

DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

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CONFIDENTIAL

December 23, 1981

To: Members of the Executive Board
From: The Acting Secretary
Subject: Mauritius - Stand-By Arrangement

Attached for the records of the Executive Directors is the text of the stand-by arrangement for Mauritius agreed at Executive Board Meeting 81/160, December 21, 1981.

Att: (1)

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 December 21, 1981 to December 20, 1982 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 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 the policy 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 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. Bank rate was increased from 9 1/2 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 amount 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 13 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.