

EBS/82/182

CONFIDENTIAL

October 7, 1982

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

Attached for consideration by the Executive Directors is a paper on the mid-term review of the stand-by arrangement for Mauritius. A draft decision appears on pages 17 and 18.

This subject will be brought to the agenda for discussion on a date to be announced.

Att: (1)

INTERNATIONAL MONETARY FUND

MAURITIUS

Mid-Term Review of the Stand-By Arrangement

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

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

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

October 6, 1982

I. Introduction

On December 21, 1981 the Executive Board approved Mauritius' request for a one-year stand-by arrangement for an amount equivalent to SDR 30 million (74.1 per cent of quota), 1/ phased to be purchased in four equal amounts. So far, Mauritius has made two purchases totaling SDR 15 million under the arrangement. As of September 30, 1982, the Fund's holdings of Mauritian rupees amounted to SDR 175.7 million, or 433.9 per cent of quota, including SDR 40.5 million, or 100 per cent of quota, under the compensatory financing facility; if the remaining amount available under the stand-by arrangement is purchased, the Fund's holdings of Mauritian rupees would rise to SDR 190.7 million, or 471.0 per cent of quota.

The mid-term review of the present stand-by arrangement was held in Washington between a Mauritian delegation, headed by the Minister of Finance, and the staff during the period September 13-16, 1982. These discussions were preceded by two brief staff visits, one in April 1982 and a second in July. 2/

1/ EBS/81/236 of December 7, 1981 and Supplement 1.

2/ Discussions that provided the basis for the mid-term review were held in Port Louis during April 3-10, 1982 and July 12-18, 1982. The staff team which participated in one or both visits consisted of Messrs Bhatia, Abu-zobaa, Gibson, Gilman, Lipton, and Mrs. Jathoo and Miss Duane (both secretaries). The staff team which carried out the discussions in Washington was composed of Messrs. Abu-zobaa (head-AFR), Gilman (AFR), and Lipton (ETR).

When the present stand-by arrangement was approved by the Executive Board, it was envisaged that the mid-term review would be concluded by the end of May 1982. The review entailed reaching understandings with the Fund on exchange policies, as well as on budgetary policies for fiscal year 1982/83 (July-June), and the establishment of performance criteria on total credit to the economy, net credit to Government, and on commitment and drawdowns of nonconcessional medium-term external borrowing beyond May 1982. The delay in carrying out the review was due to the dissolution of the Legislative Assembly on December 17, 1981, the impending general elections which were held on June 11, and the consequent delay in the preparation of the 1982/83 budget. 1/

The present stand-by arrangement is the third for Mauritius since late 1979. The background and objectives of the program are set out in Section II below; performance is reviewed in Section III; and policies for 1982/83 are set out in Section IV.

To date, Mauritius has received four IDA credits and 13 IBRD loans, totaling US\$135.5 million, of which US\$89.8 million has been disbursed. The Bank is organizing a Consultative Group of potential donors to meet in the first half of 1983. The Mauritian authorities have initiated discussions with the Bank regarding a second Structural Adjustment Loan (SAL). A first SAL of US\$15 million was fully disbursed in April 1981.

II. Background

The three successive, Fund-supported programs were necessitated by a rapidly deteriorating financial situation following the end of the sugar price boom of the mid-1970s. The large increases in domestic demand, and in particular public consumption expenditure, were clearly unsustainable and led to the widening of the external current account deficit to 14.5 per cent of GDP by FY 1980/81 (Table 1 and Chart 1). Despite the wide range of measures taken, unfavorable external developments, and adverse weather conditions slowed down the process of adjustment, and the internal and external financial situation was still difficult when the program supported by the present stand-by arrangement was designed.

1/ In view of this delay, the Executive Board approved the extension of the multiple currency practice, introduced in September 1981, when the exchange rate of the Mauritian rupee was changed, until August 31, 1982, or the completion of the mid-term review, whichever was earlier (EBS/82/79). Under the multiple currency practice, imports of rice and wheat flour on government account continued under the old exchange rate. This practice was abolished on August 31, 1982.

Table 1. Mauritius: Selected Economic and Financial Indicators,
1979/80-1982/83

	1979/80	1980/81	1981/82		1982/83
			Program	Actual	Program
(Annual per cent changes, unless otherwise specified)					
National income and prices					
GDP at constant prices	3.0	-7.0	5.0	5.0	5.5
GDP deflator	23.0	24.0	18-20	16.0	7.5
Consumer prices	32.6	26.5	25.0	13.0	12.0
External sector (on the basis of SDRs)					
Exports, f.o.b.	7.6	-6.3	14.6	16.4	6.0
Imports, c.i.f.	8.6	11.9	1.0	-13.8	8.4
Non-oil imports, c.i.f.	3.7	12.2	...	-18.7	9.5
Terms of trade (deterioration -)	-4.8	-6.4	-6.8
Nominal effective exchange rate (depreciation -)	-25.7	2.2	...	-10.1	--
Real effective exchange rate (depreciation -)	-9.4	6.1	...	-8.2	--
Government budget					
Revenue, excluding grants	27.4	12.7	21.9	8.6	24.3
Total expenditure	27.5	10.8	19.6	13.4	12.3
Money and credit					
Domestic credit	26.5	28.6	21.6	22.4	20.0
Government	38.6	36.0	23.1	28.4	26.0
Private sector	13.6	18.9	19.5	13.4	10.0
Money and quasi-money	14.3	8.6	12.3	18.0	15.0
Interest rate (annual rate one-year savings deposit)	10.0	10.0	...	12.25	12.25
(In per cent of GDP)					
Central government savings	-1.5	-2.6	-2.1	-4.5	-1.8
Central government budget deficit					
Excluding grants	13.7	13.3	12.6	13.2	11.0
Including grants	13.7	13.1	12.3 ^{1/}	12.5 ^{1/}	10.0
Domestic bank financing ^{2/}	8.8	8.6	6.2	7.6	7.5
Foreign financing ^{2/}	4.0	3.5	5.6	3.0	0.9
Gross domestic investment	23.7	22.3	...	16.6	...
Gross domestic savings	14.3	7.8	...	9.1	...
External current account deficit					
Excluding transfers	12.0	16.5	13.7	7.3	7.8
Including transfers	10.2	14.5	11.8	5.4	5.9
External debt (preliminary)	20.0	26.6	32.8	29.1	29.8
Inclusive of use of Fund credit	26.7	38.8	45.5	42.7	43.2
Debt service ratio (in per cent of exports of goods and nonfactor services, including Fund)	6.4	14.7	14.2	12.5	18.6
Interest payments (in per cent of exports of goods and nonfactor services)	5.0	9.2	...	9.1	9.1
(In millions of SDRs, unless otherwise specified)					
Overall balance of payments	-53.0	-95.3	-65.0	-33.0	-50.0
Gross official reserves (months of imports)	...	0.5	0.5	1.1	0.8

Source: Ministry of Finance; Bank of Mauritius; and staff estimates.

^{1/} Including exchange loss of Mau Rs 57 million on imports of rice and wheat flour.

^{2/} Eurodollar loans for Mauritius are recorded as domestic bank financing.

The initial targets of the program were established for fiscal 1981/82. They assumed that real GDP would grow by 5 per cent and the rate of inflation would decline to about 25 per cent. The program aimed at reducing the external current account deficit in relation to GDP from 14.5 per cent in 1980/81 to 11.8 per cent in 1981/82. ^{1/} The overall balance of payments deficit was to be limited to SDR 65 million, or about one third less than the deficit recorded in the previous year. The program aimed at reducing the overall budgetary deficit from 13.1 per cent of GDP in 1980/81 to 11.9 per cent in 1981/82 (12.3 per cent inclusive of exchange losses on imports of rice and wheat flour borne by the Bank of Mauritius--see below). The expansion in total domestic credit was to be limited to 21.6 per cent and broad money was forecast to increase by 12.3 per cent.

To attain the program targets, on September 27, 1981 the Mauritian rupee was depreciated by 16.7 per cent, in foreign currency terms, except for transactions relating to imports of rice and wheat flour on government account, where the old exchange rate of SDR 1 = Rs 10 continued to apply. ^{2/} Several fiscal measures were also introduced, in addition to those taken when the 1981/82 budget was announced and no compensating wage increases for the cost-of-living impact of the depreciation were granted during 1981/82. The interbank market was reactivated and ceilings on all deposit rates and most lending rates were eliminated, with the bank rate and the remaining lending rates being raised by 1.5 percentage points to 12 per cent and 14 per cent respectively.

III. Performance Under the Program

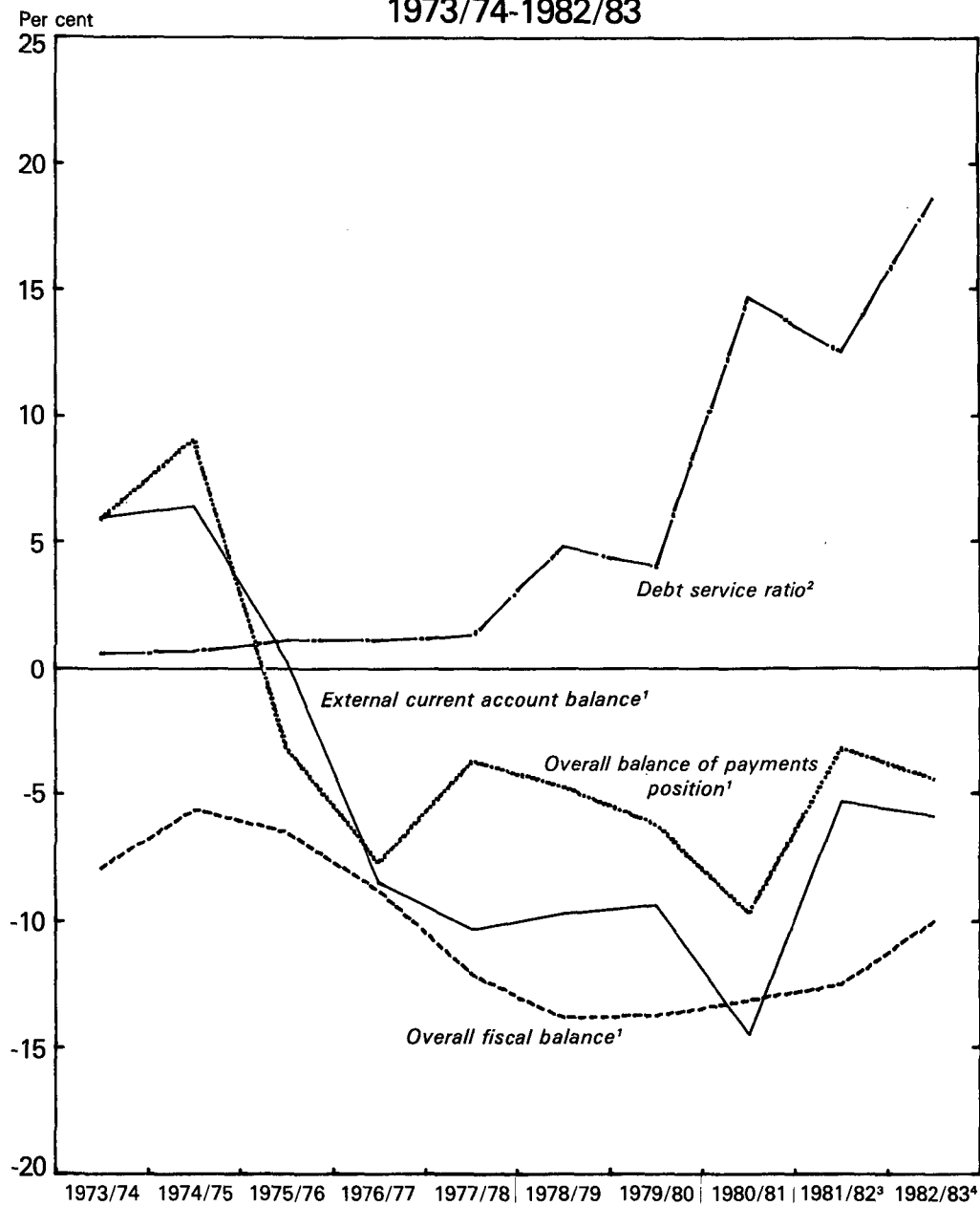
Performance under the program was encouraging. All quantitative performance criteria were observed through the end of May 1982, which was the last test date, and most of the program targets were attained, and in certain respects, surpassed (Table 1).

Preliminary estimates indicate that real GDP grew by 5 per cent in 1981/82 as assumed under the program; much of the growth was attributable to the recovery of sugar production from the very low level of the previous year. At the same time, the inflation rate, as measured by the consumer price index, slowed to about 13 per cent, compared with a program target of 25 per cent. This deceleration occurred despite the pass-through of the September exchange rate adjustment to all import prices, except for those of rice and wheat flour. Indications are that the reductions in the rate of inflation compared with the program target was due to a

^{1/} The Central Statistical Office has recently revised upwards the national accounts data. As a result, the various program targets as ratios of GDP, have been reduced by about 1 percentage point from those contained in EBS/81/236.

^{2/} The Mauritian rupee is pegged to the SDR at the rate of SDR 1 = Mau Rs 12.0. Most exports, especially sugar, are denominated in European Currency Units (ECU), while most imports, especially oil, are denominated in U.S. dollars.

CHART 1
MAURITIUS
SELECTED ECONOMIC AND FINANCIAL INDICATORS,
1973/74-1982/83



Source: Ministry of Finance, Bank of Mauritius, staff estimates.

¹Percentage with respect to GDP at current market prices.

²Debt service payments as a percentage of exports of goods and nonfactor services.

³Preliminary.

⁴Staff estimates.

lower rate of world inflation given the relatively large share of imports in GDP, a squeeze in profit margin of traders who ran down their stocks in response to higher interest rates, and a generally greater demand restraint in the aftermath of the currency depreciation.

The 1981/82 overall budgetary deficit, inclusive of the exchange losses on rice and flour imports, was limited to the equivalent of 12.5 per cent of GDP, very close to the target of 12.3 per cent. While the overall deficit was in line with the program, net credit to Government was higher than projected due to a shortfall in net foreign financing. Total revenues (inclusive of grants) increased by 11.5 per cent, or considerably less than the 22.8 per cent assumed in the program. Almost the entire amount of the estimated revenue shortfall of Rs 240 million was due to the decline in imports of about 14 per cent in SDR terms, which adversely affected receipts from taxes on imports. On the expenditure side, there has been firm control on outlays. Total expenditure and net lending was 5.2 per cent lower than programmed and represented 32.3 per cent of GDP in 1981/82, as against 34.7 per cent in 1980/81. All the decline was in capital outlays. Recurrent expenditure was kept constant at about 24 per cent of GDP, despite significant increases in interest payments on external public debt. Preliminary data indicate that outlays on wages and salaries were strictly controlled, with the total wage bill increasing by 15.5 per cent over 1980/81; of this increase the component for the cost-of-living adjustment was 13 per cent against an inflation rate of 26.5 per cent in 1980/81. Capital expenditure and net lending, which was programmed to increase by 18.0 per cent over 1980/81, fell by 6.8 per cent compared with the previous year. The decline in capital spending was due to a slow rate of project implementation and a deliberate delay in implementing low priority projects financed mostly from domestic resources.

In regard to monetary policy, the rate of credit expansion slowed to 22.4 per cent, as against 28.6 per cent during the preceding year, but was slightly higher than programmed. This moderation occurred despite the larger than programmed increase in net credit to the Government, which was partly offset by a slower than projected rate of increase in credit to the private sector. As indicated earlier, a large shortfall in net foreign financing of the fiscal deficit was responsible for a greater recourse by the Government to the banking system particularly during the last month of the fiscal year. Broad money rose by 18 per cent in 1981/82 compared with a program target of 12.3 per cent, owing mainly to a better than envisaged balance of payments performance.

The external current account deficit for 1981/82 was projected in the program at SDR 123 million (11.8 per cent of GDP) and the overall deficit at SDR 65 million. In the event, the outturn was considerably more favorable, with the current account deficit amounting to SDR 56 million (5.4 per cent of GDP) and the overall deficit to SDR 33 million. This improvement was due solely to a 13.8 per cent decline in imports, reflecting the impact of the reduction in project-related imports, the depreciation of the rupee and the prudent demand management policies.

Exports were on target. Sugar exports in 1981/82 of 546,000 tons went entirely to the EEC under the sugar protocol of the Lomé Convention, ^{1/} and other exports were about on target. The overall balance of payments deficit was financed through net purchases of SDR 20 million from the Fund under the previous and present stand-by arrangements in 1981/82 (Chart 2). In addition, on May 5, 1982, Mauritius contracted a Eurodollar loan of US\$40 million (equivalent to SDR 35.3 million) for eight years at 1-1/2 per cent above LIBOR, and with a grace period of four years. The drawdown was made in two phases: SDR 35 million was drawn on May 25 and the remainder on June 1, 1982. As a result, the Bank of Mauritius was able to increase its gross foreign exchange reserves by SDR 18 million over the course of fiscal 1981/82 to reach the equivalent of one month's imports, as compared to about two weeks' imports a year earlier. The debt service burden in 1981/82, inclusive of charges and repurchases to the Fund, was equivalent to 12.5 per cent of exports of goods and nonfactor services, compared with 14.7 per cent in the previous fiscal year; the decline is attributed to an increase in exports compared with 1980/81.

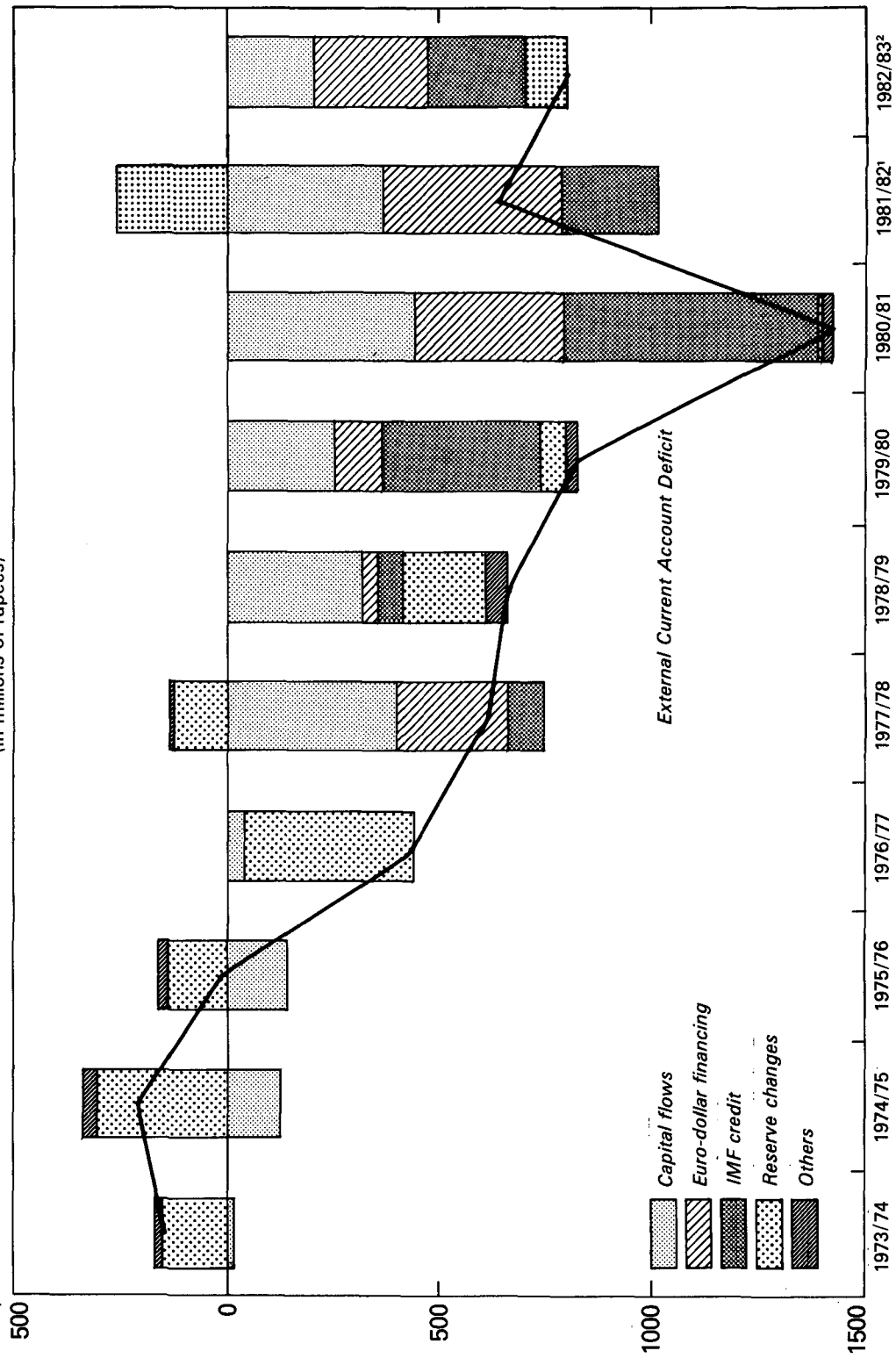
As indicated earlier, in September 1981, the Mauritian rupee was depreciated by 16.7 per cent in foreign currency terms. Between September 1981 and June 1982, the real effective exchange rate appreciated by 6.7 per cent (Chart 3), due mainly to the appreciation of the SDR vis-à-vis Mauritius' major trading partners. The authorities are aware of the implication of this appreciation on the competitiveness of the economy and are studying the question of the appropriate basket against which the rupee should be pegged.

IV. Policies for the Period Ahead

The new Government, which assumed office in mid-June 1982, quickly recognized the need to continue on the adjustment path initiated in 1979, and which has recently begun to produce positive results. The authorities moved swiftly to formulate policies designed to reduce the internal and external financial imbalances through the adoption of prudent demand management policies. The 1982/83 budget contained measures aimed at achieving the above objectives and providing the basis for discussions of the mid-term review, and even for a new program after the expiration of the present arrangement.

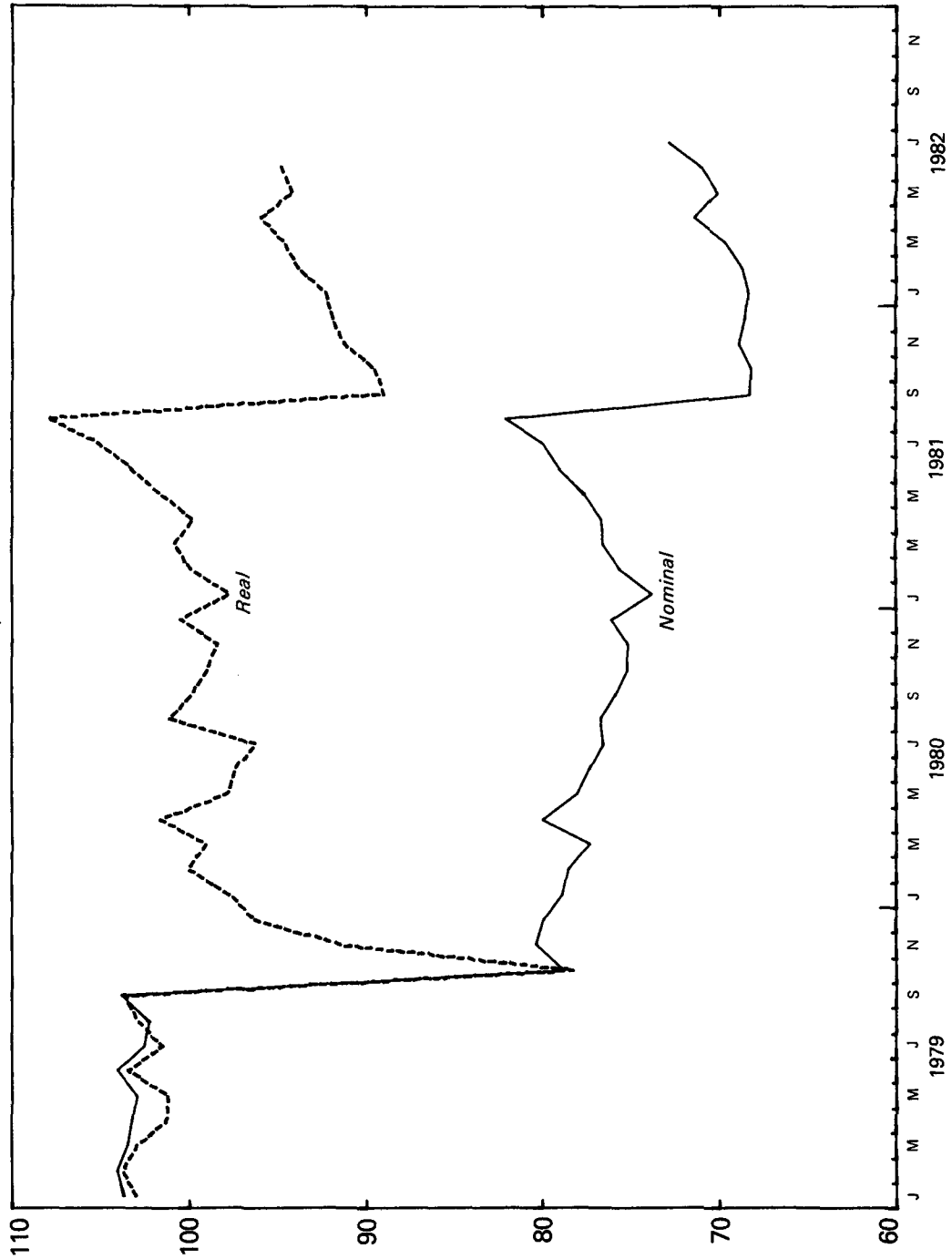
^{1/} Total sugar output was 574,500 tons, with somewhat less than 30,000 tons for domestic consumption. Under the Lomé Convention, Mauritius' annual quota is 500,000 tons; the additional 46,000 tons were exported to make up for the shortfall in the 1980/81 delivery, which was adversely affected by cyclones.

CHART 2
MAURITIUS
FINANCING OF THE EXTERNAL CURRENT ACCOUNT DEFICIT, 1973/74-1982/83
(In millions of rupees)



Source: Ministry of Finance and staff estimates.
¹Preliminary.
²Staff estimates assuming no disbursement of SAL II from IBRD.

CHART 3
MAURITIUS
NOMINAL AND REAL EFFECTIVE EXCHANGE RATES; IMPORT WEIGHTED
(January 1976=100)



The 1982/83 budget aims at reducing the overall deficit from 12.5 per cent of GDP to about 10 per cent of GDP (Table 2). The budget was approved by the Legislative Assembly in mid-August; expenditure made since the beginning of the fiscal year was carried out on the basis of appropriations of the previous year's budget. The budget assumes that, in the course of the fiscal year, the IBRD will disburse Rs 150 million under a second structural adjustment loan presently under discussion. Also, the budget assumes the receipt of Rs 132 million in foreign grants, up from Rs 77 million in 1981/82, and the authorities are now in the process of securing these additional resources. While confident that budgeted revenues, including external grants, will be realized, they have made it clear that in the event of a shortfall, they would not hesitate to take supplementary measures, including cutbacks in expenditure. The 1982/83 budget contains several new revenue and expenditure measures designed to achieve the above-mentioned reduction in the deficit.

Revenues are budgeted to recover to their 1980/81 level in relation to GDP, i.e., to rise from 19.8 per cent in 1981/82 to 22.0 per cent. Principal revenue measures include increasing the rate of stamp duties on imports, applicable to about 70 per cent of the total, from 5 per cent to 12 per cent. This measure is expected to yield an additional Rs 202 million during the fiscal year. Furthermore, the Government will soon submit draft legislation to the Legislative Assembly to introduce a sales tax applicable up to the wholesale level, but excluding services, at a rate of 5 per cent with a target introduction date of January 1, 1983. Much of the preparatory work has been carried out with technical assistance from the Fund and additional assistance has been provided to expedite implementation. The initial yield from the sales tax for the second half of 1982/83 is estimated at Rs 75 million. On the other hand, the 75 per cent surcharge on sugar export duties, introduced at the time of the October 1979 depreciation, has been reduced to 50 per cent so as to alleviate the financial burden on the sugar industry caused by the decline in world market prices and the need to increase investment in order to remain competitive.

In addition to increase in the rate on stamp duties and the planned introduction of the sales tax, a major effort is being made to improve tax administration along the lines of the recommendations of a Fund technical assistance mission in 1980. A review of existing exemptions from import duties will be carried out during the course of the fiscal year with a view to their rationalization, reduction in their scope, and setting clear guidelines for future exemptions from duty. Furthermore, a unified revenue service will be established during the fiscal year with the assistance of the Fund. Its creation should help to reduce tax evasion, although it is unlikely to lead, in the short-run, to higher revenues. The authorities are also considering the establishment of a pay-as-you-earn scheme to accelerate and verify tax collection. For the purposes of the program, no account has been taken of these prospective administrative reforms for the revenue estimates in 1982/83.

Table 2. Mauritius: Central Government Operations, 1980/81-1982/83

(In millions of rupees)

	1980/81 Actual	1981/82 Program	Prelimi- nary actual	1982/83 Program <u>1/</u>
Revenue	2,112	2,574	2,294	2,851
Grants	14	37	77	132
Total revenue and grants (in per cent of GDP)	<u>2,126</u> (21.6)	<u>2,611</u> (21.8)	<u>2,371</u> (19.8)	<u>2,983</u> (22.0)
Recurrent expenditure	2,378	2,862	2,906	3,222
Of which: food subsidies <u>2/</u>	203	282	285	246
Capital expenditure and net lending	1,038	1,225	967	1,129
Total expenditure and net lending (in per cent of GDP)	<u>3,416</u> (34.7)	<u>4,087</u> (34.1)	<u>3,873</u> (32.3)	<u>4,351</u> (32.0)
Overall deficit (in per cent of GDP)	<u>-1,290</u> (13.1)	<u>-1,476</u> (12.3)	<u>-1,502</u> (12.5)	<u>-1,368</u> (10.1)
Financing:				
External (net) <u>3/</u>	<u>344</u>	<u>669</u>	<u>357</u>	<u>118</u>
Disbursements	443	823	505	583
Amortization	-99	-154	-148	-465
Domestic	<u>946</u>	<u>807</u>	<u>1,145</u>	<u>1,250</u>
Banking system	850	742	910	1,023
Of which: Eurodollar (gross)	(354)	(403)	(414)	(269)
Nonbank	96	65	235	227
Of which: nonbank financial sector	(96)	(65)	(107)	(227)
Memorandum items:				
Eurodollar (net)	293	321	332	-93
Eurodollar (gross)	354	403	414	269
Amortization	-61	-82	-82	-362

Source: Ministry of Finance; and staff estimates.

1/ Assumes no SAL II disbursement in 1982/83.

2/ Inclusive of exchange losses on food imports in 1981/82 and 1982/83.

3/ Eurodollar financing is included in the banking system.

Total expenditure is budgeted to rise by 12.3 per cent compared with the 1981/82 outcome, but in relation to GDP remains at about the same level of 32 per cent. The increase in recurrent expenditure is being held to 10.9 per cent over 1981/82, reflecting largely the rise in wages and salaries. With regard to wages, a flat cost-of-living increase of Rs 135 per month has been granted to all employees effective July 1. Given the structure of existing employment and wages in the economy, the announced increase averages 6.4 per cent. In regard to government employees, the above wage award, combined with a one-week end-of-year bonus, would mean an increase of 8.5 per cent. These wage awards compare with the increase in the consumer price index of 13 per cent in 1981/82. Apart from the cost-of-living increase, normal increments would increase average wages by another 2-3 percentage points. The Mauritian authorities are fully cognizant of the need to continue a policy of wage restraint in order to preserve the international competitiveness of the economy. The Government is also acting on the question of food subsidies, and the amount of subsidies is set to decline from Rs 285 million to Rs 246 million. ^{1/} A white paper has been prepared on the subsidy question and an upward adjustment in retail prices of rice and wheat flour will take effect on November 1. Furthermore, the Government is carrying out a study to examine the possibility of rationalizing the subsidies so as to benefit the most needy segments of the population while keeping the lid on administrative overhead costs.

Capital expenditure and net lending are budgeted to rise by 16.8 per cent over the 1981/82 outturn; about one half of the projected expenditure is to be financed from external sources. The percentage of foreign financing will be higher to the extent that a second structural adjustment loan from the IBRD is disbursed during the fiscal year. Capital expenditure includes, inter alia, transfers to parastatal bodies such as the Development Works Corporation for "make work" projects. In recognition of the need to change this situation, the Mauritian authorities will study during the course of the fiscal year ways and means of reducing the numbers employed in the public sector. The 1982/83 budget also contains various measures designed to promote private investment and capital formation. These measures include the introduction of an investment allowance and the increase in the rates of depreciation for fixed assets.

With regard to exchange policies, the multiple currency practice, under which imports of rice and wheat flour were made at the old exchange rate of SDR 1 = Rs 10, was abolished effective August 31, 1982, the date to which the Board's approval was extended (EBS/82/79), and since then all external transactions are carried out at the rate of SDR 1 = Rs 12.

^{1/} Inclusive of exchange losses on imports of rice and wheat flour on government account.

The balance of payments is projected to remain manageable during 1982/83 (Table 3). This is based on the assumption that the projected increase in external grants and disbursements under the second SAL will not materialize in 1982/83. The current account deficit is expected to be about SDR 67 million, equivalent to about 6 per cent of GDP, up from SDR 56 million (5.4 per cent of GDP) in 1981/82, providing for a small recovery in import volume that year. Sugar output is estimated at about 700,000 tons, 70 per cent of which is to be shipped to the EEC under the Lomé Convention at preferential prices. ^{1/} Nevertheless, the value of sugar exports, when measured in SDRs, is not expected to differ from the previous year. This is due in part to the depreciation, in terms of SDRs, of the European Currency Unit (ECU) in which prices are negotiated, and the depressed prices on world markets where the remainder of sugar exports is sold. The Export Processing Zone, however, is benefiting from the continued effects of the depreciation of the rupee in September 1981, bolstered by the wage restraint, and export volume is projected to rise by about 5 per cent. In all, the increase in export value of about 6 per cent will be more than offset by a projected 8 per cent rise in imports due to restocking and the higher imports of the Export Processing Zone. The overall balance of payments deficit is expected to widen to SDR 50 million from SDR 33 million as a result of the increase in the current account deficit and a sharp rise in amortization payments falling due on Eurodollar borrowings. The authorities are optimistic that the current account and the overall deficits will be lower than projected through the receipt of the projected increase in foreign grants and the early disbursement of the second structural adjustment loan from the IBRD. The overall deficit is expected to be financed through the net use of Fund resources, including drawings on a program for 1983, some drawdown of reserves, which rose in 1981/82, and through reduced recourse to Eurodollar borrowing. The authorities expressed their firm intention that the amount of new Eurodollar borrowing will be lower than the amortization payments falling due, thereby contributing to an improvement in the external debt profile.

The debt service ratio of Mauritius, excluding obligations to the Fund, is estimated to rise from 10 per cent of exports of goods and nonfactor services in 1981/82 to about 15 per cent through 1983/84. The increase in the debt service burden is mainly the result of the bunching of repayments on Eurodollar loans contracted since 1979. Inclusive of charges and repurchases to the Fund, the debt service burden is projected to increase from 12.5 per cent to around 20-22 per cent of exports of goods and non-factor services over the next three years (Table 4).

^{1/} Of the 700,000 tons, 20,000 tons are being stored under the requirements of the International Sugar Agreement. The Mauritian authorities are expected to request use of Fund resources under the buffer stock financing facility.

Table 3. Mauritius: Balance of Payments, 1980/81-1982/83

(In millions of SDRs)

	1980/81	1981/82		1982/83
		Program	Actual	
Current account	-143	-123	-56	-67
Merchandise	-137	-101	-34	-43
Exports, f.o.b.	287	329	334	354
Sugar	(165)	(192)	(201)	(200)
EPZ	(92)	(103)	(104)	(121)
Other	(30)	(34)	(29)	(33)
Imports, f.o.b.	-424	-430	-368	-397
Imports, c.i.f.	-500	-505	-431	-467
Rice flour	(-50)	(-49)	(-41)	(-38)
Petroleum	(-73)	(-78)	(-84)	(-87)
EPZ	(-70)	(-81)	(-63)	(-73)
Other	(-307)	(-297)	(-243)	(-269)
Services	-25	-42	-42	-45
Freight and insurance	(-68)	(-75)	(-57)	(-64)
Other transportation	(12)	(30)	(14)	(18)
Travel	(20)	(24)	(22)	(29)
Investment income	(-27)	(-40)	(-43)	(-46)
Other	(38)	(19)	(22)	(18)
Transfers	19	20	20	21
Capital account	45	58	23	17
Official	20	58	31	10
Disbursements	(29)	(...)	(44)	48
Amortization	(-9)	(...)	(-13)	(-39)
Other	9	--	-7	7
Errors and omissions	15	--	-1	--
SDR allocation	3	--	--	--
Overall balance	-95	-65	-33	-50
Financed by:				
Eurodollar	(35)	(35)	(36)	(22)
IMF (net)	(56)	(28)	(20)	(19)
Bank of Mauritius (increase -)	(4)	(2)	(-23)	(9)
Memorandum items:				
Gross reserves end of period				
SDRs	21	19	38	30
In months of imports	0.5	0.5	1.1	0.8
Current Account/GDP	-14.5	-11.8	-5.3	-5.9
Overall balance/GDP	-9.7	-6.2	-3.2	-4.4
Eurodollar amortization (SDRs)	6	7	7	30

Sources: Bank of Mauritius; and staff estimates.

Table 4. Mauritius: Debt Service Payments

(In millions of rupees)

	1981/82	1982/83	1983/84	1984/85	1985/86
Eurodollar loans <u>1/</u>					
Interest	199	271	240	175	135
Principal	82	362	441	293	248
Other government loans					
Interest	104	124	142	144	152
Principal	66	100	117	129	179
Parastatal bodies					
Interest	31	42	43	42	39
Principal	<u>33</u>	<u>52</u>	<u>52</u>	<u>46</u>	<u>46</u>
Total (excluding Fund)					
Interest	334	437	425	361	326
Principal	181	514	610	468	473
Debt service ratio <u>2/</u> (excluding Fund)	9.7	15.7	15.4	10.9	9.3
Fund <u>3/</u>					
Charges	148	114	197	214	172
Repurchases	<u>—</u>	<u>61</u>	<u>235</u>	<u>530</u>	<u>505</u>
Total debt service payments in rupees	663	1,126	1,467	1,573	1,476
Total debt service payments in SDRs	57.6	93.8	122.3	131.1	123.0
Debt service ratio <u>2/</u> (including Fund)	12.5	18.6	21.8	20.7	17.2

Source: Ministry of Finance; Bank of Mauritius; and staff estimates.

1/ Assumes a new Eurodollar borrowing of 269 million rupees on January 1, 1983.

2/ As a percentage of exports of goods and nonfactor services.

3/ Assumes completion of the review and a program of 125 per cent of quota between January 1, 1983 and December 31, 1984.

Broad money is projected to increase by about 15 per cent in 1982/83 (Table 5). Taking into account the balance of payments target, total domestic credit is projected to rise by 20.0 per cent in 1982/83 compared with 22.4 per cent in 1981/82 and 28.6 per cent in 1980/81. Net credit to Government is projected to increase by 26 per cent; the increase would be lower to the extent that disbursements are made during the fiscal year under the IBRD's second structural adjustment loan. The relatively large recourse of the Government to the domestic banking system despite the reduction in the overall budget deficit is due mainly to the aforementioned larger amortization payments in respect of previously contracted Eurodollar loans.

Performance criteria relating to expansion in total domestic credit and net credit to Government were set for end-October 1982 (Table 6). The ceilings have been based on both the examination of the past seasonality pattern, as well as the official projections of various financial flows. The Government will limit during the program period the contracting, guaranteeing, and drawing down of nonconcessional external borrowing of one-to-ten years' maturity to SDR 29.7 million (i.e., the amount of the unutilized portion of a ceiling of SDR 65 million already approved in the program). The authorities expressed their intention that drawings on nonconcessional external loans would be even lower during the entire fiscal year, and the program for 1982/83 projects that such drawings will be limited to SDR 22 million. They indicated that recourse to commercial borrowing may be even lower if disbursements under the IBRD's second SAL begin during the present fiscal year.

Drawings under the current stand-by arrangement were phased so that the third purchase of SDR 7.5 million would be effected after June 10, 1982, following the conclusion of the mid-term review and the observance of end-May performance criteria. The fourth and final purchase of SDR 7.5 million, was to be made after September 10, subject to satisfaction of end-August performance criteria. The latter ceilings were to be set up at the time of the mid-term review, originally envisaged before the end of May 1982. In view of the delay in concluding the mid-term review, the third purchase under the stand-by arrangement would be available to Mauritius upon the Board's conclusion of the review, particularly since the end-May performance criteria have been satisfied. It is proposed, consequentially, that the arrangement be amended so that the final drawing would be made on or after December 1, 1982, subject to satisfaction of the performance criteria established for end-October 1982.

Table 5. Mauritius: Monetary Survey, June 1980-June 1983

(In millions of rupees)

	1980		1981		1982		1983	
	June	Dec.	June	Oct.	June	Oct.	June	Proj.
Foreign assets (net)	-361	-397	-1,342	-1,255	-1,729	-1,800	-2,327	
Bank of Mauritius 1/	(-281)	(-347)	(-1,248)	(-1,130)	(-1,696)	(...)	(...)	
Commercial banks	(-80)	(-50)	(-94)	(-125)	(-33)	(...)	(...)	
Domestic credit	4,167	4,632	5,358	5,476	6,556	6,868	7,869	
Claims on Government (net)	2,358	2,751	3,208	3,297	4,118	4,385	5,187 2/	
Bank of Mauritius 1/	(1,544)	(1,771)	(2,493)	(2,500)	(3,343)	(...)	(...)	
Commercial banks	(814)	(980)	(715)	(797)	(775)	(...)	(...)	
Claims on private sector 3/	1,809	1,881	2,150	2,179	2,438	2,483	2,682	
Money (M ₂)	3,367	3,837	3,655	3,690	4,312	4,505	4,959	
Money (M ₁)	(1,372)	(1,721)	(1,390)	(1,340)	(1,513)	(...)	(...)	
Quasi-money	(1,995)	(2,116)	(2,265)	(2,350)	(2,799)	(...)	(...)	
Other items (net)	439	398	361	531	515	563	583	
Memorandum item:								
Total domestic credit 4/	4,167	4,618	5,283	5,369	6,480	6,730	...	

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/ Inclusive of Rs 46 million in exchange losses on rice and wheat flour imports in July-August 1982. This amount is excluded from the ceilings for end-October in Table 6.
- 3/ Includes nonsugar export bills rediscounted, and credit on-lent in respect of official external loans.
- 4/ For purpose of performance criteria, defined as the sum of domestic credit less nonsugar export bills re-discounted and credit on-lent by commercial banks to the private sector in respect of official external loans.

Table 6. Mauritius: Quantitative Performance Criteria and Indicative Targets Through October 1982

	<u>1981</u> Dec.	<u>1982</u> Feb.	<u>1982</u> May	<u>1982</u> Oct.
<u>(In millions of rupees; end of period)</u>				
Credit to Government (net) <u>1/</u>				
Ceiling	...	3,610	3,730	4,282
Actual	3,545	3,525	3,720	...
Total domestic credit <u>2/</u>				
Ceiling	...	5,960	6,200	6,730
Actual	5,794	5,849	6,158	...
<u>(In millions of SDRs)</u>				
New external borrowing commitments (cumulative) within program period				
1-10 years' maturity				
Ceiling		65	65	65
Actual		...	35.3	...
Of which:				
1-5 years' maturity				
Ceiling		(20)	(20)	(20)
Actual		(...)	(...)	(...)
Drawdown on new external borrowing (cumulative)				
Ceiling		35	35	65
Actual		...	35	...

1/ 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.

2/ Defined as credit to the 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 through May 1982.

V. Staff Appraisal and Proposed Decision

The economic and financial situation of Mauritius has improved significantly under the present economic program. With the depreciation of the rupee in September 1981, the wage restraint, and the generally prudent demand management policies pursued by the authorities, the external financial imbalance has been reduced. The current account and the overall balance of payments deficits were reduced substantially, and foreign exchange reserves more than doubled. The rate of inflation fell below onehalf that of the preceding year. The overall budgetary deficit was also reduced, notwithstanding the shortfall in revenue brought about almost entirely by the decline in imports; the improvement was due to a reduction in expenditure under the capital budget. Meanwhile, the economy appears to have recovered from the depressed level caused by the cyclone in 1979/80 and the drought in the following year.

Despite the progress made thus far, the authorities are aware of the fragility of the situation. Even under the most favorable weather conditions, sugar output in 1983/84 is expected to be substantially lower than in 1982/83, owing to the need for periodic replanting; and the possible recurrence of adverse weather conditions should not be overlooked. Meanwhile, sugar prices are at a very low level and prospects for recovery in the near term are not promising. Furthermore, the preferential treatment which Mauritius receives for sugar exports to the EEC is due for renegotiation in the coming year.

The newly elected Government has underscored its intention to persist in the adjustment effort, and the measures described in the attached letter of intent set out the course of policies even after the expiration of the existing stand-by arrangement. These policies are geared to reducing the financial imbalances through the continuation of wage restraint, and prudent demand management policies. On the supply side, measures have been taken in the context of the 1982/83 budget to promote investment and capital formation through the introduction of an investment allowance and an increase in rates of depreciation for fixed assets. The objective of the above policies is to bring down the external current account deficit to a level which can be financed by long-term capital inflow while gradually reducing the outstanding level of external commercial borrowing.

The focus of budgetary policies for 1982/83 is on the reduction of the overall deficit, both in absolute terms, and in relation to GDP, while providing for a recovery in capital outlays. Considerable emphasis has been placed on raising revenue, but apart from some reduction in subsidies, insufficient effort has been made to reduce expenditure on welfare programs as well as disguised unemployment. Therefore, additional steps will be required in the period ahead to contain such outlays, with a view to further reducing the overall budget deficit to a sustainable level.

Mauritius' track record has been good, and the authorities have implemented all measures contained in the program, while continuing to maintain a basically liberal trade and exchange system. The staff will remain in close contact with the Mauritian authorities, and a team is expected to visit Port Louis shortly to carry out the Article IV consultation discussions and negotiate a new program to be supported by further use of Fund resources. The staff believes that the measures which the new authorities have taken in the context of the mid-term review reflect their determination to persevere with the adjustment effort, and hence the program deserves continued Fund support. Accordingly, the following draft decision is prepared for adoption by the Executive Board:

1. Mauritius has consulted the Fund in accordance with paragraph 4(c) of the stand-by arrangement for Mauritius (EBS/81/236, Supplement 1, and Supplement 2 of December 23, 1981 and February 24, 1982, respectively) in order to reach understandings subject to which further purchases may be made by Mauritius under the stand-by arrangement.

2. The letter from the Minister of Finance and the Governor of the Bank of Mauritius, of September 30, 1982, shall be annexed to the stand-by arrangement for Mauritius, and the letter of December 5, 1981, attached to the stand-by arrangement, shall be read as supplemented by the annexed letter.

3. Accordingly, paragraph 4(a) of the stand-by arrangement shall be amended to read:

"(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 statement attached to the letter of intent dated December 5, 1981, and in paragraph 7 of the annexed letter of September 30, 1982, or

(ii) the limit on net credit by the banking system to Government as described in paragraph 6 of the statement attached to the letter of intent dated December 5, 1981, and in paragraph 7 of the annexed letter of September 30, 1982

are not observed, or."

4. Paragraph 2 of the stand-by arrangement for Mauritius is amended to read:

"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 December 1, 1982 but none of these limits shall apply to a purchase under the 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 borrowed resources beyond 12.5 per cent of quota."

ATTACHMENT I

Relations with the Fund
(As of September 30, 1982)

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.
Intervention currency:	Pound sterling
Status:	Article XIV
Fund holdings of Mauritian rupees:	SDR 175.74 million or 433.93 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 148,544 (or 0.94 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. Further discussions relating to the mid-term review of the present stand-by were held in Port Louis in April and July, and in Washington in September 1982.

September 30, 1982

Dear Mr. de Larosière:

1. In a letter dated December 5, 1981, the Government of Mauritius requested a one-year stand-by arrangement for an amount equivalent to SDR 30 million. The arrangement, in support of a program covering calendar 1982, was approved by the Executive Board on December 21, 1981. The initial targets of the program were established for fiscal year 1981/82 (July-June), and the performance criteria in respect of the banking system's total domestic credit, net credit to the Government, as well as the utilization of nonconcessional foreign borrowing were established through end-May 1982. It was envisaged that the targets and the performance criteria for the remaining period of the program would be established in the context of the mid-term review, at which time understandings would also be reached on the exchange policy and the budgetary policies for 1982/83.

2. Performance in 1981/82 indicates that the program targets have been attained and, in many respects, even surpassed. Further, all quantitative performance criteria were observed through end-May 1982, which was the last test date prior to the mid-term review. With the depreciation of the Mauritian rupee by 16.7 per cent, in foreign currency terms (except for imports of rice and wheat flour), wage restraint, and the pursuit of tight demand management policies, pressures on the balance of payments have been alleviated. The external current account deficit amounted to SDR 56 million (5.3 per cent of GDP), compared with a program target of SDR 123 million (11.8 per cent of GDP). The overall balance of payments deficit, including a new Eurodollar loan of SDR 35.3 million as a financing item, was equivalent to SDR 33 million, compared with a program target of SDR 65 million. The overall fiscal deficit (inclusive of exchange losses on imports of rice and flour) was equivalent to 12.5 per cent of GDP, very close to the target of 12.3 per cent. Meanwhile, the rate of inflation, as measured by the increase in the consumer price index, moderated to 13 per cent in 1981/82, compared with the program target of 25 per cent. The favorable balance of payments performance was mainly due to a 14 per cent reduction in imports, in SDR terms, compared with the program target. The adverse impact of this decline on Government revenues was partly offset by a reduction in capital expenditure. Parallel with favorable financial developments, preliminary estimates indicate that the Mauritian economy grew in 1981/82 by 5 per cent as assumed under the program.

3. The mid-term review was not carried out before end-May 1982, as originally envisaged. This was due mainly to the impending general election and the resulting delay in the preparation of the 1982/83 budget. The newly elected Government that took office in mid-June 1982 is determined to press ahead with the adjustment effort so as to reduce further the financial imbalances and set the stage for sustained economic growth.

4. Consistent with these objectives, the multiple currency practice has been abolished effective August 31, 1982 and the rate of SDR 1 = Rs 12 is now applying to all external transactions.

5. Despite the sharp decline in sugar prices on the world market, the balance of payments outlook for 1982/83 is manageable. With the sugar output estimated at about 700,000 tons (of which nearly 70 per cent is sold at preferential prices to the EC), the Government intends to limit the external current account deficit to about SDR 67 million, (equivalent to 5.9 per cent of projected GDP). In view of the large increase in the amortization payments falling due, the overall deficit is estimated at about SDR 50 million. The Government expects to finance this deficit mainly by net use of Fund resources, some drawdown of reserves, and borrowing from friendly countries. Any recourse to commercial borrowing will depend on both the speed with which disbursements under a Structural Adjustment Loan from the IBRD will be made and the amount of financial resources made available by friendly countries. In any event commercial borrowing within the limit specified in paragraph 8 below will be less than the amount of repayments on existing Eurodollar loans, contributing to an improvement in the external debt profile.

6. In regard to fiscal policy, the 1982/83 budget is designed with a view to reducing the overall budgetary deficit from 12.5 per cent of GDP to about 10 per cent. The budget assumes that, in the course of the fiscal year, the IBRD will disburse Rs 150 million under a Structural Adjustment Loan for balance of payments support, and that foreign grants will amount to Rs 132 million. While the Government is confident that these resources will be disbursed as planned, it will not hesitate to take additional measures, including cutbacks in capital expenditure, if it appears that a shortfall in these resources will not be offset by an increase in revenue. The budget contains several new revenue and expenditure measures. On the revenue side, the rate of stamp duties, which is applicable to about 70 per cent of imports, was raised by 7 percentage points to 12 per cent. In addition, the Government will soon submit to the Legislative Assembly a draft legislation to introduce beginning in 1983 a sales tax at the rate of 5 per cent, which will yield Rs 75 million during the second half of the fiscal year. On the other hand, the Government has reduced the surcharge on sugar exports from 75 per cent to 50 per cent so as to alleviate the financial burden on the sugar industry caused by the decline in the world market price. In addition to the introduction of new taxes and increasing the rates of existing ones, a major effort is being made in 1982/83 to improve the tax administration along the lines of the recommendations of a Fund technical assistance mission. A thorough review of existing exemptions from import duties will also be completed during the course of the fiscal year with a view to rationalizing and reducing them and setting clear guidelines for future exemptions from duties. Furthermore, a Unified Revenue Service will be established during this fiscal year and it is the Government's hope that its establishment will contribute to a reduction in tax evasion. On the expenditure side, a tapered wage increase,

averaging 6.4 per cent, has been granted to all employees effective July 1, 1982. In respect of government employees, the wage award amounts to about 8.5 per cent, inclusive of one week end-of-year bonus. These awards compare with the inflation rate of 13 per cent in 1981/82, thereby preserving the international competitiveness of the Mauritian economy. Furthermore, expenditure on food subsidies is budgeted to decline by 30 per cent in 1982/83 as the Government will soon announce upward adjustments in the retail prices of rice and flour. Further, the Government is carrying out a study to examine the possibility of rationalizing the subsidies so as to benefit the most needy segments of the population. In addition, the budget includes various measures designed to promote investment and capital formation. These measures include the introduction of an investment allowance and the increase in the rates of depreciation for fixed assets.

7. The structure of interest rates was liberalized in November 1981, when the minimum and maximum ceilings on all lending and deposit rates were abolished with the exception of the maxima on the prime rate and the export finance rate, which were raised by 1 1/2 percentage points each to 14 per cent and 12.75 per cent, respectively. The Government is considering further liberalization of interest rates and will reach a decision before the end of 1982. For the purpose 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 8 below but to exclude credit to the private sector in respect of nonsugar export bills rediscounted or official external loans channeled as credit to the private sector through local banks), which amounted to Rs 6,480 million at the end of June 1982, will not exceed Rs 6,730 million on October 31, 1982. Within this overall ceiling, 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 8 below, less government deposits with the banking system) which amounted to Rs 4,061 million at the end of June 1982, will not exceed Rs 4,282 million on October 31, 1982. Given the projected overall budgetary deficit in 1982/83 and the anticipated net financing from foreign and domestic nonbank sources, the Government will endeavor to limit its net increase in domestic bank credit to Rs 1,023 million.

8. Since the stand-by arrangement was approved by the Executive Board, Mauritius has contracted and utilized SDR 35.3 million of medium-term nonconcessional foreign borrowing with original maturity of between 1 and 10 years. Until the stand-by arrangement expires on December 20, 1982, the Government intends to limit the contracting, guaranteeing, and drawing down of nonconcessional external borrowing of 1 to 10 years' maturity to SDR 29.7 million. It is the Government's intention that drawings on nonconcessional external loans would not exceed this amount during the entire fiscal year.

9. The Government believes that the policies set forth in this letter will ensure that the objectives of reducing the financial imbalances are being carried out as intended and will take any further measures that may become appropriate to attain these objectives.

Sincerely yours,

/s/

Indurduth Ramphul
Governor
Bank of Mauritius

/s/

Paul Raymond Bérenger
Minister of Finance

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