

Mauritius

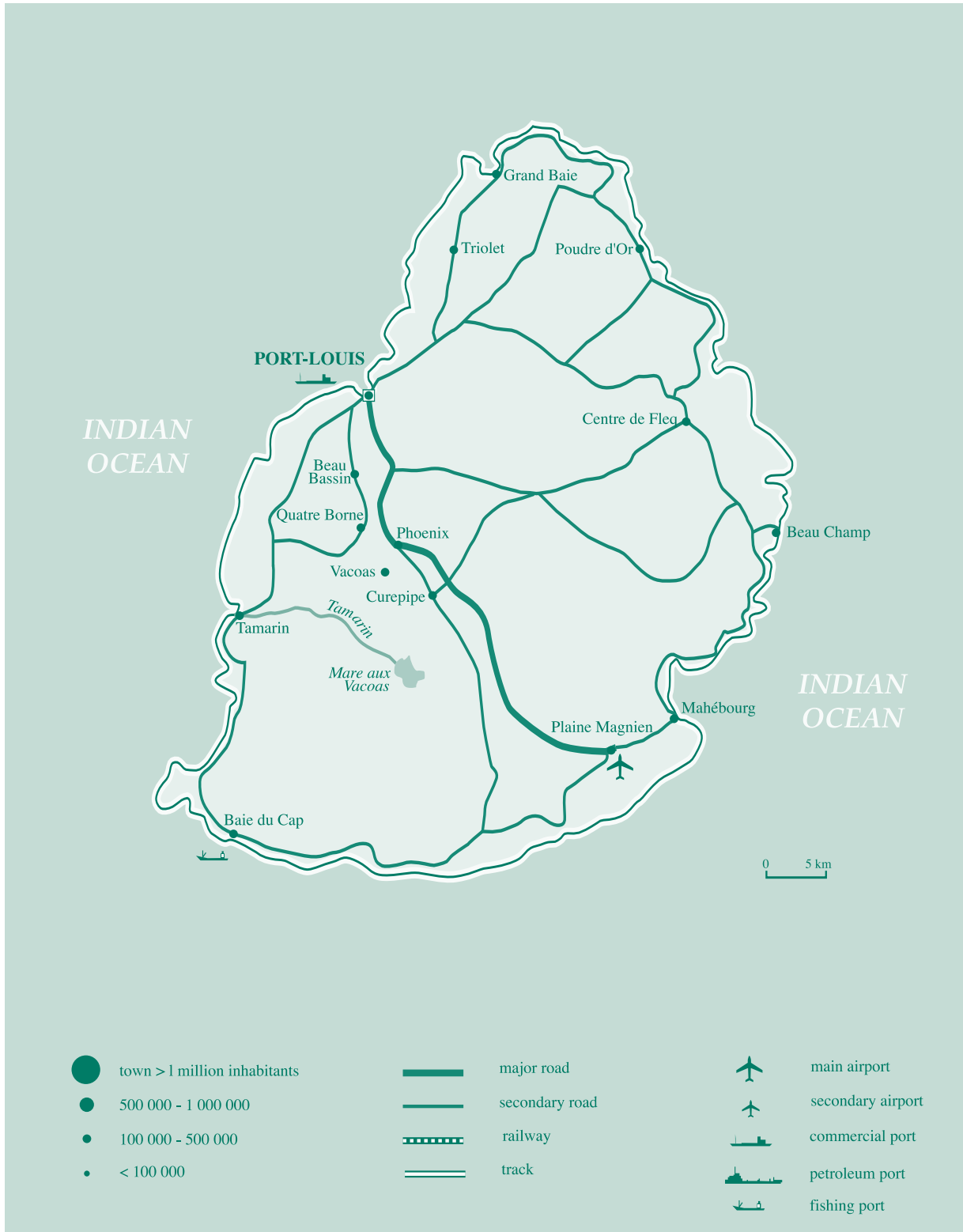


Port-Louis

key figures

- Land area, thousands of km² 2
- Population, thousands (2006) 1 256
- GDP per capita, \$ PPP valuation (2006) 14 519
- Life expectancy (2006) 72.8
- Illiteracy rate (2006) 15.6

Mauritius



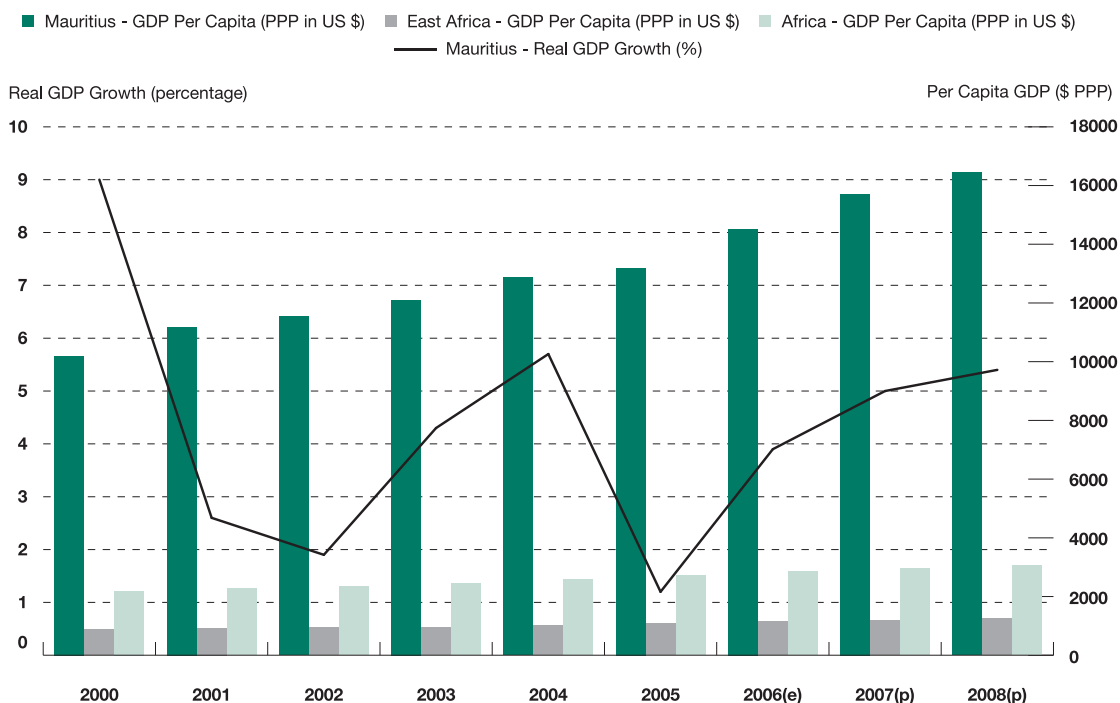
MAURITIUS HAS MADE CONSIDERABLE progress in transforming its economy from a low-income country to a middle-income country based primarily on the production and exports of sugar and textiles. This progress was made possible by a combination of sound macroeconomic and structural policies, steady investments in economic and social infrastructure, and preferential access to the European Union (EU) market under the sugar protocol and to world markets under the Multifibre Arrangement (MFA). This has enabled Mauritius to make important progress towards achieving several of the Millennium Development Goals (MDGs). In 2006, Gross Domestic Product (GDP) growth is estimated to have been 3.9 per cent, up from 1.2 per cent in 2005 due to strong growth in tourism and some recovery in the textile sector. Growth is expected

to accelerate to 5 and 5.4 per cent in 2007 and 2008, respectively, as efforts to diversify the economy begin to bear fruit.

The country's economic and social progress is now under threat from three external trade shocks. The first of these shocks was a consequence of the end of the MFA on 1 January 2005. The second was the decision by the EU to cut its guaranteed sugar import price and hence reduce the price of sugar imported from Mauritius by 36 per cent over the four-year period 2006–09. The third shock was the recent rise in world energy prices. These developments have

Economic and financial policy reforms in the 2006/07 budget will boost economic growth but increased exports are required to reduce high and persistent current account deficits.

Figure 1 - Real GDP Growth and Per Capita GDP
(\$ PPP at current prices)



Source: Central Statistical Office data; estimates (e) and projections (p) based on authors' calculations.

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led to a period of low growth, high and persistent fiscal and current-account deficits, rising public debt and high unemployment.

To remedy this situation, the government has included a number of ambitious reform measures in its 2007 budget, which was released in June 2006. The proposed measures are intended to consolidate fiscal performance and improve public-sector efficiency, trade competitiveness and the investment climate, and to democratise the economy through an empowerment programme. Most of the measures have already been converted into law through the 2006 Finance Act as well as other legislation.

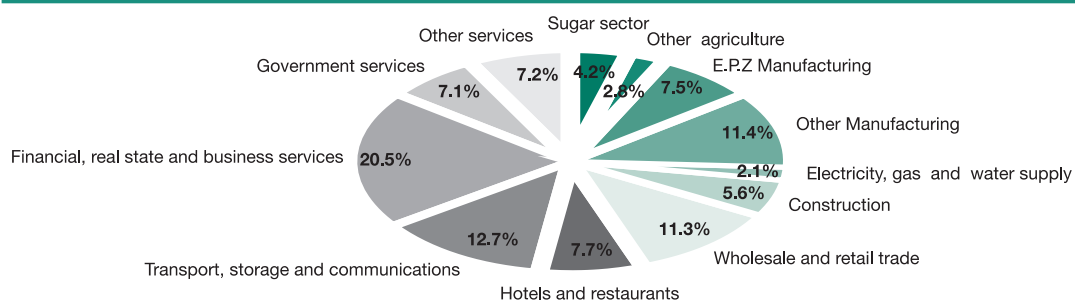
Recent Economic Developments

In 2006, the Mauritian economy exhibited real GDP growth of 3.9 per cent, considerably better than the 1.2 per cent registered in 2005. With the exclusion of sugar, the growth rate was estimated at 5.1 per cent. The sugar industry declined by 3.8 per cent, with sugar production at around 500 000 tonnes, down from 519 816 tonnes in 2005. The main contributors to growth were the industry groups involved in transport, storage and communications, financial intermediation, wholesale and retail trade, and real estate, renting and business services. In 2006, the export processing zone (EPZ) sector witnessed positive growth led primarily by recovery in the textile sub-sector. After a contraction

of 5.2 per cent in 2005, the construction industry recovered in 2006, growing by 5 per cent thanks to the construction of new hotels and the implementation of projects under the Integrated Resort Schemes (IRS). Growth in the tourism sector slowed down in 2006 compared with its formidable performance in 2005. Growth in 2006 would have been even stronger had it not been for the outbreak of chikungunya fever¹, which reduced the number of tourist arrivals from France and Réunion. The financial-services sector also did well in 2006. The economy is forecast to grow by about 5 per cent in 2007. Exclusive of sugar, the growth rate is estimated at 5.3 per cent. Sugar production is estimated at about 550 000 tonnes. The tourism sector is forecast to grow by 7.3 per cent, with tourist arrivals estimated at 850 000.

The agricultural sector currently accounts for 5.4 per cent of nominal GDP and is dominated by sugar production, with the value added by the sugar sector accounting for almost 52 per cent of the total value added in the agricultural sector. Sugar production has not fared well in recent years, falling by 19.2 per cent in 2002. After a slight recovery in 2003 and 2004, sugar production is estimated to have decreased sharply from 572 316 tonnes in 2004 to 519 816 tonnes in 2005, or the equivalent of 9.2 per cent in 2005. This dismal performance has been blamed on the adverse climatic conditions that prevailed in March, April and May 2005, the excessive rainfall in September, and the dry weather during the last months of the year. The total

Figure 2 - GDP by Sector in 2005 (percentage)



Source: Authors' estimates based on Central Statistical Office data.

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1. Chikungunya is a rare form of viral fever spread by mosquitoes

area harvested for sugarcane declined from 69 698 hectares in 2004 to 68 351 hectares in 2005, whereas the average yield of sugarcane per hectare decreased from 75.76 tonnes in 2004 to 72.92 tonnes in 2005. The rate of sugar extraction fell from 10.85 per cent in 2004 to 10.44 per cent in 2005.

Sugar exports have also declined in recent years. In 2005/06, sugar exports stood at 521 210 tonnes, compared with 564 020 tonnes in 2004/05. Of total sugar exports, 96 per cent, or 502 860 tonnes, were directed to the EU under the Sugar Protocol. In spite of the lower export volume, the contribution of sugar exports to total domestic exports increased from 22.1 per cent in 2004 to 25 per cent in 2005. To reverse these unfavourable trends, the government has announced restructuring plans for the sugar sector in the 2006/07 budget.

Since 2006, the sugar industry has been hit by a 36 per cent price reduction on all the sugar to be exported to the EU. The price reduction is to be phased in during the four-year period 2006-09. As a result, the sector is undergoing contraction and restructuring, which is likely to lead to diversification in the medium-to-long term. To help the sugar sector, the government has instituted a restructuring plan for the next ten years, which will cost MUR (Mauritian rupees) 24.5 billion, or \$732.8 million². The government plan seeks to encourage the diversification of sugar production into higher-value-added sugar (refined sugar). The plan will also use sugar by-products for the production of electricity and ethanol. In addition, the government seeks to reduce costs by instituting a programme to consolidate plantations into larger, more efficient units and to support investment in irrigation. The government has presented a Multi-Annual Adaptation Strategy - Action Plan 2006-2015 to the EU in an effort to seek increased financial support for the restructuring of the sugar industry. The plan identifies several action plans to reduce costs, increase revenue, maximise the use of by-products and alleviate debt burdens. The objective of the Multi-Annual Adaptation Strategy - Action Plan is to transform the sugar industry into a cane cluster

that will provide different types of sugar and use the by-products, such as bagasse for electricity generation or molasses for the production of ethanol and other value-added spirits. Small sugar farmers are to receive incentives and assistance in forming larger units in order to improve their productivity and reduce their production costs. In addition, the Mauritius Sugar Authority has earmarked MUR 500 million (nearly \$15 million) to be used for stone and rock clearance, irrigation, improved agricultural practices and to provide better sugarcane varieties. MUR 276 million (\$8.3 million) of the MUR 500 million (\$15 million) have been committed to the purchase of equipment for the Sugar Planters Mechanical Pool Corporation.

Another part of the government's plan for diversification of the sector is to build a "seafood hub" project. The purpose of the project is to develop Mauritius into a regional centre for the storage, processing and distribution of seafood and to offer repair and servicing facilities for fishing vessels. The government believes that the project will be one of the country's most promising new growth sectors. Its foreign-exchange earnings are expected to double to MUR 10 billion (\$299.1 million) in the next few years. In addition, the project is expected to create about 5 000 new jobs. To realise this objective, new fish-processing plants are required. Foreign direct investment (FDI) is already flowing into this project as a long-established Anglo-Mauritian enterprise, Ireland Blyth Limited, has announced plans to build a new MUR 300 million (\$8.97 million) fish-meal factory in the country to replace its existing plant.

The manufacturing sector consists of sugar milling, EPZ and other kinds of manufacturing. The manufacturing sector contracted in real terms by 5.5 per cent in 2005, compared with a growth rate of 0.3 per cent in 2004. In 2005, the sugar-milling sector accounted for 19.7 per cent of total value added in the economy. The same year, the EPZ sub-sector recorded a negative growth of 12.3 per cent following a decline of 6.8 per cent in 2004. This was due to the dismantling

2. Mauritian rupees were converted to \$ using the exchange rate of MUR 33.432/\$ prevailing on 1 January 2007.

of the MFA and the ending of the textile trade quotas on 1 January 2005, as well as to fierce competition with low-cost-textile producing countries such as China, India and Bangladesh. The total output of EPZ contracted by 5.9 per cent in 2005. However, the EPZ sector was estimated to have registered a 3 per cent growth in 2006 after four years of decline. The sugar-milling sub-sector declined by 9.2 per cent in 2005, compared with the 6.5 per cent growth rate of 2004. The non-sugar-milling and non-EPZ sub-sectors recorded zero growth in 2005 as opposed to the 6 per cent growth rate of 2004. The main EPZ markets in 2005 were the United Kingdom, France and United States while the main countries of origin for EPZ imports were India, China and France. Employment in the EPZ sector declined further by 1 091 or 1.6 per cent, from 68 022 in December 2004 to 66 931 in December 2005.

The sharp output contraction in the manufacturing sector, especially in the EPZ sub-sector, was also due to the dismantling of the MFA. This has eroded the country's preferential access to EU and United States (US) markets. Many textile enterprises have closed down or have had to adapt to the loss of preferential treatment. This has led to labour downsizing and factory consolidation. To offset these developments, the government has introduced measures to improve the country's competitiveness and intensify its diversification efforts. A number of measures in the 2006/07 budget were aimed at overhauling the framework of incentives as well as reducing distortions and biases. From 2006 to 2009, tariffs will be liberalised and Mauritius will be turned into a duty-free country. The incentive regimes for the EPZ and non-EPZ enterprises have been unified and all corporate taxes have been set at a neutral 15 per cent. These incentives will then be phased out over the next three years. A second phase of the programme will address the high costs of services. To restore global competitiveness, existing sectors, such as sugar, textiles, or clothing, are being encouraged to modernise and restructure, with government support when necessary. The government hopes to diversify into new activities such as information and communications technology (ICT), financial services, specialty tourism and land-based ocean activities.

The tourism sector performed relatively well in 2006, with an estimated real growth of 3.6 per cent, compared with a 5.6 per cent growth rate in 2005. Excluding France and Réunion, the sector registered strong growth of 17 per cent. Tourist arrivals from France and Réunion were down sharply as a reaction to negative press information on the outbreak of the chikungunya fever, which hit the islands of the Indian Ocean, including Mauritius. Tourists arriving from South Africa increased by 21.1 per cent, while those arriving from the United Kingdom (UK) increased by 7.3 per cent. Tourist arrivals fell by 0.6 per cent, from 70 793 in November 2005 to 70 394 in November 2006, while gross tourism receipts increased by 35.5 per cent, from MUR 2.472 billion (\$73.94 million) in November 2005 to MUR 3.349 billion (\$100.17 million) in November 2006. In cumulative terms, from January to November 2006, tourist arrivals reached 691 967, representing an increase of 3.2 per cent from the 670 544 arrivals registered in the corresponding period of the previous year. Tourism receipts for January to November 2006 increased by 24.2 per cent to reach MUR 28.007 billion (\$837.73 million), compared with the MUR 22.550 billion (\$674.50 million) registered for the corresponding period in 2005.

The government is projecting gross tourism receipts of MUR 31 billion (\$927.26 million) in 2007. This will represent a 17 per cent increase from 2006, which will be due partly to the rapid depreciation of the Mauritius rupee. January, February and December 2006 were good months for tourist arrivals and tourist receipts collected during this period contributed significantly to the gross tourist receipts for the year.

The government's main objective in the tourism sector is to increase tourist arrivals to 2 million by 2015. To achieve this objective, the government has implemented a guarded and selected liberalisation policy for international airlines and is promoting investment in new hotels and other facilities, which will generate employment. Virgin Atlantic Airlines has announced that it will start operating a twice-weekly service from London in November 2007. Other airlines are also expected to obtain rights to make flights to Mauritius. Ten new hotels are to be constructed within

the next two years.

The government intends to make the diversification of source markets an important element in its strategy to develop the tourism sector by reducing its dependence on the French market, which accounted for 29 per cent of the number of tourist arrivals in 2005. In addition, the government has already begun implementing the IRS, which involves the construction and sale of luxury villas with attached amenities. This project looks very promising, as inferred from the number and scale of approved projects and those currently awaiting approval. In the medium term, the sector will also include shopping and conference facilities. Funding for the Mauritius Tourism Promotion Authority was considerably increased in the 2006/07 budget. To date, the industry has depended largely on up-market tourism for its rapid growth. This policy has been criticised, as it is believed to deprive the larger population of active participation in the industry. To remedy this situation, it has been suggested that the government should democratise the sector in order to attract different types of tourists. In addition, the government has been called upon to encourage an integrated approach to the development of the sector, which would include the creation of tourist villages. This will not only assist in maximising the earnings potential of the industry but will also have a job-creating effect on low-skilled workers.

In addition to tourism, the government is actively promoting other industries such as the financial-services sector and the ICT sector. The financial-services sector, including real estate and business services, accounted for 15.5 per cent of total value added in 2005. The financial sector grew by 7 per cent in 2005, up from 4.3 per cent in 2004 with the insurance sub-sector growing by 5 per cent in 2005, the same growth rate experienced in 2004. This was due to a 9.4 per cent growth rate in offshore banks, 2.3 per cent in commercial banks and 10.2 per cent in other financial institutions. In 2006, the financial-services sector is estimated to have recorded a growth rate of 7.4 per cent. Prospects for the growth of the offshore financial sector are considerable and could be captured if significant efforts are made to improve the attractiveness of the

sector, such as setting up bilateral tax agreements with emerging economies and ensuring that the necessary supporting human-resource developments are in place.

The ICT sector has been growing fast and has considerable potential for creating jobs. The ICT sector focuses on business-process outsourcing, software development and call centres, and it is expected to boom. This sector was estimated to have registered a growth rate of 7.1 per cent in 2006.

Since 2001, Mauritius has invested heavily in state-of-the-art telecommunications, and has focused on offshore e-commerce development. This is part of the government's effort to turn the country into an information-technology free-trade zone that will provide digital parks across the island. The digital parks are designed to offer state-of-the-art technological facilities that meet the needs of information-technology (IT) businesses. IT enterprises that choose to be located in Mauritius will be able to take advantage of a new submarine-cable optic-fibre connection linking Portugal to Malaysia via the island. To nurture the development of the IT sector, the government has established an Infocom Development Authority, which is responsible for the promotion of investments in information technology and which also regulates the sector. In addition, the government has been providing a series of fiscal incentives to both foreign and domestic businesses. Furthermore, IT enterprises located in Mauritius will also be provided with electricity at preferential rates, the opportunity to buy property and land, and permanent resident status. The Indian government has been assisting in this e-development initiative and has provided a credit line of \$100 million to finance the development of the Mauritius CyberCity. Construction of the CyberCity began in 2004 and is part of the greater Ebene CyberCity project, which is intended to attract foreign IT enterprises to Mauritius. The Cyber Tower, a central feature of the Ebene CyberCity, was inaugurated in April 2005, and the new offices of the offshore management enterprise International Financial Services (IFS) in the Ebene CyberCity were inaugurated in April 2006. The CyberCity has attracted about 25 operators so far. Located at a 15-minute drive from Port Louis, it has

Table 1 - Demand Composition (percentage of GDP)

	1998	2005	2006(e)	2007(p)	2008(p)
	Percentage of GDP (current prices)		Percentage changes, volume		
Gross capital formation	25.8	21.6	12.5	7.0	7.3
Public	6.3	6.3	30.4	5.0	4.0
Private	19.5	15.3	5.0	8.0	9.0
Consumption	75.1	84.4	2.0	4.3	3.7
Public	13.7	14.8	6.8	-0.7	1.8
Private	61.3	69.6	1.2	5.2	4.0
External sector	-0.8	-6.0			
Exports	65.7	59.9	5.4	5.5	3.1
Imports	-66.5	-65.9	5.4	5.1	1.4

Source: Central Statistical Office data; estimates (e) and projections (p) based on authors' calculations.

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free-zone status and offers tax advantages to its occupants. The entire CyberCity is wired with optic-fibre and copper cables to provide high speed international bandwidth on tap. Nevertheless, in spite of the huge investments in the sector, the IFS promotion agency has not done enough to position the island at the forefront of the developing e-commerce sector internationally.

To facilitate further growth, the government is formulating a National ICT Strategic Plan to lay out its strategy to transform Mauritius into a "Cyber" Island. The ICT sector is likely to provide a boost to productivity in the economy generally. ICT can also help the government with its plans to set up a biomedical hub in Mauritius. Two Indian enterprises are already assisting the government in the project to develop medical tourism. Upon completion, the project will provide high-tech treatment for foreigners and Mauritians. The government is keen to tap into the growing international demand for medical services and to provide integrated tourist packages covering health care, welfare and relaxation. Promoting Mauritius as an international medical centre will go beyond health care to include the manufacturing and assembly of medical equipment, pharmaceutical research, medical outsourcing and telemedicine, and a number of tax exemptions for medical equipment were announced in the 2006/07 budget.

The share of aggregate consumption was 84.4 per

cent in 2005, compared with 75.1 per cent in 1998. Aggregate consumption was estimated to have grown further in 2006 by 4.9 per cent in real terms and is projected to continue to grow by an average of 4.3 per cent per year in 2007-08. The growth in aggregate consumption for 2006 implies that there has been an improvement in the living standards of Mauritians despite the severe difficulties that key sectors of the economy have experienced in recent years. Improvement in the standard of living has been made possible by the satisfactory level of investment, which was 21.6 per cent of GDP in 2005 and is estimated to have increased by 12.5 per cent in 2006. More importantly, even though the share of private investment was 15.3 per cent of GDP in 2005, down from 19.5 per cent in 1998, it still represents more than 70 per cent of total gross capital formation.

Macroeconomic Policies

Fiscal Policy

The economy is estimated to have registered an overall fiscal deficit of 5 per cent of GDP in 2005/06, after having recorded fiscal deficits of 5.4 per cent of GDP and 6.3 per cent of GDP in 2004/05 and 2003/04, respectively.

Total revenue and grants decreased slightly from 20.3

Table 2 - Public Finances (percentage of GDP)

	1998	2003	2004	2005	2006(e)	2007(p)	2008(p)
Total revenue and grants^a	19.8	20.0	20.3	19.9	20.1	20.4	20.5
Tax revenue	17.0	17.3	17.5	18.5	18.2	18.7	18.9
Grants	0.2	0.2	0.4	0.2	0.3	0.2	0.1
Total expenditure and net lending^a	21.5	26.4	25.6	24.9	25.4	25.1	24.9
Current expenditure	20.5	21.0	21.0	21.0	21.4	21.4	21.2
<i>Excluding interest</i>	<i>16.8</i>	<i>16.8</i>	<i>17.0</i>	<i>17.0</i>	<i>17.7</i>	<i>17.2</i>	<i>16.8</i>
Wages and salaries	6.8	6.3	6.6	6.4	6.3	6.1	5.8
Interest	3.7	4.3	4.0	4.0	3.8	4.2	4.4
Capital expenditure	2.8	4.7	4.3	3.5	3.6	3.6	3.7
Primary balance	2.0	-2.1	-1.4	-1.0	-1.6	-0.5	-0.1
Overall balance	-1.7	-6.3	-5.4	-5.0	-5.3	-4.7	-4.4

a. Only major items are reported

Source: Ministry of Finance data; estimates (e) and projections (p) based on authors' calculations.

<http://dx.doi.org/10.1787/113505808154>

per cent of GDP in 2004/05 to 19.9 per cent of GDP in 2005/06. This was due to a decline in grants. Tax revenue, on the other hand, increased from 17.5 per cent of GDP in 2004/05 to 18.5 per cent of GDP. The increase in tax revenue was essentially due to increases in corporate taxes and value-added taxes, even though the rise in tax revenue was partly offset by declines in customs duty and excise duties. Taxes on income (including profits and capital gains), taxes on goods and services, and taxes on property increased by 28.1 per cent, 3 per cent and 15.5 per cent, respectively. The increase in revenue from corporate taxes accounted for 86.9 per cent of the increase in revenue from taxes on income, profits, and capital gains. Net revenue from VAT increased 9.4 per cent in 2005/06. One way the government may be able to increase revenue is to institute a gradual liberalisation of the price of sugar on the local market, which is highly subsidised by the sugar industry³. This will reduce revenue losses to the government. Non-tax revenue composed mainly of property income and fees, charges, and sales also rose by 25.9 per cent in 2005/06, reflecting mainly earnings on overseas investments by the Bank of Mauritius.

Total expenditure and lending (minus repayments) declined from 25.6 per cent of GDP in 2004/05 to 24.9 per cent of GDP in 2005/06. Current expenditure

remained unchanged at 21 per cent in 2005/06, while the major components – interest and wages and salaries – also remained unchanged. The share of wages and salaries decreased slightly from 6.6 per cent of GDP in 2004/05 to 6.4 per cent of GDP in 2005/06. On the other hand, the share of capital expenditure in GDP declined from 4.3 per cent in 2004/05 to 3.5 per cent of GDP.

As a result of higher government expenditures in 2005/06 as compared with total revenue, the overall central government balance registered a deficit of 5 per cent of GDP. This is a decline from the 5.4 per cent of GDP figure that was recorded in 2004/05. The budget deficit was financed from domestic sources, including both the bank and non-bank sectors. Financing from the central bank resulting in an expansion of the money supply was also positive. In terms of instruments, only medium and long-term securities were used to finance the budget deficit

Mauritius's public debt was estimated to have declined from 58.2 per cent of GDP in 2005 to 57.9 per cent of GDP in 2006, reflecting a reduction in the fiscal deficit in 2006. This means that the scale of government borrowing was much less than the previous year. Internal public debt accounted for 92.4 per cent

3. Since 1995, the Mauritius Sugar Syndicate has been importing and selling sugar on the local market at prices determined by the Syndicate, which are lower than the import price

of total public debt in 2006. The proportion of short-term debt in total internal public debt has decreased steadily from 85.8 per cent in 2003 to 52.9 per cent in 2006.

Monetary Policy

During fiscal year 2005/06, the Bank of Mauritius (BoM) tightened its monetary policy stance by raising its interest rate on two occasions by an initial increase of 50 basis points from 10 per cent to 10.5 per cent in August 2005 and by a further 100 basis points to 11.50 per cent on 7 December 2005. The increases in the interest rate were intended to contain inflationary pressures in the economy driven largely by a sustained rise in energy prices, a large build-up of excess liquidity and government borrowing arising from financing the persistent fiscal deficits. The annual rate of inflation was estimated at 8.9 per cent in 2006, a sharp increase from the rate of 5 per cent recorded in 2005. The rise in the rate of inflation was due largely to the removal of subsidies on flour and rice that was announced in the 2006/07 budget, the depreciation of the Mauritian rupee, rising freight costs and soaring energy prices during the year. Inflation is projected to decline to about 5 per cent in 2007, since some of the contributing factors were just one-time occurrences. The interest-rate increase was also intended to preserve the attractiveness of key rupee-denominated financial instruments, because the value of the rupee deteriorated in relation to the major international currencies. Moreover, the interest-rate increase helped to contain emerging-demand pressures in the foreign-exchange markets. The banks adjusted their rupee deposits, advances and lending rates in line with changes in the discount rate, but this did not seem to have much of an effect on short-term market interest rates. Thus, the money supply returned to a double-digit growth rate of 11.2 per cent, from a single-digit rate of 8.5 per cent in 2004/05. Following

its Article IV consultation with the International Monetary Fund (IMF), the BoM has indicated a willingness to manage liquidity more actively.

A number of banking developments occurred in 2005/06 as the BoM continued to implement the Banking Act of 2004, which made it easier for banking business to be carried out under a single banking license⁴. The BoM issued a “Guideline on Segmental Reporting under a Single Banking License Regime” to banks in June 2005, which provided, amongst other things, for the reporting of banking activities under Segment A and Segment B and the treatment of specific deposit liabilities for the cash-reserve ratio requirement. Other key banking developments involve the Mascareignes International Bank Limited, which merged with the Banque des Mascareignes Limitée. RMB (Mauritius) Limited ceased all banking operations. HSBC Bank (Mauritius) Limited was granted a banking license and started operations in August 2006. Barclays Bank was also allowed to issue bonds to the public.

External Position

The current account of the balance of payments deteriorated significantly to record a deficit of 7.4 per cent of GDP in 2006, up from 5.2 per cent of GDP in 2005. The deterioration was largely due to a worsening trade balance, which was to some extent offset by the combined surpluses in services and current transfers. The worsening trade balance was caused by high imports driven by a higher import bill for oil products and a sharp increase in the imports of telecommunications equipment. Both items were responsible for more than 50 per cent of the increase in total imports.

In 2007, Air Mauritius plans to purchase two new aircraft. This will lead to an increase in the import bill and will have an adverse impact on the trade balance,

4. The Banking Act 2004 removed the distinction between Category 1 banks (commercial banks) and Category 2 banks (offshore banks) and provided for banking business to be conducted under a single license regime. All banks are now free to transact in all currencies, including the Mauritian rupee. Segment B relates to the banking business that gives rise to “foreign-source income”. All other banking business is classified under Segment A. Banks reported their statement of assets and liabilities based on segmental reporting for July 2005 together with a comparative statement for June 2005.

which is projected to reach 16.2 per cent of GDP. In contrast, the surplus on the services account of the balance of payments is projected to increase at a sustained pace of 8.4 per cent of GDP, due mainly to higher surpluses on the travel account.

The worsening trade deficit in 2006, which was partly blamed on high imports, was also due to weak growth in export earnings. Export revenue could therefore improve significantly if Mauritius could take advantage of the many opportunities it could derive from its membership in its regional bodies, such as the Southern Africa Development Community (SADC) and the Common Market for Eastern and Southern Africa (COMESA). COMESA has already established a Free Trade Area and is working towards the creation of a Customs Union, which Mauritius is actively supporting.

Mauritius is negotiating the establishment of an Economic Partnership Agreement (EPA) with the EU as a member of the Eastern and Southern Africa (ESA) group. Mauritius is also pursuing a policy of tariff liberalisation in order to foster the “duty-free island” concept. Even though Mauritius does not need to harmonise external tariffs within a future COMESA Common External Tariff (CET), Mauritius could still become a member of both the SADC and COMESA Free Trade Areas, giving support to the COMESA CET, while keeping a network of free-trade agreements with countries bordering the Indian Ocean (e.g. India and Malaysia) as well as with the EU. Mauritius can also increase its export earnings through continued benefit from the US African Growth and Opportunity Act (AGOA), which ensures the country’s preferential

access to the US market for certain products. Mauritius is therefore actively campaigning for further extension of AGOA. Mauritius also signed a Trade and Investment Framework Agreement with the United States in 2006.

In 2005/06, net inflows of FDI amounted to MUR 1.564 billion (\$46.78 million), compared with outflows of MUR 61 million (\$1.82 million) in 2004/05. As a result, gross FDI in Mauritius reached MUR 4.683 billion (\$140.08 million) in 2005/06. This was due largely to investments in the tourism sector, which also reflected the significant developments in the IRS and the banking sector. Disinvestments from Mauritius were quite considerable, amounting to MUR 3.119 billion (\$93.29 million) in 2005/06, which was partly due to non-residents’ disposal of shares in the banking and commercial sectors. Direct investment abroad by residents recorded net outflows of MUR 986 million (\$29.49 million) in 2005/06 as against net outflows of MUR 826 million (\$24.71) in the previous fiscal year. Gross FDI by Mauritian residents amounted to MUR 1.783 billion (\$53.33 million) in 2005/06 and was addressed mainly to the tourism sector in Maldives and Seychelles, the manufacturing sector in Madagascar and the agricultural sector in Mozambique. As a result, direct investment registered net inflows of MUR 578 million (\$17.29 million) in 2005/06, compared with net outflows of MUR 887 million (\$26.53 million) in 2004/05.

The net international reserves of the Bank of Mauritius comprise the net foreign assets of the banking system, the foreign assets of the government and the country’s reserve position in the IMF. Net international

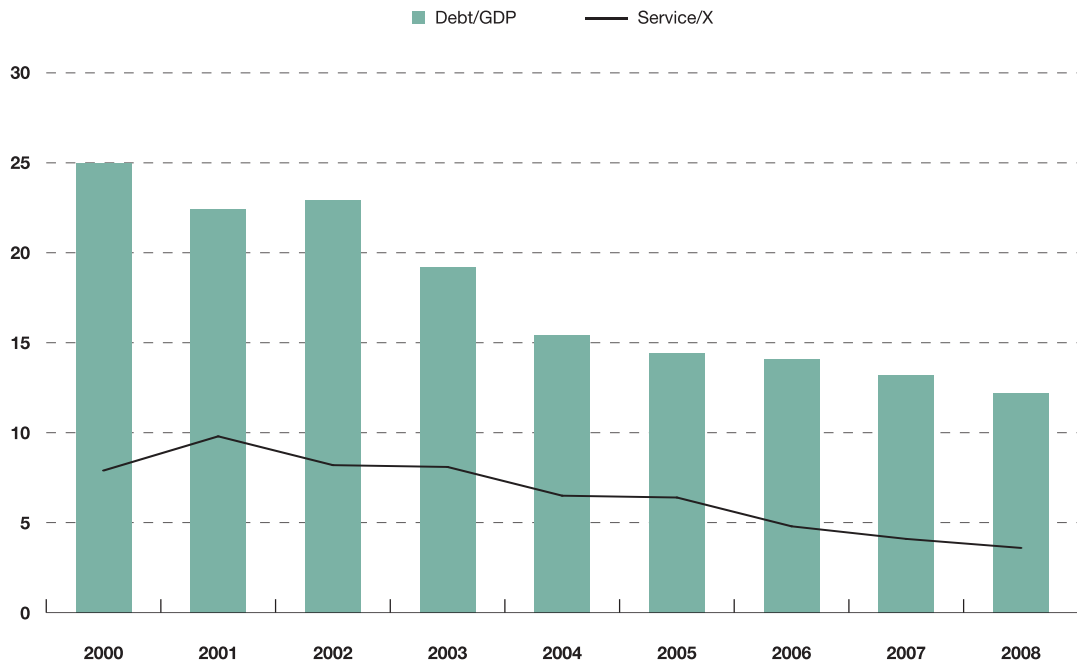
Table 3 - Current Account (percentage of GDP)

	1998	2003	2004	2005	2006(e)	2007(p)	2008(p)
Trade balance	-5.6	-5.3	-9.1	-12.7	-16.3	-16.2	-19.8
Exports of goods (f.o.b.)	43.7	33.7	31.3	34.1	32.8	32.0	31.5
Imports of goods (f.o.b.)	49.3	39.0	40.4	46.8	49.1	48.3	51.3
Services	4.8	6.6	6.7	6.7	7.9	8.4	9.0
Factor income	-0.6	-0.5	-0.2	-0.1	-0.1	-0.1	-0.1
Current transfers	2.3	0.9	0.8	1.0	1.1	1.1	1.1
Current account balance	0.8	1.7	-1.8	-5.2	-7.4	-6.8	-9.7

Source: Bank of Mauritius; estimates (e) and projections (p) based on authors’ calculations.

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Figure 3 - Stock of Total External Debt (percentage of GDP)
and Debt Service (percentage of exports of goods and services)



Source: IMF.

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reserves increased from MUR 53.932 billion (\$1.62 billion) at the end of June 2005 to MUR 61.974 billion (\$1.86 billion) at the end of June 2006 (an increase of 14.9 per cent in nominal terms). The level of net international reserves of the country at the end of June 2006 represented about 7.4 months of imports based on the value of the import bill for fiscal year 2006 excluding imports of aircraft, compared with 7.7 months of imports at the end of June 2005. The end-of-June 2007 level of international reserves of the country has been estimated as the equivalent of 6.8 months of imports.

The country's external public debt fell from MUR 9.2321 billion at the end of June 2005 to MUR 8.6484 billion at the end of June 2006. This was due to a decline in both foreign loans and foreign investment in treasury bills. In spite of the decline in total external debt, the debt-service ratio of the country increased from 6.5 per cent in 2005 to 8.4 per cent in 2006.

Structural Issues

In recent years, the Mauritian economy has been affected by a number of problems including low economic growth, high unemployment, widening fiscal and external deficits, and excessive public debt. These problems have been compounded by the impact of the “triple shock”, namely: the EU decision to cut its guaranteed sugar import price, which is expected to lead to a 36 per cent decline in the price of sugar imported from Mauritius in the course of 2006-09; the end of the MFA on 1 January 2005; and the recent increase in international energy prices. To tackle these challenges, the government announced 40 bold reform measures in the 2006/07 budget. The reforms were designed to make the economy more open and flexible, as well as to provide new controls on public spending by overhauling the outdated tax and public-spending system. Most of these measures have been transformed into law by the Finance Act of 2006, while other policies are in the process of being legislated. The measures include the following: a) a Business Facilitation Act has been passed, aimed at

improving the business climate in Mauritius by simplifying procedures for incorporating business, opening up the economy to foreign investors, reducing bureaucratic procedures and streamlining regulations that affect business start-ups; *b*) it has been made easier to obtain work and resident permits; *c*) the procedure for acquiring property for business development has also been simplified; *d*) in order to improve trade competitiveness, the government is currently implementing a phased tariff reduction with the aim of eventually achieving a duty-free country by reducing the top *ad valorem* tariff rate from 65 to 30 per cent and reducing average tariffs by 2 per cent; *e*) the tax and regulatory regimes for EPZ and non-EPZ enterprises have all been unified, except for labour regulations; and *f*) the international private leased circuits (IPLCs) have been reduced by 20 to 35 per cent in order to turn the country into an ICT Free Trade Zone⁵.

The high unemployment rate of 9.6 per cent in 2006 was partly due to the rigidity of the country's labour market. The labour laws provide a high level of worker protection and make it difficult to dismiss workers. Real wages are also very high. Furthermore, the labour markets are segmented. Labour-law reforms are therefore being contemplated. These reforms include abolishing the National Tripartite Commission and replacing it with a National Wage Council. Wages would be linked to productivity, and the degree of job protection would be reduced. The various labour markets would be integrated into one regime with the same rules and procedures for all.

In the area of fiscal policy, changes in personal and enterprise taxation have been announced. The government plans to eliminate many complex exemptions, tax abatements and allowances, and to reduce the number of tax brackets. These reforms are intended to lead to a flat-rate regime system with a single personal and enterprise tax rate of 15 per cent by July 2009. These changes are designed to simplify the tax-

administration system significantly and to reduce the scope for tax fraud, and consequently to bring about a higher rate of revenue collection.

Proposed reforms of the government's land policy are intended to ensure that more land is made available to non-sugar producers. For some time, farmers have been encouraged to move into agro-industry-based activities such as food processing. As a result, pickles and fruit juices are now being processed in Mauritius. Some land is also being used for flower production. Having strengthened its framework for managing environmental risks, the government is better prepared to assess whether the major reforms being contemplated might have important environmental impacts. To manage environmental risks, the Environment Protection Act now mandates the maintenance of a list of activities that require short or full environmental impact assessment (EIA). For the mini- or short EIA, a preliminary report is required, which can be approved by the Director of the Department of Environment after stakeholders have been given sufficient time to present their views. To deal with the activities responsible for heavy pollution, a full EIA is required. In the case of waste-water projects, the Department of Environment monitors the impact of waste water on marine pollution. The problem of waste water is becoming increasingly important in the tourism sector with the development of the IRS scheme. To deal with the problem of improper disposal of plastic bags, fines are now levied on those found throwing plastic bags on the streets.

Access to Drinking Water and Sanitation

Water in Mauritius is mainly available from underground and surface sources (mainly rainfall), and it is collected in reservoirs around the island. Water comes 52 per cent from boreholes and 48 per cent from the surface. Mauritius has an average annual rainfall of 2 100 millimetres and an annual volume of freshwater of 3 900 million m³ of which only 33 per cent is captured. Unfortunately, this volume of water

5. The IPLC service enables connection between two points either by fibre or satellite. Mauritius Telecom can offer IPLC on the basis of bilateral agreement with other carriers or on a full-circuit basis from its Point of Presence in Paris. The service is used mostly by service providers, public operators and foreign carriers.

is unequally distributed due to the land topography, thereby requiring the use of dams and reservoirs. In normal climatic conditions, Mauritius has a storage capacity of one year. Water consumption per capita is about 160 litres per day and if all sectors are included, it amounts to 250 litres per day.

Several institutions are involved in the production and distribution of water. They include the Central Water Authority (CWA), which, according to the CWA Act, is responsible for the control, development and conservation of water resources and also for the treatment and distribution of water to domestic, industrial and institutional consumers. The legislation also entitles the CWA to carry out operations relating to sewerage and irrigation. A second institution involved in the water sector is the Water Resources Unit (WRU), which is located in the Ministry of Public Utilities and is responsible for developing water policy and for carrying out studies to determine water requirements. It is currently working on a Water Act. The third institution involved in the water sector is the Waste Water Management Authority, which is responsible for sewerage operations.

The achievements of Mauritius in providing access to drinking water and sanitation have gone well beyond the MDGs. More than 99.6 per cent of the population has access to safe drinking water while 99.9 per cent of the population has access to improved sanitation services in both the urban and rural areas.

As regards the supply of drinking water, the CWA mobilised an average of 525 000 m³ of potable water daily in 2003, of which 78 per cent was sold to domestic subscribers and the rest to government institutions and

commercial enterprises. The demand for water from 1995 to 2003 increased cumulatively by 32 per cent. Since then, water demand has been increasing by an average annual rate of 3 per cent. The number of subscribers has also been growing by a steady 2.8 per cent. According to the CWA forecast, water requirements during 2007-08 and 2009-10 will amount to 550 000 m³ and 565 000 m³ respectively.

Table 4 shows water consumption by type of client. Domestic consumption accounts for the highest consumption of water (77.5 per cent). A significant portion of water is used for irrigation purposes. These latter account for 60 to 70 per cent of the impounded raw water, which is available mainly from boreholes and some reservoirs.

In Mauritius, the regularity of water supply is determined by seasonal factors. During the normal season, 87 per cent of households have access to 24-hour water supply. The other households have a supply varying from 10 to 18 hours. Water supply is rationed during the May-November dry season and some regions receive a minimum of 10-hour water supply a day. However, due to climatic changes, the dry season has now lengthened to December, thereby adding extra pressure on the water supply.

The domestic water supply throughout the island is generally safe for consumption. To ensure that this is the case, the CWA has two fully equipped laboratories that comply with World Health Organisation (WHO) standards. The Ministry of Health also monitors regularly the quality of water meant for consumption.

The cost of water is very low, MUR 9.95 (\$0.30)

Table 4 - Water Consumption by Type of Client (percentage)

Type of client	Share of water consumed
Domestic	77.5
Government	5.5
Commercial users	6.3
Hotels	4
Industry	5.2
Agriculture (treated)	1.5

Source: Central Water Authority.

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per cubic metre, or less than MUR 0.01 (\$0.0003) per litre. The average price of water for domestic purposes is much less, MUR 5 (\$0.15) per cubic metre. This rate, subsidised up to 75 per cent, is made possible mainly through a cross-subsidy system. The government purchases water at MUR 17 (\$0.51) per cubic metre. Private-sector commercial users are charged MUR 16 (\$0.48) per cubic metre, hotels pay MUR 29 (\$0.87) per cubic metre and vegetable growers pay MUR 7 (\$0.21) per cubic metre. Borehole users are licensed and charged MUR 0.50 (\$0.015) per cubic metre. New connections to the water network for households are completed in a maximum of 15 days. The water tariff is increased every five years and the decision to do so is vested in the Ministry of Public Utilities.

Unaccounted, or non-revenue, water consumption (about 47 per cent) is attributed to a number of factors and usages. Some operators such as the Fire Services are authorised users and have access to free water amounting to 5 to 6 per cent of available water. However, 35 per cent is attributed to pilferage and 7 per cent to leakages as a result of old pipes (more than 50 years old). There is, however, an ongoing plan to reduce the level of unaccounted water to a level of 25 per cent

For the past 20 years, the CWA has invested an average of MUR 350 million (\$10.47 million) annually in the water and infrastructure system in order to maintain a regular supply of water in the country. The main focuses have been on mobilising water resources from underground sources as well as surface sources, extending the water-supply network and increasing storage and treatment capacity.

The WRU is planning to invest in new projects such as the Bagatelle Dam, which is to supply the capital city with water, especially during the dry season. Another dam, Chamarel, will supply the western coast. The total cost of this investment is estimated at \$10 million. The CWA has access to various loans to finance its projects. At present, a number of projects are being financed by the African Development Bank (ADB) Group, the European Investment Bank (EIB), the Kuwait Fund, the French development fund Caisse

Française de Développement (CFD), the Saudi Fund and the Arab Bank for the Economic Development in Africa (BADEA).

The water sector faces a number of challenges. The first is how the CWA can reduce non-revenue water from 47 per cent to 25 per cent. To do this, the CWA has developed an action plan and has developed a project for 2007-11 costing MUR 890 million (\$26.69 million) aimed at renewing old pipes and water meters. The reduction of pilferage is being monitored by a fraud squad. The second challenge is how to mobilise more surface water by investing in major projects such as dams. This is the result of the high water demand, which has caused Mauritius to reach its limit in terms of underground water resources exploitation. A number of ongoing ground water exploration programmes are being instituted across the island in order to satisfy demand.

According to the United Nations Development Programme (UNDP) Human Development Report, Mauritius is already facing a situation of water stress because it has a supply of 1 083 m³ per person per year (based on actual population), which is below the norm of 1 700 m³ per person per year. According to the same sources, Mauritius is expected to suffer from water scarcity by 2020 with a projected supply of 974 m³ per person per year (based on a projected population of 1 335 000). Although the figures can be interpreted in various ways, they provide an indication of the problems that Mauritius may face in the future regarding water supply. Some recorded statistics, which tend to substantiate this trend, show that there has been a drop of 8 per cent in available water resources over the last 30 years in Mauritius. The WRU is therefore developing plans to mobilise additional water resources. The fourth challenge faced by the CWA is that of capacity building and how to keep pace with new technology. In order to encourage training, the CWA is using 1 per cent of its total investment funds for capacity building.

With respect to sanitation services, almost 99.9 per cent of the population has access to proper sanitation in their homes in both urban and rural areas. Regarding

the treatment of waste water, only 25 per cent of households are currently connected. The treatment of waste water is carried out by the Wastewater Management Authority (WMA), which was established as a corporate body under the Wastewater Management Authority Act. Its main responsibilities are the collection, treatment and disposal of wastewater. This organisation operates under the aegis of the Ministry of Public Utilities.

Each household is connected to the sanitation network wherever sewerage networks exist. Those connected are the only ones whose bills are annexed to their water bills and pay the equivalent of their water bill in rupees. The government has committed to spend MUR 6 billion in the next six years to reach a sanitation connection level of 50 per cent.

Political Context and Human Resources Development

Since attaining independence in 1968, Mauritius has been a stable democracy with regular free elections, a free press, the rule of law and a positive human-rights record. The head of state of Mauritius is the President, who is elected for a five-year term by the National Assembly, the unicameral Mauritius Parliament. The National Assembly comprises 62 members elected directly by popular vote, with between 4 and 8 further members appointed from “best losers” election candidates to represent ethnic minorities. The government is headed by the Prime Minister and a Council of Ministers. The most recent general elections were held on 3 July 2005 in all the 20 mainland constituencies as well as the constituency covering the island of Rodrigues. Observers of the international community judged the elections free and fair. The Labour Party, the largest party in the Alliance Sociale, won a substantial majority in Parliament. This majority helped the new government implement bold and radical economic reforms, which were announced in the 2006/07 budget that was presented in June 2006. However, the reforms include the imposition of controversial tax increases and the removal of subsidies on rice, flour and other essential commodities.

Although Mauritius was rated as one of the least

corrupt countries in Africa in the Transparency International Corruption Perception Index of 2005, there has been an increase in the incidence of corruption in recent years. Given this perception, the government has reiterated its commitment to fighting corruption. To this end, legislation was enacted in September 2005 to reform the practices and management of the Independent Commission Against Corruption (ICAC). However, action has yet to be taken to deal with the issues raised in the audit director’s report on government finances for 2004/05, which was published in November 2005 and severely criticised the management of government finances. This lack of action has undermined the government’s credibility and commitment to fighting corruption.

In terms of regional relations, the government will continue to participate in negotiations with the EU to set up a free-trade agreement for members of the SADC before the Cotonou Agreement expires in 2020. The government will also continue negotiations with India on the Comprehensive Economic Cooperation and Partnership Agreement aimed at consolidating the excellent relations between the two countries. However, Mauritius may have to accept changes in the highly advantageous clause in their double-taxation-avoidance agreement. The government will also seek to develop links with China.

In terms of fostering democratic governance, Mauritius has made considerable progress in promoting the protection of human rights since its independence. In 2005, it launched its National Human Rights Strategy. The government of Mauritius has established a number of national human rights institutions including the National Human Rights Commission, the Office of the Ombudsperson for Children and an Ombudsperson. The country has ratified all major United Nations (UN) international human-rights instruments with the exception of the International Convention for the Protection of the Rights of all Migrant Workers and Members of Their Families. Nonetheless, the Second Optional Protocol to the International Covenant on Civil and Political Rights, the Optional protocol to the Convention on the Elimination of All Forms of Discrimination against

Women and the Convention on the Rights of the Child have not been ratified yet.

Gender mainstreaming is now receiving new impetus. In August 2005, the government of Mauritius, in collaboration with the UNDP and the International Labour Organisation, started a three-year programme titled Capacity Building for Gender Equality and Empowerment of Women. The programme is aimed at an environment that will ensure the development of policies, legislation, financial and economic mechanisms in Mauritius to promote gender equality in social, economic and political spheres as well as to empower women. Achievements in gender have so far included a substantial increase in the representation of women in parliament. Of the candidates nominated by each major group in the current parliament following the July 2005 general elections, 16 were women and 12 of these candidates were elected (11 directly and 1 woman through the “best loser” system). This raised the representation of women in parliament from 5.7 per cent, or 4 women, in the outgoing parliament, to 17.1 per cent in the new legislature.

Although Mauritius has made important progress in achieving the MDGs, the country still faces several challenges, including dealing with pockets of poverty in an economic environment beset by low job creation. While no national poverty line has been established, it is estimated that around 12 per cent of the population live in poverty. The figure is much higher for Rodrigues, where about 37.5 per cent live in poverty. One way that the government can make significant progress in addressing poverty is to promote social participation, cohesion and create well-being for all citizens. This includes fostering stronger participation of women in economic and political decision-making processes. The

special measure announced in the 2006/07 budget, which was intended to democratise the economy, will ensure greater participation and social cohesion through the creation of an Empowerment Programme. The programme will spend MUR 5 billion (\$150 million) over 5 years, which is a step in the right direction. The programme will focus on supporting workers in transition and supplying land for social housing and small businesses. It will also provide finance and technical support for small and medium-size enterprises.

Progress on the MDGs, as based on the 2003 Status Report (the latest available), showed that Mauritius had made significant progress in the social sector. With respect to education, primary school is now compulsory and free. Both boys and girls have the opportunity of attending primary schools, and the primary-school enrolment ratio attests to this. Mauritius has met the target for universal primary education. The maternal-mortality rate has also decreased and is comparable to that of the developed countries. This target was reached in 2000. Investment in the health sector would ensure that the maternal-mortality rate does not deteriorate over time until 2015. The child-mortality target was also on track with low rates observed in recent years.

HIV/AIDS is not a serious problem in Mauritius. However, an increase in new cases has recently been reported, and this has become a matter of concern to the government. The government has therefore stepped up its awareness campaign and is providing the necessary care and support for those already affected by the disease. The prevalence rate of HIV/AIDS amongst the adult population, aged 15 to 49, was estimated at 0.6 per cent in 2005. Women aged 15 to 49 with HIV/AIDS were estimated at less than 1 000.