FOR AGENDA

EBS/85/205
Correction 2

CONFIDENTIAL

September 17, 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 43, Para #11, line 5: for "coming fiscal" read "current fiscal"

line 7: for "initially hoped" read "might have been hoped"

Page 47: line 1 added

The following correction has been made in EBS/85/205, Correction 1 (9/11/85):

Page 40, Para #1, line 5: for "just ending" read "just ended"

Corrected pages are attached.

Att: (3)

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 ended 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

in the transparency and uniformity of sugar companies' accounts, and an industry-wide revaluation of their assets with a view to ensuring reliability and credibility. If, upon examination of these data and further analysis in consultation with the World Bank, it becomes evident that further measures need to be taken to provide for adequate investment in the sugar industry, we will act accordingly so as to ensure that production and exports are maintained. Meanwhile, although we continue to aim at ensuring an average sugar crop of 650,000 tons a year, we are actively promoting agricultural diversification so as to increase self-sufficiency in noncereal foodcrops and promote nonsugar agricultural exports. A key element in a thus-far successful program has been the stabilization of producer prices for certain crops with only limited subsidies that are terminated as production becomes profitable on its own. We have also recently greatly strengthened our tea industry, transforming parastatal employees into independent smallholders and raising production capacity.

10. The impressive growth in EPZ activity that has taken place since 1983 reflects the impact of policies carried out by the Government under the last five stand-by arrangements. These policies include: a flexible exchange rate policy, geared to an improvement in external competitiveness; cost-of-living settlements that have led average earnings to rise more slowly than domestic prices; the special fiscal incentives extended to the EPZ; priority given to productive activities in the extension of commercial bank credit, as regards both the availability and the terms of such credit; export and investment promotion missions abroad; and complementary investment undertaken by the Government, such as the construction of new industrial sites. The Government will maintain all these policies during 1985/86. In particular, a flexible exchange rate policy will be aimed at continued improvement in the international competitiveness of the Mauritian economy. In addition, the recent agreement governing wage settlements in 1985/86 will limit the total of cost-of-living increases and year-end bonuses to an average of 5.8 percent, corresponding to 70 percent of the average increase in the cost of living during the previous fiscal year. These measures not only serve to stimulate the further growth of the EPZ but also to help ameliorate the financial condition of the sugar industry and encourage other export activities, as well as import substitution.

11. As a result of the measures just enumerated and the financial policies described below, the external current account deficit is expected to decline from SDR 25 million in 1984/85 to SDR 9 million in 1985/86, and an overall balance of payments surplus of SDR 18 million is projected for the current fiscal year. Despite a 22 percent growth in EPZ exports and lower costs for petroleum imports, this overall result is less favorable than might have been hoped because, inter alia, of a disappointingly small inflow of concessional assistance. Gross international reserves of the Bank of Mauritius, which were projected at an amount equivalent to only two weeks' imports by the end of June 1985, are projected to rise slightly, enough to keep them at the equivalent of two weeks' imports by the end of 1985/86. Because an uninterrupted flow of imports has become crucial to

Mauritius's export drive, and foreign exchange receipts are subject to wide fluctuations, the Bank of Mauritius has found it increasingly necessary to resort to temporary use of short-term lines of foreign bank credit in order to maintain a liberalized import system. In view of these difficulties, the Bank of Mauritius will seek to enlarge these lines of credit to US$40 million.

12. With respect to government finances, the budget for 1985/86 will ensure a further reduction in the overall deficit to no more than 5.3 percent of GDP, despite major initiatives to promote vigorous and sustained economic growth. On the revenue side, following last year's reduction in corporate tax rates and elimination of the dividend exclusion, we have substantially widened the brackets and reduced to 35 percent the highest marginal rate of the individual income tax, which previously reached 70 percent on taxable incomes over Mau Rs 91,000 (equivalent to some SDR 5,700) per year. In so doing, we expect to greatly increase incentives for work and saving, while sharply reducing those for tax evasion. This measure will be accompanied by a substantial and well-publicized step-up in enforcement, concentrated on current obligations. As a result, we expect the revenue loss to be limited to Mau Rs 90 million, or 2.7 percent of total 1984/85 revenues. A plan for the rationalization and gradual reduction of import tariffs is presently being formulated, in close collaboration with the World Bank as regards industrial policy, and subject to the aim of protecting government revenues. To these ends, we intend to lower some exceptionally high tariff rates by January 1986, offsetting any revenue losses with increases for lightly dutied inputs and equipment or with other tax measures; and we expect to present the above described plan for tariff reform by February 1986. In order to limit the 1985/86 overall budget deficit to the above-mentioned target, the stamp duty on imports was increased from 13.2 percent to 17 percent, as a result of which additional revenue of Mau Rs 140 million is expected. The Government is conscious of the heavy dependence of the budget on taxes on international trade and transactions. We will examine with the Fund, on the occasion of the second review, this situation, and consider the possible options available to reduce this heavy dependence of the budget on one sector. We will also continue with the ongoing program of improvements in tax administration, including, if necessary, amendments to the Unified Revenue Act to strengthen the Board's administrative powers. Meanwhile, additional staff are being provided to strengthen enforcement of income and sales tax collections.

13. With respect to government expenditure, it is our firm intention to continue the policy of stringency in recurrent spending while endeavoring to permit a long-overdue upturn in essential capital expenditures. To ensure that the latter no longer bear the brunt of further adjustment in the overall deficit, and despite the burden already imposed on our people by a necessary but long and difficult period of adjustment, we

only for reserve management purposes on a temporary basis; such borrowing will not exceed US$40 million at any time during this period and the average of the daily amounts outstanding shall not exceed US$30 million during any three consecutive calendar months. These limits will be reviewed at the time of the second review of the program.

17. The Government of Mauritius believes that the policies and measures 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 information necessary to monitor the program's results, and will consult with the Fund in accordance with the policies of the Fund.

Very truly yours,

/s/

Indurduth Ramphul
Governor
Bank of Mauritius

/s/

Seetanah Lutchmeenaraidoo
Minister of Finance

Mauritius--Statistical Issues

1. Outstanding statistical issues

a. Government finance

Data in the 1984 Government Finance Statistics Yearbook cover the period 1974-83 and relate to the transactions of the budgetary central government only. The reply to the 1985 questionnaire has already been received with data for 1984 for publication in the next issue of the Yearbook. The possibility of obtaining data for extrabudgetary units in order to enable the publication of consolidated central government data was explored during the present consultation mission and, in view of the long time lags in the availability of data, a technical assistance mission would be useful.

b. Monetary accounts

Some differences between the data reported by the Bank of Mauritius for publication in IFS and those received by the African Department, for program monitoring, cannot be fully identified on the basis of the available data breakdown. The main problems are: (a) the classification and sectorization of "other assets/liabilities" components, in order to reduce their relative importance in the Bank of Mauritius's balance sheets; (b) the valuation procedures for foreign assets/liabilities in these balance sheets; (c) the revision of the IMF accounts; and (d) the appropriate treatment of bankers' acceptances in the commercial banks' balance sheets. There is room for improvement in the current procedures for compiling the data and a technical assistance mission in this field should also be considered.

2. Coverage, currentness, and reporting of data in IFS

The table below shows the currentness and coverage of data published in the country page for Mauritius in the August 1985 issue of IFS. The data are based on reports sent to the Fund's Bureau of Statistics by the Bank of Mauritius, which during the past year have been provided on a timely basis.