

DOCUMENT OF INTERNATIONAL MONETARY FUND  
AND NOT FOR PUBLIC USE

**FOR  
AGENDA**

EBS/81/236

CONFIDENTIAL

December 7, 1981

To: Members of the Executive Board

From: The Secretary

Subject: Mauritius - Request for Stand-By Arrangement and Approval of  
Multiple Currency Practice

Attached for consideration by the Executive Directors is a paper on a request from Mauritius for a stand-by arrangement equivalent to SDR 30 million, together with Mauritius' request for approval of multiple currency practice. A draft decision appears on page 26.

It is proposed that this subject be brought to the agenda of a meeting scheduled for Monday, December 21, 1981.

Att: (1)



INTERNATIONAL MONETARY FUND

Mauritius--Request for Stand-By Arrangement and  
Approval of Multiple Currency Practice

Prepared by the African Department and the  
Exchange and Trade Relations Department 1/

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

Approved by J.B. Zulu and S. Kanesa-Thasan

December 7, 1981

I. Introduction

In the attached letter dated December 5, 1981, the Government of Mauritius requests a stand-by arrangement for a period of one year, in an amount equivalent to SDR 30 million, representing 74.1 per cent of the quota of SDR 40.5 million. Of this amount, SDR 16.72 million would be from the Fund's ordinary resources, and SDR 13.28 million from the enlarged access resources. The Fund's holdings of Mauritian rupees 2/ (as of October 31, 1981) amounted to SDR 160.74 million or 396.9 per cent of quota; excluding the purchases under the compensatory financing facility (SDR 40.5 million), the Fund's holdings totaled SDR 120.24 million (296.9 per cent of quota), of which SDR 55.95 million represented purchases under the supplementary financing facility.

The proposed stand-by arrangement, if fully utilized, would increase the Fund's holdings of rupees to 471.0 per cent of quota (or 371.0 per cent of quota excluding holdings under compensatory financing facility), of which 138.2 per cent of quota would be in respect of supplementary resources and 32.8 per cent would be in respect of enlarged access resources. This arrangement would represent the fourth use of Fund resources since 1978, and proposed phasing, as well as scheduled repurchases, is summarized in Table 1. To date, Mauritius has received five IDA credits and 12 IBRD loans, totaling US\$135.5 million. In October 1980 the Bank, in close

---

1/ Discussions that provided the basis for the proposed stand-by arrangement were held in Port Louis during September 7-14, Washington, September 24-October 6, and concluded in Port Louis, October 21-November 2. The staff team comprised Mr. Bhatia (head) and Ms. Puckahtikom of the African Department, Ms. Tseng (ETR), and Mrs. Tighe (secretary-TRE).

2/ Mau Rs 12.0 = SDR 1, except for imports of rice and flour to which the rate Mau Rs 10.0 = SDR 1 is applicable. Hereafter, rupees refer to Mauritian rupees and will be abbreviated to Rs.

Table 1. Mauritius: Proposed Purchases and Repurchases  
During the Stand-By Arrangement, December 1981-December 1982

(In millions of SDRs; during period)

	Dec. 1981- Mar. 9, 1982	Mar. 10- June 9, 1982	June 10- Sept. 9, 1982	Sept. 10- Dec. 1982	Total
Proposed purchases	<u>7.50</u>	<u>12.99</u>	<u>7.50</u>	<u>7.50</u>	<u>35.49</u>
Stand-by arrangement	7.50	7.50	7.50	7.50	30.00 <sup>1</sup>
Ordinary resources	(7.50)	(7.50)	(1.72)	(--)	(16.72)
Enlarged access resources	(--)	(--)	(5.78)	(7.50)	(13.28)
Reserve tranche	--	5.49	--	--	5.49
Repurchases	--	<u>5.49</u>	--	--	<u>5.49</u>
Reserve tranche	(--)	(5.49)	--	--	(5.49)
Net purchases	7.50	7.50	7.50	7.50	30.00
Total Fund holdings (cumulative, end of period)	168.24	175.74	183.24	190.74	...
In per cent of quota					
Total holdings	(415.41)	(433.92)	(452.44)	(470.96)	(...)
Holdings excluding CFF	(315.41)	(333.92)	(352.44)	(370.96)	(...)

Source: Staff estimates.

cooperation with the Fund, organized a Consultative Group of potential donors. In April 1981 Mauritius obtained from the World Bank a structural adjustment loan of \$15 million; for that purpose it agreed with the Bank on an investment program and on other medium-term targets and policies. The Fund cooperated actively with the Bank in these discussions.

A multiple currency practice was introduced by the Government of Mauritius on September 27, 1981 for which the Government seeks Fund approval on a temporary basis. A decision to approve the practice is proposed in this paper.

The proposed stand-by arrangement is a continuation of the stabilization efforts launched in late 1979 and an overall view of the adjustment effort is provided in Section II. Economic developments and performance during the period of the last stand-by arrangement that expired on September 4, 1981, are reviewed in Section III. The context and the principal elements of the stabilization program for 1981/82, in support of which the Mauritian authorities have requested a new stand-by arrangement, as described in Section IV, while the staff appraisal and decisions for consideration of the Executive Board are contained in Section V.

## II. Background--An Overall View of the Adjustment Effort 1/

Since late 1979 the Government of Mauritius has been engaged in implementing a serious adjustment effort which has been supported by two stand-by arrangements from the Fund. However, weather has not been kind to the country, which has suffered a serious cyclone in the 1980/81 sugar crop season and a drought in the following season. Nor have external economic developments been helpful; Mauritius has experienced an 18 per cent decline in the terms of trade since mid-1979. As a result and notwithstanding the stabilization effort, the financial situation continues to be precarious.

The 1979 program was launched in the wake of a deteriorating balance of payments which had been transformed from a peak surplus of SDR 52 million in 1974 to a deficit of SDR 50 million in 1978 and in recognition of the prospects of further increasing deficits in the following years. This adverse transformation reflected the Government's expansionary policies induced by the sugar boom of the mid-1970s. These policies allowed an estimated 30 per cent increase in real wages between 1974 and 1979, provided budgetary subsidies on basic consumer goods reaching 3 per cent of GDP by 1978/79 and resulted in overall budgetary deficit rising to 16 per

---

1/ Background to the Mauritian economic position was detailed in the staff report on the 1980 Article IV consultation discussions (SM/81/58, 3/16/81), and in the report on recent economic developments (SM/81/79, 4/8/81).

cent of GDP by 1978/79. The resulting cost-push pressures made Mauritian exports noncompetitive, the effects of which were particularly deleterious for the export processing zone (EPZ) sector.

In the circumstances, the initial strategy of the stabilization program, supported by a two-year stand-by arrangement, was to restore the competitiveness of the export sector, to force a reduction in private consumption through appropriate pricing, interest, and wage policies, and to reduce the overall government deficit. To this end, the rupee was devalued by 23 per cent in October 1979 and the ratio of subsidies to import costs of the subsidized products was brought down from 60 per cent in mid-1979 to 38 per cent by mid-1981. Real wages sustained a decline of 25 per cent in the two fiscal years 1979/80 and 1980/81, the ratio in government expenditure to GDP was brought down from 40.5 per cent in 1978/79 to 38.8 per cent in 1980/81, and the domestic demand at constant prices was reduced by almost 10 percentage points.

It was assumed that two years of stabilization efforts would provide a firm basis for an EFF type of program with the Fund. However, soon after the introduction of the stabilization program, a series of cyclones hit the island destroying about one third of the sugar crop and causing other serious damage to production and property. In view of this, the two-year stand-by arrangement from the Fund was replaced by a one-year arrangement which expired on September 4, 1981. Subsequent recovery in the current crop year was also only partial because of a drought. In addition to these weather vagaries, results from the stabilization policies were compromised by unanticipated external price and exchange rate developments. In early 1980 oil prices nearly doubled and in 1981 the appreciation of the dollar and the relative depreciation of European currencies produced a worsening of the terms of trade for Mauritius <sup>1/</sup> and, as explained below, created further serious difficulties for the sugar industry.

These developments have set back in time the achievement of the goals of the stabilization policies and the date at which an EFF-type program could be introduced. The proposed new arrangement is to be regarded as a continuation of the earlier stabilization efforts, and the program supported by it includes policies introduced in May 1981 as part of the budget for the current fiscal year (July-June). The Government of Mauritius has been in frequent contact with the Fund staff and its budget proposals for 1981/82 had been discussed in detail prior to their introduction to ensure that they could be consistent with continuing Fund support. Thus, the policies introduced in mid-1981 provided the basis for the program for the period of the proposed arrangement.

---

<sup>1/</sup> Most exports, especially sugar, are denominated in European currencies while imports, especially oil, are principally quoted in U.S. dollars.

### III. Developments and Performance Under the 1980/81 Stand-By Arrangement

On September 5, 1980 the Executive Board approved a one-year stand-by arrangement in the upper credit tranche with Mauritius in an amount of SDR 35 million (EBS/80/183). This arrangement replaced an earlier two-year arrangement that had become inappropriate mainly because of the cyclones in late 1979 and early 1980 which made the underlying assumptions of the program largely irrelevant. The program attempted to avoid exacerbating the depressing effects of the cyclones, while maintaining the effort toward adjustment. The objectives were to limit the current account deficit in FY 1980/81 (July-June) to SDR 118 million (14.5 per cent of GDP), and the overall balance of payments deficit to SDR 75 million, compared with the deficits of SDR 88 million (11.6 per cent of GDP) and SDR 58 million, respectively, during FY 1979/80. These targets were predicated on the assumptions that the sugar crop would be 525,000 tons (i.e., a 25 per cent shortfall, equivalent of SDR 100 million in exports, from the normal crop of 700,000 tons), and that the decline in real GDP would be limited to 4 per cent; domestic inflation was targeted to decelerate to 18 per cent (Table 2). To achieve these targets, the main instruments were a further reduction in consumer subsidies, a continuing restrictive wage policy, a containment of the fiscal deficit through limiting the growth of expenditure as well as raising revenues, and a relatively tight credit policy. Performance criteria comprised quarterly limits on (a) domestic credit to the economy, (b) net domestic credit to the Government, and (c) net external borrowing.

Performance under the arrangement was broadly satisfactory as all the policy measures were implemented as envisaged and performance criteria fully observed (Table 3); Mauritius purchased the entire amount available under the arrangement. On the wage front, in keeping with the policy adopted since 1978, the Government granted in July 1980 an average wage increase of 9.5 per cent for the public sector and 10.5 per cent for the private sector, thus compensating for only one half of the increase during the preceding 12 months in the cost of living (that was not attributable to the devaluation in 1979 when the devaluation impact on the COL was partially compensated for in advance). To complement the wage policy, the authorities also made further progress toward reducing food subsidies. In July 1980 the Government announced increases (averaging 50 per cent) in the retail prices of rice and flour, thereby reducing the effective subsidy element to an estimated 38 per cent of the average cost, and tripling the retail prices of these staples in a period of less than one year (Table 4). Domestic retail price of sugar was also doubled in order to increase export availability. As a result of these movements in nominal wages and prices, real monthly earnings declined in FY 1980/81 by 12 per cent, following a cut of 13 per cent in the previous year (Table 1).

Table 2. Mauritius: Selected Economic and Financial Indicators, 1978/79-1981/82

	1978/79	1979/80	1980/81		1981/82
		Est.	Program	Est.	Program
<u>National income and prices</u>					
	(Annual per cent changes)				
GDP at constant prices	4.0	3.0	-4.0	-7.0	5.0
Domestic demand at					
constant prices	2.5	-4.9	-4.0	-4.8	-4.0
GDP at current prices	13.5	26.5	14.0	15.0	24-26
GDP deflator	8.9	23.0	18.0	24.0	18-20
Consumer prices	8.0	32.6	18.0	28.2	25.0
Wages: nominal	11.0	17.0	10.9	13.5	17.0
real	(2.5)	(-13.0)	(-5.6)	(-12.0)	(-7.0)
<u>External trade 1/</u>					
Exports, f.o.b.	7.9	12.3	-5.4	-9.7	14.2
Imports, c.i.f.	6.1	12.1	2.8	8.2	0.6
Export prices	6.4	7.8	11.0	9.6	2.4
Import prices	13.3	27.2	10.0	12.7	10.8
Terms of trade	-5.9	-15.3	1.0	-2.8	-7.6
<u>Government budget</u>					
Revenue and grants	15.0	27.4	17.4	13.3	22.8
Expenditure	20.5	27.5	13.8	10.8	18.1
Overall deficit	30.3	27.8	6.0	6.8	10.4
<u>Money and credit</u>					
Domestic credit	29.0	26.5	30.2 2/	28.6 2/	20.7 2/
Government	(37.4)	(38.6)	(41.4) 2/	(36.1) 2/	(21.5) 2/
Private sector	(21.1)	(13.6)	(15.6)	(18.9)	(19.5)
Money and quasi-money (M2)	18.8	14.3	14.0-16.0	8.6	12.3
Velocity (ratio of GDP					
relative to M2)	2.05	2.27	2.27	2.41	2.65
Interest rate (annual rate					
12-month saving deposits)	8.5	10.0	10.0	10.0	...
(In per cent of GDP)					
Revenue	24.7	24.8	25.7	24.2	23.7
Expenditure	40.5	40.8	40.9	38.8	36.7
Overall budgetary deficit	15.8	16.0	15.2	14.7	12.9
Current account deficit	10.9	10.5	14.5	16.1	12.8
External debt	21.6	25.3	31.5	32.1	35.6
Inclusive of use of Fund					
credit	(26.5)	(33.0)	(44.3)	(45.8)	(49.5)
Debt service ratio (service					
payments in per cent of					
exports of goods and					
services) 3/	5.0	8.0	11.0	13.0	14.2

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

1/ Staff estimates; in terms of SDRs.

2/ Inclusive of budgetary use of nonproject external loans.

3/ Inclusive of Fund obligations.



Table 3. Mauritius: Quantitative Performance Criteria Under the 1980/81 Program

(End of period)

	1980		1981	
	Sept.	Dec.	March	June
(In millions of rupees)				
Credit to the economy <u>1/</u>				
program ceiling	4,690	5,110	5,090	5,425
Actual	4,230	4,618	4,723	5,283
Credit to Government (net) <u>2/</u>				
Program ceiling	2,670	3,060	3,020	3,333
Actual	2,441	2,751	2,744	3,208
(In millions of SDRs)				
Net external borrowing (cumulative) <u>3/</u>				
Program ceiling	45	45	45	45
Actual <u>4/</u>	--	35	35	35
(In millions of rupees)				
Memorandum items:				
Operative ceilings <u>5/</u>				
Credit to the economy <u>1/</u>	4,640	5,010	4,940	5,325
Credit to the Government (net) <u>2/</u>	2,620	2,960	2,870	3,233

Sources: EBS/80/183, 8/22/80; and data provided by the Mauritian authorities.

1/ Defined as credit to Government (net) and credit extended by the banking system to the private sector with the exception of credit granted against nonsugar export bills and commercial bank loans refinanced by the Development Bank of Mauritius.

2/ Defined as credit to the Government from the banking system less government deposits plus any budgetary use of new nonconcessional loans of 1-10 years' maturity.

3/ Defined as new external borrowing on nonconcessionary terms contracted or guaranteed by the Government of 1-10 years' original maturity.

4/ Converted at end-December 1980 rate of US\$1.27 = SDR 1.

5/ Formed the operational basis for the authorities and if exceeded the authorities proposed to consult with the Managing Director of the Fund.

Table 4. Mauritius: Selected Retail Prices, 1978-81

(Prices in effect at July)

	1978	1979	1980	1981
Rice <u>1/</u> (rupees per pound)	0.36	0.36 <u>2/</u>	1.00	1.00
Flour <u>1/</u> (rupees per pound)	0.30	0.30 <u>2/</u>	0.90	0.90
Sugar <u>1/</u> (rupees per pound)	0.19	0.40	0.84	1.05
Petrol (rupees per gallon) (premium gasoline)	9.45	15.00	25.00	30.00 <u>3/</u>

Source: Data provided by the Mauritian authorities.

1/ These are controlled prices.

2/ These prices were raised in October 1979 to Rs 0.70 per pound for rice and Rs 0.58 per pound for flour.

3/ Before the latest cost increase following the depreciation in September 1981. In October, the price of petrol was raised to Rs 32.50 per gallon.

Fiscal performance was also generally in accordance with the program's targets. The 1980/81 budget had introduced several discretionary revenue measures estimated to yield Rs 150 million or about 2 per cent of GDP. These measures included a 10 per cent surcharge on all taxes, fees, etc., with a few exceptions, principally the personal income tax and the sugar export duty; an increase in the import stamp duty from 2 per cent to 5 per cent; and a reintroduction of import duties on a number of food imports. The budget also provided for a 14 per cent increase in expenditures (compared to a 17 per cent increase in revenues and grants), implying a 4 per cent cut in real terms. The expenditure economies were attributable to the limiting of the increases in wage and salary costs and in food subsidies. Provisional estimates indicate that the overall budget deficit for the year was Rs 1,290 million (14.7 per cent of GDP), compared with the program target of Rs 1,280 million; domestic bank financing was held down to Rs 850 million compared with the programmed requirement of Rs 867 million (Table 5). As a proportion of GDP the overall budget deficit declined by 1.3 percentage points from that reached in the previous year. This outcome was achieved despite some revenue shortfalls and mainly reflected the Government's success in maintaining controllable recurrent spending to the

Table 5. Mauritius: Central Government Operations, 1978/79-1981/82 1/

(In millions of rupees)

	1978/79	1979/80 Prov.	1980/81		1981/82	
			Program	Actual	Revised Budget <u>2/</u>	Program
Revenue and grants <u>3/ 4/</u>	1,472	1,876	2,162	2,126	2,386	2,611
Revenue	1,471	1,874	2,160	2,112	2,355	2,574
Grants	1	2	2	14	31	37
Total expenditure and net lending	2,417	3,084	3,442	3,416	4,036	4,035
Recurrent expenditure <u>3/</u>	1,779	2,002	2,238	2,378	2,811	2,810
Of which: food subsidies	(178)	(221)	(173)	(203)	(236)	(236)
Capital expenditure and net lending	638	1,082	1,204	1,038	1,225	1,225
Overall deficit	-945	-1,208	-1,280	-1,290	-1,650	-1,424
External financing (net)	<u>148</u>	<u>351</u>	<u>400</u>	<u>344</u>	<u>622</u>	<u>669</u>
External borrowing	168	414	511	443	746	823
Amortization	-20	-63	-111	-99	-124	-154
Domestic financing (net) <u>5/</u>	<u>757</u>	<u>857</u>	<u>880</u>	<u>946</u>	<u>1,028</u>	<u>755</u>
Banking system <u>5/</u>	697	776	867	850	933	690
Of which: Eurodollar loan	(216)	(119)	(...)	(354)	(...)	(...)
Nonbank	60	81	13	96	95	65
(As per cent of GDP)						
Revenue and grants	24.7	24.8	25.7	24.2	...	23.7
Total expenditure and net lending	40.5	40.8	40.9	38.8	...	36.7
Overall deficit	15.8	16.0	15.2	14.7	...	12.9

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

1/ Adjusted to cash basis.

2/ Prior to the September 1981 measures.

3/ Includes gross operating receipts and expenditures of departmental enterprises.

4/ Social security contributions accruing to the National Pension Fund which have been collected since July 1978 are not included in revenue but the surpluses of the Fund are invested in government securities and represent nonbank financing.

5/ Includes budgetary use of local currency counterpart of nonconcessional foreign borrowing undertaken during the fiscal year.

budget level combined with a slowing in capital expenditures. The shortfalls in revenue occurred on account of lower sugar export duty due to a larger-than-assumed shortfall in the sugar crop, and lower import duties due to a larger-than-projected reduction in the effective collection rate (caused by a shift in import composition due to the 1979 devaluation). In line with the shortfall in capital expenditures, foreign financing was smaller than budgeted but recourse to bank financing was contained by larger nonbank financing.

Credit developments during the program period also conformed to the program targets, reflecting the fiscal performance and the effective restraint on private sector credit. The credit limits in the program were designed under exceptional uncertainty regarding the full economic impact of the cyclones, and consequently the performance criteria had provided a margin for forecasting errors. However, a lower set of limits was also provided as the operative ceilings, which if exceeded would trigger consultation with the Managing Director of the Fund. Actual credit developments remained below even the operative ceilings (Table 3). Domestic credit expansion during FY 1980/81 amounted to 29 per cent compared with the programmed ceiling of 30 per cent. Moreover, the pace of credit expansion during the first half of the financial year was more moderate than expected owing to the temporary liquidity of the sugar industry--a situation that reflected the advance receipt of the insurance compensation for cyclone damage combined with an accelerated flow of export receipts because of the improved efficiency of the new bulk terminal at the port. The rate of monetary expansion, at 9 per cent, was slower than envisaged, but there was a larger loss in net foreign assets of the banking system, i.e., Rs 981 million compared with the projections of Rs 750 million (Table 6).

The larger-than-expected loss of foreign assets occurred despite a satisfactory execution of the budgetary and credit policies. The current account deficit, at SDR 142 million was SDR 24 million larger than target and the overall payments deficit, at SDR 97 million, exceeded the program's target by a similar amount (Table 7). There was only a marginal reduction in export receipts because the unanticipated shortfall in sugar exports (35,000 tons valued at SDR 20 million) was offset by better performance of other exports. In addition, the receipts from sugar reinsurance were also higher. However, imports were 10 per cent above projection owing to the initial underestimates of the import base as well as the larger-than-assumed increase in import prices. Also the volume of imports appears to have fallen by 4 per cent instead of 7 per cent as envisaged in the program. The overall payments deficit was financed by drawings on the Fund under the stand-by arrangement (SDR 30 million) and under the compensatory financing facility (a net amount of SDR 29.5 million), and through a Eurocurrency loan of US\$45 million (or SDR 36 million). The latter was within the program limit of SDR 45 million on nonconcessional external borrowing.

National accounts data are not yet available but real GDP is estimated to have fallen by as much as 7 per cent, reflecting mainly the 33 per cent

Table 6. Mauritius: Monetary Survey, June 1980-June 1982

(In millions of rupees)

	1980			1981			1982	
	June	Sept.	Dec.	March	June	Sept.	Dec. Proj.	March Proj. June Proj.
Foreign assets (net)	-361	-600	-397	-710	-1,342	-1,391	-1,516	-1,618
Bank of Mauritius 1/	(-281)	(-536)	(-347)	(-647)	(-1,248)	(-1,325)	(-1,422)	(-1,524)
Commercial banks	(-80)	(-64)	(-50)	(-63)	(-94)	(-66)	(-94)	(-94)
Domestic credit	4,167	4,255	4,632	4,734	5,358	5,492	5,835	6,090
Claims on Government (net)	2,358	2,441	2,751	2,744	3,208	3,283	3,525	3,640
Bank of Mauritius 1/	(1,544)	(1,656)	(1,771)	(1,985)	(2,493)	(2,549)	(2,775)	(2,860)
Commercial banks	(814)	(785)	(980)	(759)	(715)	(734)	(750)	(780)
Claims on private sector 2/	1,809	1,814	1,881	1,989	2,150	2,209	2,310	2,450
Money (M2)	3,367	3,354	3,837	3,626	3,655	3,756	3,919	4,085
Money (M1)	(1,372)	(1,345)	(1,721)	(1,430)	(1,390)	(1,431)	(1,540)	(1,520)
Quasi-money	(1,996)	(2,009)	(2,117)	(2,196)	(2,264)	(2,325)	(2,379)	(2,565)
Other items (net)	439	302	398	398	361	345	400	387
Of which: exchange loss 3/	(...)	(...)	(...)	(...)	(...)	(--)	(-22)	(-37)
Memorandum items								
Total domestic credit 4/	4,167	4,230	4,618	4,723	5,283	5,430	5,795	6,047
								6,418

Source: Data provided by the Bank of Mauritius.

1/ Includes Eurocurrency loans contracted or utilized by the Government, and revaluation of foreign assets (in September 1981).

2/ Includes nonsugar export bills rediscounted, and credit on-lent in respect of official external loans.

3/ Classified as other assets.

4/ For purpose of performance criteria, defined as the sum of domestic credit and exchange loss less nonsugar export bills rediscounted and credit on-lent by commercial banks to the private sector in respect of official external loans.

Table 7. Mauritius: Balance of Payments, 1978/79-1981/82

(In millions of SDRs)

	1978/79	1979/80 Prov.	1980/81 Prog.	1980/81 Prov. act.	1981/82 Prog.
Current account	-86	-88	-118	-142	-123
Merchandise	-130	-145	-168	-214	-179
Exports, f.o.b.	284	319	290	288	329
Sugar	(190)	(205)	(185)	(165)	(192)
EPZ	(70)	(85)	(85)	(90)	(103)
Other	(24)	(29)	(20)	(33)	(34)
Imports, c.i.f.	-414	-464	-458	-502	-505
Rice, wheat	(-31)	(-30)	(-41)	(-49)	(-49)
petroleum	(-36)	(-70)	(-70)	(-73)	(-78)
EPZ	(-44)	(-59)	(-51)	(-71)	(-81)
Other	(-303)	(-305)	(-296)	(-309)	(-297)
Services (net)	33	43	33	57	33
Other transportation	(11)	(24)	(19)	(24)	(30)
Travel	(14)	(17)	(20)	(20)	(24)
Investment income	(-10)	(-18)	(-25)	(-27)	(-40)
Reinsurance	(--)	(--)	(10)	(21)	(--)
Other	(18)	(20)	(9)	(19)	(19)
Transfers (net)	11	14	16	15	20
Capital account	41	27	40	42	58
Official long-term (net) <sup>1/</sup>	(48)	(30)	(40)	(34)	(58)
Other capital including errors and omissions	(-7)	(-3)	(--)	(8)	(--)
SDR allocation	3	3	3	3	--
Overall deficit	-42	-58	-75	-97	-65
Financed by:	42	58	75	97	65
Bank of Mauritius	38	58	75	97	65
Assets	25	6	--	2	2
Liabilities	13	52	75	95	63
Use of Fund credit	(8)	(40)	(35)	(60)	(28)
Eurodollar loan	(5)	(12)	(40)	(35)	(35)
Commercial banks (net)	4	--	--	--	--

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

<sup>1/</sup> Excludes Eurocurrency borrowing.

shortfall in the sugar output; the final figure for the 1980/81 crop was put at 472,000 tons. Real domestic demand, on the other hand, declined by about 5 per cent but was not enough to prevent a further deterioration in the current account balance to 16 per cent of GDP, compared with 10.5 per cent in 1979/80 and 14.5 per cent as the program target. Mauritius' official net foreign assets declined by SDR 97 million in 1980/81, and at the end of September 1981 its gross foreign exchange reserves amounted to SDR 31 million, or equivalent of three weeks' imports.

#### IV. The Financial Program, 1981/82

The formulation of the financial program for the fiscal year 1981/82 began in April 1981 when a Mauritian delegation, headed by the Minister of Finance, visited the Fund to consult with the Managing Director and the staff on their budget proposals for the year. At that time it was assumed that the sugar crops would recover to 640,000 tons and the terms of trade would remain stable. On these assumptions, the Mauritian Government introduced a budget incorporating new substantial revenue measures as well as a cutback in the rate of growth in expenditure implying, among other things, a continuation of wage policy that foresaw a further reduction in real wages. It was expected at that time that such a budget could constitute the base for a new stand-by arrangement with the Fund after the expiry of the arrangement approved in September 1980.

Developments since then, however, have been considerably more unfavorable. As a result of the drought, the sugar output now is expected to reach only 580,000 tons. Moreover, the appreciating dollar and the depreciating European currencies have implied worsening terms of trade, and along with rising international interest rates increased external debt service burden for Mauritius. In the circumstances, the Government has further tightened its financial policies to complement those policies already introduced in mid-1981; these together constitute the overall program described in the attached "Statement on Economic and Financial Policies of the Government of Mauritius, 1981/82" for purposes of the proposed stand-by arrangement.

##### 1. Elements of the program

The stabilization program covers the one-year period ending December 1982. Targets and policies are defined only for the current financial year through June 1982. Targets and policies for the rest of the program period would be quantified, and understandings reached with the Fund, before end-May 1982 in the context of the formulation of the next year's budget when a mid-term review of the program is also envisaged.

The program assumes that real GDP would grow by 5 per cent and targets the rate of domestic inflation at about 25 per cent, or 3 percentage points below that recorded in 1980/81. It aims at limiting the overall balance

of payments deficit to SDR 65 million, thus envisaging almost a one-third reduction in the deficit recorded in the previous fiscal year. These targets imply that real domestic demand would be reduced by at least 4 per cent during the current financial year.

The main policies to realize the above targets include an exchange rate adjustment, restrictive wage adjustments, reduced budgetary deficit, restrained growth in domestic credit, higher interest rates, and a continued liberal trade and exchange system. These policies are summarized in Table 8 and described in detail in the following paragraphs.

The program contains performance criteria relating to (i) total domestic credit, (ii) net credit to the Government, (iii) new external medium-term nonconcessional borrowing with original maturity of between one and ten years, with a subceiling on such loans of original maturities between one and five years and a drawdown subceiling, and (iv) the exchange and trade practices; the first three criteria are summarized in Table 9. The reaching of understandings before the end of May 1982 on performance criteria beyond May 1982, on budgetary policies for 1982/83, and on exchange policy also constitutes a performance clause.

a. External policies

The balance of payments target for FY 1981/82, i.e., an overall deficit of SDR 65 million and a current account deficit of SDR 123 million, incorporates the downward revised forecast of the sugar crop of 580,000 tons, of which 546,000 tons would be exported to the EEC market. 1/ Although the EEC has announced a 7.5 per cent increase in the price (expressed in ECU) for the 1981/82 season, average export prices in terms of SDRs are assumed to decline by 1 per cent to SDR 350 per ton (Table 10), due to the depreciation of the ECU vis-à-vis the SDR. 2/ Some increase in receipts is also expected from the export processing zone (EPZ) industries, which have witnessed a remarkable rise in exports following the 1979 devaluation, and from tourism. Thus, total export receipts are projected to increase by 14 per cent (to SDR 329 million) over the 1980/81 level. Imports, on the other hand, are expected to decline by about 9 per cent in volume, reflecting the impact of the recent exchange rate adjustment and the other stabilization policies described below. In value terms, imports are projected to rise by only 1 per cent to SDR 505 million. This projected decline in imports is consistent with the 1979 devaluation experience when the volume

---

1/ Mauritius' annual quota, under the terms of the Lomé Convention, is 500,000 tons and the additional 46,000 tons are to make up for the shortfall of the 1980/81 delivery which was adversely affected by the cyclones.

2/ The assumed ECU/SDR rate is SDR 1 = ECU 1.111 in 1981/82. A 5 per cent variation in the ECU/SDR rate is estimated to result in a variation of SDR 10 million in export receipts.



Table 8. Mauritius: Summary of the Financial Program

Assumptions: Sugar crop of 580,000 tons, of which exports valued at SDR 192 million

- terms of trade loss 8 per cent
- real GDP growth 5 per cent

Targets:

- inflation 25 per cent
- balance of payments
  - current account deficit SDR -123 million (12.8% of GDP)
  - overall deficit SDR -65 million ( 6.3% of GDP)

Principal elements of the program

1. Exchange rate: a 16.7 per cent depreciation, except for transactions (equivalent to 4 per cent) relating to imports of rice and flour, where the old rate SDR 1 = Rs 10 will apply.
  - policy to be reviewed and understandings reached before end-May 1982
2. Wage policy: no compensating wage increases for the cost-of-living impact of devaluation will be granted during FY 1981/82
3. Budget: overall deficit to be reduced to 12.9 per cent of GDP. Discretionary revenue effort, including the impact of devaluation, equals 3 per cent of GDP.
  - policies for FY 1982/83 to be reviewed in May 1982; target to reduce the overall deficit to less than 11 per cent of GDP
4. Money and credit: limit total credit expansion to 21 per cent and monetary expansion to 12 per cent with appropriate quarterly ceilings as performance criteria.
  - reactivate interbank market
  - eliminate ceilings on most lending and on all savings deposit rates, raise bank rate and all other rates by 1.5 percentage points.
5. External medium-term borrowing: commitments limited to SDR 65 million, with a drawdown limit of SDR 35 million for FY 1981/82

Table 9. Mauritius: Quantitative Performance Criteria  
for the Period through May 1982 1/

	1981		1982	
	Sept. Actual	Dec. <u>2/</u> Proj.	Feb.	May
	(Outstanding at end of period; in millions of rupees)			
Credit to Government (net) <u>3/</u>	3,283	3,525	3,610	3,730
Total domestic credit <u>4/</u>	5,430	5,795	5,960	6,200
	(In millions of SDRs)			
New external borrowing commitments (cumulative) <u>5/</u>				
1-10 years' maturity	...	65	65	65 <u>6/</u>
Of which: 1-5 years' maturity	...	20	20	20
Drawdown of new external borrowing (cumulative) <u>5/</u>	...	20	20	35

Source: Statement on the Economic and Financial Policies of the Government of Mauritius, 1981/82.

1/ Understanding on performance criteria for 1982/83 will be reached before the end of May 1982.

2/ Not a performance criteria.

3/ Defined as credit to the Government from the banking system less government deposits plus any budgetary use of new nonconcessional loans of 1-10 years' maturity.

4/ Defined as credit to Government (net) plus credit extended by the banking system to the private sector (with the exception of credit granted against nonsugar export bills and commercial bank loans in respect of external official loans), plus exchange loss on rice and flour imports.

5/ Defined as new external borrowing on nonconcessionary terms contracted or guaranteed by the Government.

6/ This ceiling applies for the entire period of the stand-by arrangement.

Table 10. Mauritius: Principal Assumptions for Balance  
of Payments Projections, 1981/82

(Annual per cent change in SDR terms,  
unless otherwise indicated)

	1978/79	1979/80	<u>1980/81</u> Provisional	<u>1981/82</u> Program
Exports, f.o.b.				
Volume	3.2	4.2	-17.6	11.5
Unit value	4.0	7.8	9.6	2.4
Sugar				
Volume ('000 tons)	619	628	466	546
Unit value (SDR/ton)	306.9	327.7	354.6	350.3
(implicit average ECU/ SDR rate)	1.112	1.042	1.012	1.111
EPZ				
Volume	10.0	8.5	...	5.0
Unit value	10.0	11.5	...	8.9
Imports, c.i.f.				
Volume	1.3	-11.9	-4.0	-9.0
Unit value	6.0	27.2	12.7	10.8
Oil				
Volume	...	-1.9	-14.7	-7.0
Unit value	...	98.2	22.3	14.7
Rice and flour				
Volume	...	-19.0	26.4 <u>1/</u>	-13.9
Unit value	...	19.0	29.2	9.1
EPZ				
Volume	4.0	17.0	13.7	3.4
Unit value	7.0	14.6	5.8	10.3
All other imports				
Volume	...	-12.2	-4.2	-11.1
Unit value	...	14.6	5.8	10.3

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

1/ Data for volume of rice imports in 1980/81 is biased upward due to time lags in data recordation.

of imports declined by 12 per cent. The deficit on the trade account is, therefore, projected to decline by more than 15 per cent to SDR 179 million, despite the terms of trade being projected to worsen by about 8 per cent. The surplus on the services account, however, is projected to shrink owing to higher interest payments and the nonrecurrence of the 1980/81 reinsurance receipts for the cyclone damage to the sugar crop. Net capital inflows are projected to be higher in the current year as a result of external assistance from donor countries participating in the Consultative Group and from the IBRD structural adjustment loan amounting to SDR 11 million and SDR 13 million, respectively. After allowing for use of Fund resources under the proposed stand-by arrangement, a financing gap of SDR 35 million remains to be covered and the authorities have already made preliminary contacts with a view to borrowing in the international financial markets.

The projected commercial borrowing and purchases from the Fund would raise Mauritius' outstanding external debt by about 18 per cent, bringing total debt to about 50 per cent of GDP. However, almost half of the outstanding debt is on concessional terms, and debt service payments in 1981/82 are projected at SDR 65 million or 14 per cent of exports of goods and services. Assuming a gradual improvement in external borrowing conditions, and the continuation of a cautious borrowing policy, staff projections suggest that the debt service (including Fund obligations) ratio would reach a peak of 20 per cent in 1983/84; debt servicing obligations to the Fund would amount to 5 per cent of exports of goods and services. For these reasons, the Government intends to follow prudent debt management policy. Accordingly, the program contains for the period of the stand-by arrangement a limit of SDR 65 million on the contracting of external non-concessional debt in the maturity range of one to ten years, and a sublimit of SDR 20 million in the maturity range of one to five years. A drawdown limit for FY 1981/82 of SDR 35 million is also provided for as a performance criterion.

On September 27, 1981 the exchange rate of the rupee was adjusted by 16.7 per cent, from Rs 10 = SDR 1 to Rs 12 = SDR 1, except for transactions relating to imports of rice and flour to which the old rate is applicable. The new depreciated rate is estimated to cover more than 96 per cent of the total current account transactions and, of course, 100 per cent of the capital account transactions. The exception for rice and flour is viewed by the authorities as a transitory necessity for limiting the devaluation impact on the prices of these staples and will be the subject of the mid-term review.

The exchange rate adjustment was made in response to the exchange rate movements of major currencies which had produced an appreciation of 10 per cent in the export-weighted effective exchange rate of the rupee since the latter was unilaterally depreciated in October 1979. Thus, the action may be viewed partly as a corrective adjustment designed to conserve the earlier depreciation. However, more importantly, the exchange adjustment also addresses the serious problems confronting sugar, the key export

industry (Table 11). Several factors have contributed to its financial difficulties that have recently grown to critical proportions. The 1979 devaluation was deemed to have more than corrected for the earlier excessive wage increases decreed by the Government, and in fact a surtax (equivalent of 7.5 per cent of export value) was introduced to mop up windfall profits from the devaluation. Since then, however, the gain has been eroded. First, the industry has suffered two consecutive years of output losses, totaling 25 per cent of potential output, and wage and other import costs have also crept up, contributing to an increase of about 65 per cent in unit labor cost over the last two years. Second, export prices in local currency terms have weakened because the entire exports of sugar in 1981/82 are destined for the EEC market with prices fixed in terms of the European Currency Unit which has been depreciating vis-à-vis the SDR and, therefore, vis-à-vis the Mauritian rupee, which is pegged to the SDR. According to staff estimates, prices received by the major producers, adjusted for increases in the unit labor cost would have fallen in 1981/82 to the lowest level in ten years. Consistent with these indirect indicators of declining profitability, about one half of the large producers have already incurred substantial operating losses and have had severe difficulties coping with their liquidity needs for the current crop season. Irrigation and fertilizer application has been cut back and replanting (affecting future output) has been scaled down by about 15 per cent. The latest exchange rate action should provide a temporary breather to the industry during which it must rationalize to achieve a longer-term viability.

The depreciation should also help the EPZ sector which has demonstrated its dynamism following the 1979 devaluation. Since that period EPZ export receipts have increased by about 25 per cent. Furthermore, it has gained an important footing in the U.S. market following the imposition of quotas on textile imports (accounting for about 70 per cent of total EPZ exports) in its major European markets (France and United Kingdom). However, in September this year the U.S. Government negotiated a bilateral agreement with Mauritius which allows for only a modest increase in the volume of textile imports during the next 12 months. In view of this protectionist environment the recent depreciation should help Mauritius in diversifying its markets.

b. Wages and pricing policies

The program continues with a restrictive wage policy to help curb demand and to complement the exchange rate action in restoring the competitiveness of the export sector. Adhering to this policy the 1981/82 wage award granted in June amounted to an average increase of 15.5 per cent for most sectors of the economy, and 13 per cent in the public sector. These increases represent only a partial compensation for the 28 per cent increase in the CPI during the preceding 12-month period. No additional wage increases are intended for the rest of the present fiscal year through June 1982. For the public sector, the scheduled adjustment of pay scales

Table 11. Mauritius: Indices of Ex-Syndicate 1/ Prices of Sugar, 1970/71-1981/82

(1970/71 = 100.0)

	1970/71	1971/72	1972/73	1973/74	1974/75	1975/76	1976/77	1977/78	1978/79	1979/80	1980/81	1981/82 Proj. Prog.
<b>Nominal ex-Syndicate price</b>												
Average, all producers	100.0	109.9	134.3	163.5	413.3	517.2	341.0	354.0	368.0	450.4	503.1	480.3 591.6
Producers under 20 tons 2/	(100.0)	(116.6)	(126.4)	(183.6)	(500.0)	(588.6)	(377.8)	(396.7)	(412.5)	(530.5)	(611.6)	(585.9) (719.2)
Miller planters 2/	(100.0)	(109.9)	(134.3)	(144.4)	(279.8)	(320.9)	(329.5)	(340.1)	(353.7)	(428.7)	(478.8)	(457.3) (563.0)
<b>Real ex-Syndicate price (deflated by unit labor cost index)</b>												
Average, all producers	100.0	121.8	124.7	150.0	342.4	236.8	162.2	131.9	129.9	149.1	100.1	96.3 118.6
Miller-planters	(100.0)	(121.8)	(124.7)	(132.5)	(231.8)	(146.9)	(156.8)	(126.7)	(124.8)	(141.9)	(100.1)	(93.3) (112.8)
<b>Real ex-Syndicate price (deflated by nominal wage index)</b>												
Average, all producers	100.0	96.9	97.5	97.5	219.4	243.2	118.6	97.8	87.9	100.7	100.3	90.3 111.2
Miller-planters	(100.0)	(96.9)	(97.5)	(86.1)	(148.5)	(150.9)	(114.6)	(94.0)	(84.5)	(95.9)	(93.8)	(86.0) (105.9)
<b>Memorandum items</b>												
Unit labor cost	100.0	190.2	107.7	109.0	120.7	218.4	210.2	268.4	283.4	302.1	509.6	498.9 498.9
CPI (CY average)	100.0	100.3	105.6	119.9	154.8	177.7	201.5	220.0	238.7	273.3	376.7	421.9 471.0
Average wage (daily paid workers employed by miller-planters)	100.0	98.5	137.8	139.4	145.5	168.2	240.9	293.9	336.4	377.3	450.0	531.8 531.8

Sources: Mauritius Sugar Syndicate; and staff estimates.

1/ Prices received by sugar producers.

2/ The differing trend in the nominal ex-Syndicate price reflects the increasingly progressive export tax structure that distinguishes producers by size (for details, see Mauritius: Recent Economic Developments, SM/81/79, April 8, 1981).

of civil servants, estimated to add another 3 per cent to the average wage in this year, is being postponed. The wage policy for the fiscal year 1982/83 will be the subject of the mid-term review when the fiscal and other targets for FY 1982/83 will be discussed with the Fund and before the annual round of negotiations opens between the trade unions and the Government.

On pricing policies, domestic retail prices of sugar were further raised by 25 per cent in July 1981 in an effort to reduce domestic consumption and to increase export availability. In addition, to conserve energy consumption, the import duty on gasoline was also raised in June 1981 from Rs 11/gallon to Rs 13.50/gallon. Together with the long-standing policy of a complete pass-through of petroleum import costs, retail gasoline prices have been raised by about 50 per cent during the past 18 months to over US\$3.20/gallon, including the most recent pass-through subsequent to the September depreciation. Demand for petroleum and petroleum products, as indicated by the import data, has shown a significant sensitivity to price changes and the most recent price increases are expected to reduce this demand even further. As regards the prices for rice and flour, which are currently subsidized, the authorities have reiterated their policy to reduce gradually the proportion of subsidies. However, in the present circumstances, they felt that further increases could become intolerable, politically and socially, during the immediate period ahead. This was the rationale behind the decision to retain the more favorable exchange rate for these imports. The policy on subsidies, as well as the dual exchange rate, will be reviewed before mid-May; the authorities are fully cognizant that subsidies as a proportion of costs must be reduced significantly.

c. Budgetary policies

The existing overall budgetary deficits of the recent years are unsustainable. Accordingly, the authorities intend to reduce the ratio of the overall deficit to GDP in 1981/82 by about 2 percentage points from the level reached in 1980/81. To achieve this objective, budgetary measures were implemented in two stages: first at the time of the introduction of the 1981/82 budget in May, and more recently in October following the exchange rate action.

Altogether, and taking into account the impact of the devaluation, the overall budget deficit (excluding the exchange loss in respect of imports of rice and flour) in 1981/82 would be limited to Rs 1,424 million (12.9 per cent of GDP), compared with Rs 1,290 million (14.7 per cent) in 1980/81; the exchange loss, projected at Rs 50 million (0.4 per cent of GDP), is being borne by the Bank of Mauritius. Revenues are now projected to increase by 23 per cent, reflecting mainly the impact of discretionary revenue measures and of the devaluation. Expenditures and net lending are expected to rise by 18 per cent representing a 6 per cent cut in real terms. The ratio of receipts to GDP would be maintained at 24 per cent,

while the expenditure ratio would drop to 37 per cent, from 39 per cent in the previous year. The apparent inelasticity of the revenue system reflects not only the delayed impact of the depressed economy of the previous year, but also the declining effective tax rate on imports. The staff has pointed out this latter factor to the authorities and suggested that the causes may lie in weak administration and in the number of exemptions granted.

The principal revenue measures include (1) increasing from 10 per cent to 20 per cent the surcharge on indirect taxes (except on sugar exports); (ii) raising the specific import duty on gasoline by 20 per cent; (c) expanding the coverage of the 5 per cent stamp duty on imports to 70 per cent from 25 per cent previously; (d) introducing an import duty on aviation fuel. The yield from these increases is presently estimated at Rs 300 million, or 3 per cent of GDP. This projection allows for some deterioration in the average rate of collection of customs duty, as indicated by preliminary data on collections in the first quarter. If this tendency proves to be an aberration, actual revenue performance may turn out to be better than assumed in the program. The authorities are looking into this question, and intend to take additional measures as necessary if existing policies prove insufficient for attaining the budgetary position.

Recurrent expenditure is projected to grow by 18 per cent. Of this amount, expenditure on personal emoluments <sup>1/</sup> and pensions accounts for about 60 per cent, and the balance is accounted for almost entirely by the increase in interest payments on external debt; water subsidies have been eliminated, and only marginal increase has been provided for the remaining expenditure on goods and services. Capital expenditure and net lending which in the budget shows an 18 per cent increase, mainly for projects already in progress, is not being adjusted to take account of the depreciation. The authorities recognize that adhering to these targets could require close monitoring, and have established monthly guidelines of total government expenditure for this purpose.

External financing (excluding use of new nonconcessional medium-term loans) for the budget deficit is projected to increase substantially to Rs 670 million. Of this, Rs 135 million represents foreign assistance emanating from the 1980 Consultative Group, about Rs 140 million corresponds to the Structural Adjustment loan granted by the IBRD in April 1981, and the balance consists of project assistance. Domestic financing is expected to decline to Rs 755 million, of which Rs 690 million would be from the banking system (including use of external nonconcessional medium-term loans). Bank financing, so defined, would amount to 6.3 per cent of GDP in the current fiscal year, compared to

---

<sup>1/</sup> As mentioned above, the COL adjustment in wages averaged 13 per cent for the public sector; in addition, normal increases and new recruitment account for about a 4-5 per cent rise in the wage bill.



about 10 per cent in the previous two years. Nonbank financing is projected to decline since the Sugar Insurance Fund, traditionally the main source of financing, will be obliged to liquidate its holdings of government securities in order to pay compensation for the shortfall in the sugar crop.

Budgetary policies for the following fiscal year will form a part of the mid-term review. Given the still high level of the overall deficit, the 1982/83 budget proposals will be geared to reducing the ratio of the deficit to GDP to below 11 per cent. Tax administration and collections would need to be improved, and the tax system could be streamlined. It appears, however, that the limits on taxation may have been reached and that permanent fiscal improvement will have to be sought through expenditure economies. A major and inevitable action in this domain will have to concern the present level of subsidies which account for over 2 per cent of GDP. A thorough examination of capital expenditure and rationalization of major state enterprises is also needed.

d. Monetary policies

The principal objective of monetary policy continues to be that of restraining domestic demand while directing credit to the export and other productive sectors. For this purpose, the monetary authorities have used both credit directives and a flexible interest rate policy. The program for 1981/82 provides limits on the rate of expansion of total domestic credit and subceilings for net credit to the Government. Certain far-reaching innovations have also been recently introduced in respect of interest rate policy.

Under the program, total liquidity during the fiscal year 1981/82 is planned to increase by 12 per cent. Set against the projected rise of 25 per cent in GDP, this increase in liquidity implies a 10 per cent rise in income velocity, from 2.4 at the end of 1980/81 to 2.6 at the end of 1981/82. This projected continuing rise in the velocity is consistent with the experience in 1979/80 when similar circumstances, i.e., a devaluation and an increase in the structure of interest rates, produced a similar increase in velocity.

On the basis of the above, and taking into account the balance of payments target, total domestic credit expansion (including exchange losses from the dual exchange rate) is being limited to about 21 per cent, or Rs 1,160 million; for purposes of the performance criterion, the ceiling on total domestic credit, as summarized in Table 9, excludes rediscounts of nonsugar export bills and credit on-lent to the private sector in respect of external official loans. As a subceiling, net credit to the Government 1/

---

1/ The exclusion of exchange losses from the ceiling on net credit to the Government was essentially dictated by administrative consideration relating to the monitoring of that subceiling. In any case, this exclusion would apply only for a short period.

will be limited to Rs 690 million for FY 1981/82; this subceiling is consistent with the prospects for the budget as discussed above. The overall credit ceiling would allow an increase of Rs 395 million or 19 per cent, for the private sector. It is estimated that of this amount the sugar sector could claim about Rs 140 million leaving Rs 255 million representing about 16 per cent growth in the credit for the other sectors.

The quarterly ceilings, as stated in Table 9, have been based on both the examination of the past seasonality pattern, as well as the official projections of various financial flows. There is considerable divergence in the results from these two series. Furthermore, the observed seasonal pattern is not stable and the official projections are qualified by the uncertainties, e.g., those concerning the pace of spending on lumpy capital projects and the matching foreign financing.

The Bank of Mauritius has also acted on the interest rate front. It was recognized that the present system of credit ceilings leaves banks in uneven liquidity positions which could not be corrected by the placing or borrowing of short-term funds. Accordingly, in October the Bank of Mauritius reactivated the interbank market where interest rates are determined by market forces. Since then the interbank rate has climbed from an initial 9 per cent to the present 13 1/2 per cent. More recently, the officially determined maxima on most types of lending and on all savings deposit rates were abolished, freeing the banks to compete. Simultaneously, the bank rate was raised by 1.5 percentage points to 12 per cent, and a similar increase was provided for the maxima of the two lending rates that were not freed, i.e., the rate applicable to primary producers and to industries holding a Development Certificate or in the EPZ, and the discount rate for nonsugar export finance. It is hoped that this decontrol of the interest rate structure would both increase flows of financial savings and induce a more rational allocation of the credit.

#### V. Staff Appraisal and Proposed Decision

Since late 1979 the Mauritian authorities have been implementing stabilization measures, the contents of which have been comprehensive and execution satisfactory. The focus of these efforts has been to redress imbalances in the economy through exchange rate adjustment, rationalization of wage policies, reduction in consumer subsidies, and relatively tight financial policies. Appropriate medium-term strategies were formulated in 1980 and were supported by the Consultative Group assistance and the first structural adjustment loan from the World Bank. The financial program for FY 1980/81, supported by the last stand-by arrangement, was designed to take special account of the effects of the cyclones but also to restrain demand. Under this program, principal measures were implemented as intended, the budget deficit as a proportion of GDP declined for the first time in several years, and domestic demand pressures were reduced. However, the external imbalances widened because of the drastic shortfalls

in export output and earnings caused by the cyclones. Prospects for the current fiscal year are also disquieting as the confluence of unfavorable exogenous factors (i.e., a drought and the worsening terms of trade) threatens a further deterioration. To prevent such a deterioration and to limit the external deficit to manageable proportions, the Government has formulated a program and requested the proposed stand-by arrangement.

The program retains the strategy adopted in the recent programs, and focuses on improving the competitiveness of the export- and import-competing sectors and on restraining domestic demand. The principal elements are the exchange rate adjustment, wage restraint, a strong effort to reduce the budget deficit, and restrictive financial policies. Despite the unfavorable developments in sugar production and in external terms of trade, the budget deficit to GDP ratio will be reduced by nearly two percentage points. The interest rate structure has also been freed, the interbank market reactivated, and the Bank rate raised. Real domestic demand and imports are expected to continue their declining trend, and the current account deficit programmed to decline within a framework of relatively liberal trade and payments system; as a ratio of GDP the decline in the current account deficit will be substantial, from 16 per cent to under 13 per cent. The overall payments deficit would be limited to SDR 65 million, and Mauritius will need to continue its reliance on a medium-term inflow of foreign capital.

The staff has made calculations regarding the medium-term prospects for the balance of payments. If the sugar production returns to normal as expected, if no major unfavorable external developments intervene, and if the present stance of policies is further reinforced, especially in regard to consumer subsidies, wages, and the growth in government expenditure, Mauritius' current account deficit could be further reduced to about 7.0 per cent of GDP by 1983/84. These estimates take into account the servicing of the required financing of the deficits in the intervening years, and include projections that in 1983/84 the value of exports would rise by about 23 per cent and imports by 12 per cent over the 1981/82 level.

Mauritius has maintained a satisfactory performance record under the past stand-by arrangements and has adhered to an essentially liberal trade and exchange system. The staff believes that the actions already initiated and the policies under the proposed program reflect a large measure of political courage and represent a continued strong commitment of the Mauritian authorities toward adjustment. Nevertheless, the budgetary deficit remains unsustainably high and needs to be brought down even further in the immediate years ahead. While external factors have contributed to this deficit, domestic adjustment measures will have to offset their impact if the balance of payments deficits are to be reduced to viable proportions within a two- to three-year period and before Mauritius has exhausted its capacity to attract external balance of payments support.

The exceptional revenue effort contained in the present program is in recognition of this need to adjust. However, as the recent slippage in collection of import duties indicates, the tax potential may have been tapped to its limit and additional revenue could come mainly through improved tax administration and collections. In the circumstances, expenditure policies should be given greater emphasis in the authorities' strategy to bring down the budget deficit. In this connection, the authorities cannot afford any slippage in the implementation of the program, and the proposed mid-term review with the Fund before end-May 1982 would be crucial. The authorities have assured the staff of their intention to further intensify the adjustment efforts when the policies for the fiscal year 1982/83 would be formulated. At that time the authorities also intend to eliminate the existing multiple currency practice which was introduced in September to limit the impact of the exchange rate adjustment on the cost of living, and review the subsidy policy. During the review, understandings will be reached with the Fund regarding exchange policies, budgetary policies for 1982/83, and on performance criteria for the period beyond May 1982. On the basis of these assurances and the policies in place for the first half of the program year, the staff believes that the program represents a substantial effort toward achieving a viable balance of payments situation and is deserving of further Fund support. Accordingly, the following draft decision is proposed for adoption by the Executive Board:

1. The Government of Mauritius has requested a stand-by arrangement for the period from December , 1981 to December , 1982 for an amount equivalent to SDR 30 million.
2. The Fund approves the stand-by arrangement attached to EBS/81/236 (12/7/81) and waives the limitation in Article V, Section 3b(iii).
3. The Fund grants approval for the retention of the multiple currency practice described in EBS/81/236 until May 31, 1982.

Relations with the Fund  
(As of October 31, 1981)

Date of membership:	September 23, 1968
Quota:	SDR 40.5 million
Exchange rate system:	The Mauritian rupee is pegged to the SDR at Rs 12 = SDR 1 for all transactions except for imports of rice and flour where the rate Rs 10 = SDR 1 applies.
Intervention currency:	Pound sterling
Status:	Article XIV
Fund holdings of Mauritian rupees:	SDR 160.74 million or 396.89 per cent of quota, including SDR 40.5 million or 100 per cent in respect of the compensatory financing facility, SDR 55.95 million or 138.15 per cent in respect of the supplementary financing facility.
SDR position:	SDR 1.15 million (or 7.37 per cent of net cumulative allocations of SDR 15.74 million).
Trust Fund:	SDR 9.1 million in first period, ineligible in second period.
Direct distribution of profits from gold sales (July 1, 1976- July 31, 1980):	US\$3.48 million
Gold distribution (four distributions):	18,827.858 fine ounces
Staff contacts:	The last Article IV consultation was held in December 1980 and the staff report (SM/81/58) was discussed at the Executive Board on April 10, 1981. Discussions in connection with the use of Fund resources took place in May and July 1980, and a one-year stand-by arrangement was approved by the Executive Board on September 5,

Relations with the Fund (concluded)  
(As of October 31, 1981)

Staff contacts: (continued)

1980 (EBM/80/131); stand-by review took place in December 1980 and discussed by the Executive Board on April 10, 1981 (EBS/81/59). Further discussions on use of Fund resources were held in April, September and October 1981.

Mauritius--Stand-By Arrangement

Attached hereto is a letter, with annexed Statement on economic policies, dated December 5, 1981 from the Minister of Finance and the Governor of the Bank of Mauritius requesting a stand-by arrangement and setting forth:

- (a) the objectives and policies that the Government of Mauritius intends to pursue for the period of this stand-by arrangement;
- (b) the policies and measures that the Government of Mauritius intends to pursue for the first six months of this stand-by arrangement; and
- (c) understandings of Mauritius with the Fund regarding a review that will be made of progress in realizing the objectives of the program and of the policies and measures that the Government of Mauritius will pursue for the remaining 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 a period of one year from                      to                      Mauritius will have the right to make purchases from the Fund in an amount equivalent to SDR 30 million, subject to paragraphs 2, 3, 4, and 5, below, without further review by the Fund.
2. Purchases under this arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 7.5 million until March 10, 1982, SDR 15 million until June 10, 1982, and SDR 22.5 million until September 10, 1982 but none of these limits 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 supplementary financing or borrowed resources beyond 12.5 per cent of quota.
3. Purchases under this arrangement shall be made from ordinary resources until purchases under this stand-by arrangement reach the equivalent of SDR 16,718,493, and thereafter wholly from enlarged access resources, provided that any modification by the Fund of the proportions of ordinary and enlarged access resources shall apply to amounts that may be purchased after the date of modification.
4. Mauritius will 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 supplementary financing or borrowed resources beyond 12.5 per cent of quota:

- (a) during any period in which the data at the end of the preceding period indicate that
  - (i) the limit on total domestic credit described in paragraph 6 of the attached statement, or
  - (ii) the limit on net credit to the Government described in paragraph 6 of the attached statementare not observed, or
- (b) if Mauritius fails to observe the limits on authorizations or drawdown of new public and publicly guaranteed foreign indebtedness described in paragraph 7 of the attached statement; or
- (c) during the last six months of this stand-by arrangement until understandings have been reached with the Fund pursuant to paragraph 4 of the attached letter, and until suitable performance criteria have been established in consultation with the Fund as contemplated by paragraph 4 of the attached letter, or after such performance criteria have been established, while they are not being observed; or
- (d) throughout the duration of the 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
  - (v) 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 stand-by 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 stand-by 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 outstanding amount of its currency that results from a purchase under this arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchase 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 repurchase will be completed not later than seven years from the date of purchase.

10. During the period of the arrangement Mauritius shall remain in close consultation with the Fund. These consultations, including those pursuant to the provisions of paragraph 4 of the attached letter, 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 and annexed statement.

11. In accordance with paragraph 4 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 or whenever the Managing Director requests consultation because any of the criteria in 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.

December 5, 1981 .

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

Dear Mr. de Larosière:

1. Since October 1979 the Government of Mauritius, with the Fund's technical and financial support, has been implementing stabilization programs to reduce the internal and external financial imbalances in the economy. Adjustment policies have included the depreciation in October 1979 of the rupee by 30 per cent, wage restraint, which has achieved a sizable reduction in real wages, increases in retail prices of subsidized consumer goods, and restrained fiscal and credit policies. The Government was able to implement rigorously the stabilization program for 1980/81, which was supported by a stand-by arrangement that expired September 4, 1981; all the performance criteria were observed. However, results from these policies have been compromised by a series of cyclones in 1979/80 and a drought in 1981, as well as the decline in the terms of trade.

2. The Government has been in continuous contact with the Fund staff regarding policies which it intends to pursue in 1981/82. Important revenue measures were adopted in the context of this year's budget and have been further reinforced by additional fiscal, exchange, and other measures within the framework of a program period of one year beginning December 1, 1981. These measures are described in the attached "Statement on the Economic and Financial Policies of the Government of Mauritius", giving a detailed description of the financial program for the current fiscal year through June 30, 1982 and broad indication of policies for the rest of the program period; these latter will be made more precise after the mid-term review referred to in paragraph 4 below.

3. In support of its program, and in view of the balance of payments need, the Government of Mauritius requests a stand-by arrangement for a period of one year for an amount equivalent to SDR 30 million.

4. The Government of Mauritius believes that the policies described in the attached statement are adequate to achieve the objectives of its program and set the stage for further substantial reduction in the financial imbalance in the coming year, but will take any further measures that may become necessary for these purposes. The Government will remain in 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. The Government will, in any case, consult with the Fund before May 31, 1982, in order to reach understandings prior to any further drawings under the stand-by arrangement regarding the exchange policies with a view to abolishing the recently introduced multiple currency

practice, the budgetary policies for 1982/83, and the performance criteria in respect of total domestic credit, net credit to the Government, and nonconcessional external borrowing to be utilized covering the period of the program after May 31, 1982.

Sincerely yours,

/s/

C. Bunwaree  
Governor

/s/

Sir Veerasamy Ringadoo, Kt.  
Minister of Finance

Statement on the Economic and Financial Policies  
of the Government of Mauritius

---

1. The Government has been implementing adjustment policies over the past two years to correct the large external imbalances facing Mauritius and to lay a basis for sustainable growth. These policies have been supported by technical and financial assistance from the Fund and by a structural adjustment loan from the World Bank. Although these adjustment policies, including a devaluation of the rupee by 30 per cent (in local currency terms) in October 1979 and strict wage policies that have produced a 25 per cent reduction in real wages, have been substantially implemented, imbalances remain large, mainly because of the emergence of unfavorable, and frequently unforeseen, factors beyond the control of the Government. These include several severe cyclones in 1979-80 and a drought in 1981 which have reduced the sugar crop well below the normal levels, an increase in oil prices, a deterioration in the terms of trade, the appreciation of the U.S. dollar, and the rise in international interest rates.

2. The Government has been in continuous consultation with the Fund staff. In keeping with the terms of the last stand-by arrangement, in April the Government discussed with the Fund staff the budget proposals for 1981/82 (July-June) with a view also to entering into another stand-by arrangement after September. Understandings were arrived at with respect to budgetary policies, most of which were later incorporated into the budget as approved by the Legislative Assembly. The overall deficit was to be limited to Rs 1,350 million, or 12.7 per cent of GDP projected at that time (but over 13 per cent if account is taken of the most recent projections in view of the unanticipated shortfall of 9 per cent in sugar output). The budget introduced several revenue measures, including raising the specific duty on gasoline from Rs 11 to Rs 13.5 per gallon, and increasing the surcharge on virtually all indirect taxes from 10 to 21 per cent. On the expenditure side, subsidies on water were eliminated and average wage increases in the public sector were limited to 13 per cent, or under two thirds of the increase in the cost of living during the preceding 12 months. Domestic prices of sugar were also raised by 25 per cent in order to increase export availability. Budgetary policies were reinforced by credit policies that envisaged the continuation of restrained credit expansion of the previous years. Actual credit developments in the first quarter of the financial year 1981/82 were in conformity with the informal understandings reached with the Fund staff last April.

3. Economic assumptions underlying the 1981/82 budget have since turned out to be optimistic, especially those concerning the size of the sugar crop (only 580,000 tons compared with the assumed level of 640,000 tons), the movement of exchange rates of the major currencies and international interest rates. In addition, the effective rate of collection of import duties also has fallen, reflecting primarily a shift in the composition of imports in favor of imports paying low import duty. As a result,

the budgetary deficit for 1981/82 threatens to reach Rs 1,650 million and the overall balance of payments deficit to SDR 110 million. In addition, the profitability of the sugar sector has been seriously compromised by the appreciation of the rupee (linked to the SDR) vis-à-vis the ECU and its viability further eroded by the two successive bad weather years. Accordingly, the Government has reinforced the thrust of the policies announced with the 1981/82 budget by additional measures designed to limit the overall balance of payments deficit (before taking account of commercial balance of payments loans) to SDR 65 million.

4. Effective September 27, 1981, the exchange rate of the Mauritian rupee was changed from Rs 10 = SDR 1 to Rs 12 = SDR 1 (implying a 20 per cent depreciation in local currency terms) for all international transactions, except for imports of rice and wheat flour on government account, which will continue to benefit from the old rate of Rs 10 = SDR 1. Furthermore, the existing 5 per cent stamp duty on imports, which formerly covered only about 25 per cent of imports, was extended in late October to cover about 70 per cent of imports; exemptions are limited to essential items, viz., rice and flour, pulses, salt fish, kerosene and aviation fuel, public transport equipment, and inputs for EPZ and other export industries holding Development Certificates. The combined revenue impact of these new measures and of those introduced at the beginning of the year is presently estimated at over Rs 300 million, or about 3 per cent of GDP. On the expenditure side, the Government has decided to defer the adjustments of the pay scales due this year which decision would save about Rs 50 million. The Government also intends to grant no additional increase in wages, nor to allow increases in other appropriations, during the rest of the present fiscal year to compensate for the adjustment in the exchange rate, except as it relates to the servicing of public debt. As a result, total expenditure for the full financial year will be limited to Rs 4,316 million, and the overall budget deficit (excluding the Sinking Fund contributions and external capital repayments), will be limited to Rs 1,425 million, or 13 per cent of GDP. Domestic bank financing of the deficit will be limited to Rs 690 million, compared with Rs 850 million in the previous year. In order to monitor the budget the Government has established monthly indicators in respect of recurrent expenditure which imply that cumulatively such expenditure will approximate Rs 1,500 million during the first half of the financial year through December 1981 and Rs 2,130 million through March 1982.

5. It is too early at this stage to provide detailed quantitative indications for the 1982/83 budget. The Government will discuss with the Fund its proposals in this respect before the end of May 1982 in the context of the mid-term review of the program. It is, nevertheless, the objective of the Government to reduce further the overall deficit (excluding the Sinking Fund contributions and capital repayments) to less than 11 per cent of GDP.

6. The present restrictive credit policy will be maintained to reinforce other policies to achieve the balance of payments target. In

February 1981 the lending rate for industries in the Export Processing Zone was increased from 11.75 per cent to 12.5 per cent. Also, effective October 1981, the interbank interest rates were freed in order to reactivate the interbank market, and the interest rate in this market has gradually moved up from 9.5 to 13.5 per cent. Furthermore, on November 21, 1981 bank rate was increased from 9.5 per cent to 12 per cent. Simultaneously, the monetary authorities abolished, with certain limited exceptions, the present maxima on interest rates applicable to bank lending in order to allow a more active role for the play of demand and supply factors in the market. These exceptions are in respect of lending to priority sectors, mainly sugar and the export processing zone. The maximum rate on saving deposits has also been abolished. These measures will enhance the mobilization of resources and provide for a more efficient allocation of credit. For purposes of monitoring the program, total domestic credit (defined so as to include the local currency counterpart in respect of purchases from the Fund as well as the utilization of any additional medium-term nonconcessional external loans as defined in paragraph 7 below and the exchange loss incurred by the Bank of Mauritius in respect of rice and wheat flour imports but to exclude credit to the private sector in respect of nonsugar export bills rediscounted or official external loans channelled as credit to the private sector through local banks) which amounted to Rs 5,430 million at the end of September 1981, will not exceed Rs 5,960 million on February 28, 1982, and Rs 6,200 million on May 31, 1982. Within these overall ceilings, net credit to the Government (defined as the sum of credit from the banking system plus the use of local currency counterpart in respect of purchases from the Fund as well as any medium-term external nonconcessional loans, as defined in paragraph 7 below, less government deposits with the banking system) which amounted to Rs 3,208 million at the end of June 1981 and to Rs 3,283 million at the end of September 1981, will not exceed Rs 3,610 million on February 28, 1982 and Rs 3,730 million on May 31, 1982. The ceilings for the balance of the program period after May 31, 1982 will be determined in the context of the review which will take place before the end of May 1982.

7. Mauritius' external debt service burden, including obligations to the Fund, accounts for about 14 per cent of exports of goods and services. Keeping in view the possibility that it will take a few years to achieve a sustainable payments position, while in the meantime additional balance of payments loans may need to be contracted, the Government intends to limit the contracting and guaranteeing of new nonconcessional foreign borrowing with original maturity of between 1-10 years to no more than SDR 65 million during the program period. Of this amount, no more than SDR 20 million will be contracted with original maturity of between one to five years, and no more than SDR 20 million would be drawn down before February 28, 1982, and no more than SDR 35 million before end-May 1982. The Government is hopeful that in the course of 1982 the second Consultative Group will be convened by the World Bank and discussions will begin on a second structural adjustment loan.

8. 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 arrangements with Fund members.