

EBS/81/236
Correction 1

CONFIDENTIAL

December 18, 1981

To: Members of the Executive Board
From: The Secretary
Subject: Mauritius - Request for Stand-By Arrangement and Approval of
Multiple Currency Practice

The following corrections have been made in EBS/81/236 (12/7/81):

Page 35, para. 1, line 11: for "These include several severe"
read "These include severe"

para. 2, line 19: for "continuation of restrained"
read "continuation of the policy of restrained"

Page 36, line 2: for "deficit to SDR 110"
read "deficit SDR 110"

Page 37, lines 5 and 6: for "Furthermore....increased from 9.5 per cent"
read "Bank rate was increased from 9 1/2 per cent"

line 21: for "which amounted to"
read "which amount to"

first full para., line 2: for "14 per cent"
read "13 per cent"

Corrected pages are attached.

Att: (3)

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.