund staff the appropriate policies to achieve this objective.

8. With a view to minimizing fluctuations in the rupee exchange rate arising from variations in the exchange rate of major world currencies, the rupee's peg has been changed from the SDR to a basket of currencies which is more representative of Mauritius' trade pattern. While the Government believes that the balance of payments objectives can best be attained by the pursuit of restrictive fiscal, monetary, and wage policies, it will continue to adopt a flexible stance regarding the exchange rate policy. To this end, the Government will continue to keep the exchange rate under constant review and will reach understandings with the Fund staff in the context of the reviews envisaged for July 1983 and January 1984.

9. Mauritius continues to implement a liberal system of trade and payments for current international transactions. The Government emphasizes that the import licensing and quota system, currently in place, is intended to protect infant industry and is not intended for balance of payments purposes. The system has been recently further streamlined by combining the issuance of import permits and licenses and is being administered liberally. Moreover, as part of the SAL II program, the Government is examining with the World Bank the appropriateness of the system to ensure the achievement of the purposes for which it was designed.

10. We believe the policies outlined above form a package of measures which are consistent with our request for the use of Fund resources. In view of the fact that most of the period of the stand-by arrangement would fall in FY 1983/84, we propose that a first review of the program with special emphasis on the 1983/84 budget policy be held with the Fund before end-July 1983. We also propose a second review of the program with the Fund before end-January 1984. As noted above, the financial program *adopted for 1982/83 at the time of the mid-term review of the 1982 stand-by* arrangement is on track. With a view to providing further support to the achievement of the 1982/83 targets, we propose that the following performance criteria apply to the remainder of 1982/83, with criteria for 1983/84 to be established at the time of the first review of the program. Therefore, we propose that total domestic credit and net credit to the Government, which amounted, respectively, to Mau Rs 7,221 million and Mau Rs 4,760 million on December 31, 1982 and are expected to amount, respectively, to Mau Rs 7,495 million and Mau Rs 4,900 million on March 31, 1983, will be limited, respectively, to Mau Rs 7,870 million and Mau Rs 5,084 million on June 30, 1983. In regard to nonconcessionary foreign borrowing, it should be noted that so far in 1982/83 Mauritius did not contract, guarantee, or

draw down on loans in the 1-10 years maturity range. During the program period ending June 30, 1984 the Government will limit the contracting and guaranteeing of nonconcessionary loans in the 1-10 years maturity range to US$50 million; no loans in the 1-5 years maturity range will be contracted or guaranteed. Of the total amount no more than US$20 million will be drawn through June 30, 1983. During the program period, the Government will not engage in nontrade external borrowings of less than one-year maturity.

11. During the program period, the Government does not intend to introduce any multiple currency practice, or impose any new, or intensify any existing, restrictions on payments and transfers for current international transactions, or introduce any new, or intensify any existing, restrictions on imports for balance of payments reasons, or enter into any bilateral payments agreements with Fund members.

12. The Government of Mauritius believes that the policies set forth in this letter are adequate to meet the objectives of its program, but will take any further measures that may become necessary for these purposes. The Government will remain in close contact with the Fund staff, will provide the Fund with all the data necessary to monitor the program's results, and will consult with the Fund in accordance with its policies. In any case the Government will consult with the Fund before end-July 1983 and end-January 1984 in order to reach understandings on the performance criteria in respect of domestic credit, net credit to the Government, and the draw-down on nonconcessional foreign borrowing for the remaining periods of the proposed stand-by arrangement.

Very truly yours,

/s/

Indurduth Ramphul
Governor
Bank of Mauritius

/s/

Paul Raymond Bérenger
Minister of Finance

Mr. Jacques de Larosière
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.