FOR AGENDA

EBS/85/205
Correction 1

CONFIDENTIAL

September 11, 1985

To: Members of the Executive Board

From: The Secretary

Subject: Mauritius - Staff Report for the 1985 Article IV Consultation and First Review of the Stand-By Arrangement

The following corrections have been made in EBS/85/205 (8/28/85):

Page 16, 1st full para., line 4: for "May 1985" read "June 1985"

line 5: for "12.2 percent" read "12.7 percent"

line 6: for "9.0 percent" read "13.0 percent"

lines 8 and 9: for "5 percent and 2.7 percent" read "5.6 percent and 4.4 percent"

Page 30, para #2, lines 1, 5, and 9: for "August 28, 1985" read "August 23, 1985"

Page 31, Appendix I, column 6, lines 14 and 15: for "-1.9" and "-3.6" read "-5.6" and "-4.4"

Page 40, date: for "August 28, 1985" read "August 23, 1985"

Corrected pages are attached.

Att: (4)

1983, and in part to shortages of vegetables in early 1985 caused by heavy storms; the rapid credit expansion in the third quarter of 1984 was considered another possible factor. The increase in consumer prices slackened off, however, during the second quarter of 1985, and the authorities expected that prices could be held to an average increase of about 7 percent in 1985/86.

The wage settlement for 1985/86 provided for cost-of-living increases for wages and salaries averaging 5.0 percent, equal to 60 percent of the average rise (8.3 percent) in the CPI in 1984/85. Additionally, an additional 0.8 percent was held aside for possible selective end-year bonuses. Recent wage experience suggests that the rise in average wages will therefore not exceed the increase in the CPI. 1/ The wage award, as in the past several years, favored lower-paid workers; those with monthly incomes of Mau Rs 1,200 or less received increases slightly higher than the 8.3 percent increase in the CPI, while all others received only an additional Mau Rs 100 per month, leaving those in the highest salary bracket with an increase of only 1.4 percent. The authorities were concerned that this pattern of wage and salary increases had resulted in the emigration of employees with professional qualifications, and this concern underlay the sharp reductions in income tax rates announced in the new budget (see subsection 4 below).

3. External policies

The authorities believed that their policies to improve Mauritius's external competitiveness--a flexible exchange rate policy, average wage awards lower than increases in the CPI, the reduction of quantitative controls on imports, and special incentives to exporters of manufactures and certain other nontraditional goods and services--had contributed greatly to the narrowing of the current account deficit between 1980/81 and 1984/85 (Table 4, p. 8). Most of this improvement was accounted for by the growth of net EPZ exports (exports net of imports from this sector) and by the growth of other nonsugar exports, mainly tea. The Government also emphasized the importance of its promotional efforts, now centered in the recently established Mauritian Export Development and Investment Authority (MEDIA). The Government has also been active in lobbying the country's main customers for greater market access and more favorable terms. Notably, a fivefold increase was recently negotiated in the U.S. quota on shirts manufactured in Mauritius.

Sugar export receipts tend to reflect external market conditions more than annual fluctuations in production, as stocks are managed to ensure that EC and U.S. quotas are met and any excess now sold on the

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1/ The increase in average wages is pushed upward by wage drift but downward by the shift toward low-wage employment in EPZ firms.

free market has little value. In 1984/85 extremely low prices led the Syndicate to discontinue sales in the free market, with the result that total volume shipped fell even more (7 percent) than output (5 percent) and some 30,000 tons of stocks were carried over into the new fiscal year despite prospects for a good crop. Even in the protected foreign markets, realized prices declined in 1984/85 by some 3 1/2 percent in SDR terms, due to stability of ECU prices for exports to the EC and the appreciation of the SDR. Although little improvement in free-market prices was anticipated in 1985/86, the Syndicate expected that substantial sales would have to be made in that market to avoid an excessive addition to stocks. As for protected markets, Mauritius's EC quota had just been raised by some 3,000 tons, but the Syndicate did not assume that the extra shipments made in the past two years to make up other countries' shortfalls would continue; at the same time, ECU prices for 1985/86 were raised by only a little over 1 percent. U.S. quotas, meanwhile, were cut substantially, but for 1985/86 the Syndicate expects that Mauritius's quota will remain close to 26,000 tons because of a special allocation to correct for the past undercalculation of the country's entitlement. Because of these factors, a further small decline in average realized prices in SDR terms and only a modest increase in export value are projected by the Fund staff.

The Mauritian rupee was unlinked from the SDR on February 28, 1983, and linked to a basket of trading partners' currencies. Since late in that year, the Mauritian authorities have adjusted the exchange rate from time to time. Between February 1983 and June 1985 the nominal and real trade-weighted exchange rate indices depreciated by 12.7 percent and 13.0 percent, respectively, thereby reversing the real appreciation of the rupee that had occurred between September 1981, when the rupee was last devalued, and February 1983. The changes in these indices were 5.6 percent and 4.4 percent, respectively, during the course of the 1984/85 fiscal year. The authorities restated their commitment to continuing a flexible exchange rate policy as a major element of the overall strategy of strengthening Mauritius's external competitiveness.

The Mauritian representatives reported that since the removal of the last remaining import quotas on January 31, 1985, there have been no significant delays in the processing of import permits for any goods. Nevertheless, the authorities found it difficult, under a liberalized import regime, to deal with fluctuations in international payments and receipts so long as the official reserve position remained extremely weak. While the overall balance of payments for 1985/86 is projected to reach a surplus of SDR 18 million, this will be nearly matched by net repurchases to the Fund of at least SDR 16 million, so that gross official reserves will not show substantial improvement. The authorities preferred to deal with the tight reserve situation by relying on temporary use of short-term lines of credit from foreign banks rather than undertaking a new borrowing on the Eurocurrency market.

VII. Proposed Decisions

The following draft decisions are proposed for adoption by the Executive Board:

1985 Consultation

1. The Fund takes this decision in concluding the 1985 Article XIV consultation with Mauritius, in the light of the 1985 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.

Review under Stand-By Arrangement

1. Mauritius has consulted with the Fund in accordance with paragraph 4(b) of the stand-by arrangement for Mauritius (EBS/85/27, Supplement 2, March 4, 1985) in order to establish suitable performance criteria as contemplated in paragraph 11 of the letter dated December 7, 1984 from the Minister of Finance and the Governor of the Bank of Mauritius attached to the stand-by arrangement. Also by telex dated July 4, 1985 Mauritius has requested a waiver pursuant to paragraph 4 of the stand-by arrangement concerning the observance of the performance criterion on government guarantee of foreign borrowing referred to in paragraph 4(a)(iii) of the stand-by arrangement.

2. The letter dated August 23, 1985 from the Minister of Finance and the Governor of the Bank of Mauritius shall be attached to the stand-by arrangement for Mauritius, and the letter dated December 7, 1985 shall be read as modified and supplemented by the letter of August 23, 1985. Accordingly, the performance criteria on total domestic credit and net credit to the Government, and the contracting and guaranteeing of nonconcessional foreign borrowing referred to in paragraph 4(a) of the stand-by arrangement shall be those specified in paragraph 16 of the letter of August 23, 1985.

3. The Fund finds that, notwithstanding the nonobservance of the performance criterion on government guarantees of foreign borrowing, no further understandings are necessary, and that Mauritius may proceed to make purchases under the stand-by arrangement.

Mauritius: Selected Economic and Financial Indicators, 1980/81-1985/86

Fiscal years (July-June)	1980/81	1981/82	1982/83	1983/84	1984/85 Program	1984/85 Prov. Actual	1985/86 Program
	(Annual percentage changes, unless otherwise specified)						
National income and prices, and employment							
GDP at constant market prices 1/	-5.9	4.8	5.0	1.1	2.9	4.2	5.7
Nonsugar GDP at constant factor cost	0.7	2.7	3.0	4.4	4.0	4.8	4.3
GDP deflator 1/	16.6	11.8	7.7	8.8	8.8	7.6	6.0
Consumer prices (average)	26.5	13.4	7.5	5.6	9.5	8.3	7.0
Employment (larger establishments)	-1.2	-0.4	-1.4	--	...	4.7	...
Unemployment rate (percent, end-FY)	12.7	14.7	17.2	17.2	...	17.0	...
External sector (in terms of SDRs)							
Exports, f.o.b.	-8.0	16.3	-5.1	12.6	2.5	4.7	12.4
Imports, c.i.f.	10.2	-13.7	-3.5	4.3	1.6	3.2	9.6
Non-oil imports, c.i.f.	10.8	-18.3	-3.7	8.3	1.9	3.8	13.5
Terms of trade (deterioration -)	-6.4	-4.5	3.6	3.4	2.0	-4.3	-1.0
Effective exchange rates 2/							
Nominal	-6.0	-8.3	0.7	-4.1	-6.5	-5.6	...
Real	7.8	-5.9	1.1	-4.7	-2.5	-4.4	...
Government budget							
Revenue	13.7	7.9	26.2	9.5	9.1	8.1	9.9
Total expenditure and net lending	24.3	9.2	8.4	-0.1	9.1	10.0	10.1
Money and credit 3/							
Domestic credit	19.8	14.3	19.4	15.5	5.9	5.2	11.0
Government (net)	20.5	15.0	26.1	14.3	-1.6	-2.2	7.2
Private sector	18.9	13.4	10.0	17.5	17.5	16.6	15.8
Money and quasi-money	8.6	18.0	20.9	7.8	13.9	16.5	15.0
Interest rate (annual rate - one-year time deposit)	10.0	12.25	12.0	10.25	10.5	10.5	10.5
	(In percent of GDP at market prices, as revised)						
Central government budget							
Savings (current balance)	-4.3	-5.6	-3.3	-2.0	-1.9	-2.0	-0.8
Overall deficit (-)							
Excluding grants	-14.2	-13.5	-9.7	-6.7	-6.6	-7.0	-6.9
Including grants	-14.0	-12.8	-9.5	-6.4	-5.9	-6.0	-5.3
Domestic bank financing	5.4	4.0	7.1	4.6	-1.3	-1.6	1.2
External financing (net)	7.7	7.4	-1.4	-1.0	4.8	4.6	1.2
Gross domestic investment 3/	23.0	21.7	17.7	18.9	18.7	20.3	...
Gross domestic savings 3/	12.6	15.1	16.2	17.5	18.0	19.3	...
External current account deficit (-) 4/							
Excluding transfers	-17.6	-7.9	-7.7	-4.6	-5.3	-5.0	-4.3
Including transfers	-15.5	-5.7	-5.2	-2.5	-2.8	-2.5	-0.9
External debt (year-end) 4/							
Excluding Fund credit	30.1	37.6	34.1	33.7	40.0	39.2	39.6
Including Fund credit	42.5	52.1	49.5	50.4	54.4	54.4	52.6
	(In units indicated)						
Debt service ratio (percent) 4/	15.8	14.7	21.7	24.1	28.2	26.3	22.7
Interest payments	9.3	9.2	9.8	7.9	9.9	8.4	8.1
Overall balance of payments (in millions of SDRs) (deficit -)	-60.0	-9.0	-28.0	-28.0	30.0	18.0	18.0
Gross central bank reserves (in months of imports)	0.7	1.1	1.0	0.5	0.6	0.5	0.5
Memo: GDP at current market prices (in millions of Mauritian rupees)	9,236	10,818	12,242	13,470	15,070	15,090	16,900

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

1/ Sugar crops and milling included in fiscal year harvested; otherwise averages of calendar-year data.
2/ Trade-weighted annual averages of end-of-month rates; negative indicates depreciation.
3/ Based on averages of calendar year data.
4/ Including the Fund.

Mauritius: Assumptions Underlying Medium-Term Balance of Payments and External Debt Service Projections

(Prices and Values in SDRs)

I. Current Account

1. Sugar. A crop of 660,000 tons is projected in 1985/86 and crops averaging 625,000 tons thereafter. Quotas at 505,000 tons in the EC and 26,000 tons in the United States prevail throughout the period. Prices in the EC rise at 6 percent in 1985/86 and 4 1/2 percent thereafter, reflecting *World Economic Outlook* assumptions with regard to depreciation of the U.S. dollar vis-à-vis European currencies. World market prices in 1986/87 and beyond are assumed to remain roughly constant at the average of 1983-84. Sugar prices in the protected U.S. market are projected to fall 1 percent per year.

2. EPZ. In 1985/86 EPZ exports are projected to rise by 22 percent while imports rise 19 percent. In later years the values of exports and imports are both assumed to rise at 10 percent per annum (of which 4 percentage points are accounted for by the WEO-assumed rise in world prices of manufactures).

3. Other exports. These are projected to rise by 8.6 percent in 1985/86 and 6 percent thereafter. Prices are projected to rise by 4 percent and volume by 2 percent.

4. Petroleum. Based on contracts already signed, it is projected that imports of petroleum will fall by 7 percent in 1985/86. In the year thereafter, imports are projected to increase 3 percent in volume terms--in line with the growth in GDP--and zero percent in prices. This price assumption reflects recent developments in the world oil market and the WEO's assumption that the U.S. dollar will depreciate against the SDR.

5. Rice and flour. Values of rice and flour imports are projected to increase by 5.5 percent. This is explained by an assumed 4 percent increase in price and 1.5 percent increase in volume--the projected rate of population growth.

6. Other imports. Other imports are projected to rise by 7 percent after rising 12 percent in 1985/86. The 7 percent figure comprises a 3 percent real increase in line with real GDP growth and a 4 percent price increase in line with world trade prices.

7. Investment income. This item consists primarily of interest payments and receipts. It is assumed that LIBOR will be at 9 percent during the projection period and that the Bank of Mauritius will earn

Mauritius--Status of Bank Group Operations

(As of June 30, 1985)

A. Bank Loans and IDA Credits

Loan or Credit Number	Year	Borrower	Purpose	US$ millions Amount (less cancellations) 1/ Bank	IDA	Undisbursed
Ten Loans and Five Credits fully disbursed				96.46	20.42	--
Of which: SAL I and SAL II				(55.00)		--
1543	1978	Mauritius	Second Education	15.20		4.26
1548	1978	Mauritius	Second Power	14.85		5.11
1789	1980	DBM	Development Bank V	5.59		2.86
1926	1981	Mauritius	Urban Rehabilitation and Development	15.00		6.28
2164	1982	DBM	Development Bank VI	6.00		5.14
2229	1983	Mauritius	Water Supply	12.20		10.09
2337	1983	Mauritius	Highways	15.20		14.95
2362	1983	Mauritius	Technical Assistance	5.00		4.79
Total				184.50	20.42	53.48
Less: Repaid				18.56	.52	--
Total now outstanding				165.94	19.90	--
Less: Sold				4.95	--	--
Of which: repaid				(4.95)	(--)	(--)
Total outstanding to Bank and IDA				160.99	19.90	53.48

B. IFC Investments

Year	Type of Business	Loan	Equity	Total
1971	Tourism	0.6	--	0.6
Total gross commitment		0.6	--	0.6
Less: cancellations, terminations, repayments and sales		0.56		0.56
Net held by IFC		0.04		0.04
Total undisbursed		--	--	--

Source: IBRD.

1/ Prior to exchange adjustments.

Port Louis, Mauritius

August 23, 1985

Mr. J. de Larosière
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. de Larosière:

1. In our letter of December 7, 1984 we outlined the targets and the policies to be pursued in fiscal year 1984/85 (July/June), during the last six months of which the program supported by the current 18-month stand-by arrangement was initiated. In this letter we review developments during the fiscal year just ending and describe the policies to be taken during 1985/86, the remainder of the program period.

2. The encouraging upturn in economic growth that had begun to appear in the previous two years strengthened in 1984/85. It was chiefly accounted for by increases in the output of Export Processing Zone (EPZ) industries and nonsugar agriculture, both areas where growth makes an especially strong contribution to external adjustment. Real GDP has risen by an estimated 4 percent, despite a poor sugar crop in 1984 (for the second year in a row), with nonsugar GDP alone increasing by 4.8 percent as compared with a program assumption of 4.0 percent. As expected, there was also some upturn in domestic inflation, due mainly to import price developments, but the estimated 8.3 percent rise in average consumer prices was considerably below the 9.5 percent forecast, and by year-end it appeared to be slowing. In line with our tight incomes policy, cost-of-living increases of wages were again held below the rise in the consumer price index. A particularly heartening sign was the rapid increase in manufacturing employment, due chiefly to the expansion in the size and number of manufacturing firms in the EPZ, which more than fully offset continuing job losses in sugar and other sectors. Private investment has also turned up substantially, and foreign investment is assuming increased significance.

3. While the sugar crop to be harvested in 1985 now appears to be a good one, the financial difficulties of the sugar sector still constitute a major economic problem--a matter described at some length in our previous letter to you. In that letter, we stated our intentions with respect to the first measures to be taken under a program of structural improvement in the sugar sector. These measures have now been taken. Legislation was enacted in March 1985 to rationalize the export duty on sugar, and to