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Mauritius: 2003 Article IV Consultation—Staff Report; Staff Statement; and Public Information Notice on the Executive Board Discussion

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2003 Article IV consultation with Mauritius, the following documents have been released and are included in this package:

- the staff report for the 2003 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on March 18, 2003, with the officials of Mauritius on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on June 3, 2003**. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a staff statement of June 30, 2003 updating information on recent developments.

- a Public Information Notice (PIN) summarizing the **views of the Executive Board as expressed during its June 30, 2003 discussion** of the staff report that concluded the Article IV consultation.

The documents listed below have been or will be separately released.

Financial System Stability Assessment
Selected Issues Paper and Statistical Appendix

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

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MAURITIUS

Staff Report for the 2003 Article IV Consultation

Prepared by the Staff Representatives for the 2003 Consultation with Mauritius

Approved by Anupam Basu and Shigeo Kashiwagi

June 3, 2003

- The 2003 Article IV consultation discussions were held in Port Louis during March 3-18, 2003. The mission met with the Deputy Prime Minister and Minister of Finance, The Honorable Mr. Paul R. Bérenger; the Governor of the Bank of Mauritius, Mr. Rameswurlall Basant Roi; the Minister of Economic Development, Financial Services, and Corporate Affairs, The Honorable Mr. Sushil Khushiram; the Financial Secretary, Mr. Ayub Nakhuda; other senior government officials, and representatives of the private sector and trade unions.

- The staff team comprised Mr. McDonald (head), Mr. Anne, Mr. Floerkemeier, Mr. Laporte, and Mr. Yao (all AFR). Mr. Ondo Mañe (Executive Director for Mauritius) met with the authorities during the mission's stay, and his Advisor, Mr. Ismael, participated in several of the discussions. A parallel mission consisting of Mr. Ouanes (MAE) and Ms. Rennie (World Bank) focused on the finalization of the Financial Sector Assessment Program (FSAP). The surveillance mission also overlapped with a Fund/Bank technical assistance mission on anti-money laundering and the combating of the financing of terrorism (AML/CFT).

- Mauritius is on the standard 12-month consultation cycle. At the conclusion of the 2002 Article IV consultation on May 24, 2002, Executive Directors noted that the economy's resilience had enabled it to weather the global economic slowdown relatively well. Directors underscored, however, the need for (i) medium-term fiscal consolidation through an increase in the value-added tax (VAT) rate, a broadening of the value-added, income, and customs tax bases, a strengthening of tax administration, and a prioritization of capital projects; (ii) implementation of an automatic and transparent mechanism for the pricing of petroleum products; and (iii) reforms to increase labor market flexibility, so as to address the trend rise in unemployment.

- Mauritius accepted the obligations of Article VIII, Sections 2 (*a*), 3, and 4 on September 29, 1993, and its exchange system is free of restrictions on the making of payments and transfers for current international transactions. Mauritius also maintains a liberal capital account.

- Appendix I presents an assessment of medium-term fiscal sustainability. Mauritius's relations with the IMF, including technical assistance, are summarized in Appendix II, and its relations with the World Bank Group in Appendix III. The quality and timeliness of Mauritius's reporting of core data and other economic and financial statistics are, in general, satisfactory for conducting surveillance. Statistical issues are discussed in Appendix IV, social and demographic indicators are presented in Appendix V.

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EXECUTIVE SUMMARY

Over the past two decades, Mauritius has made impressive gains in the macroeconomic and social areas. Real output growth averaged just below 6 percent per year, leading to a more than doubling of per capita income and a marked improvement in social indicators. Since the early 1990s, however, unemployment has risen steadily, despite continued robust growth, mainly as a result of a mismatch between the qualifications of the labor force and the skills demanded by the workplace, as well as of labor market rigidities.

The main medium-term challenge is to develop new sources of economic growth and reduce unemployment, while improving the country's ability to compete in a global environment. Two of the key pillars of thc economy—sugar and textiles—are likely to see their preferential export arrangements eroded in coming years. The new growth sectors (information and communications technology, and free port and financial services), taken together, arc unlikely to create a significant number of jobs. Mauritius will need to focus increasingly on institutional reform to make the economy more competitive, flexible, and adaptable, and on structural reforms to create more opportunities for private sector investment.

After expanding at a robust pace of 4 percent in 2001/02 (July-June), real GDP growth is expected to slow in 2002/03 to about 3½ percent and recover in 2003/04 to about 5½ percent, largely led by a sharp rebound in sugar production and exports from the export processing zone. However, downside risks continue to dominate the near-term outlook, mainly reflecting the uncertainties related to the effects of the war in Iraq and the strength and sustainability of the global recovery. The overall fiscal deficit is projected at about 6 percent of GDP in 2002/03, and, given the rise in private savings, the external current account surplus is expected to remain strong at about 4½ percent of GDP.

To ensure fiscal sustainability, Mauritius should reduce its budget deficit to under 5 percent of GDP in 2003/04. This should be achieved principally by broadening the domestic tax base while restraining capital expenditures. In order to promote medium-term macroeconomic stability, the government should aim to reduce the deficit further over that period to 2-3 percent of GDP. This would allow the public debt-to-GDP ratio to fall to about 61½ percent by 2006/07 from about 69 percent in 2001/02. Given the openness of the Mauritian economy, sustainable fiscal policies will need to be accompanied by prudent monetary and exchange rate policies to protect the economy from the risks associated with sudden and potentially large swings in investor confidence. The government should also implement the recommendations of the FSAP to address potential vulnerabilities in the banking sector.

The government should adopt a preannounced medium-term tariff reform program, and should continue to implement tariff reforms within the context of the SADC and COMESA.

I. Introduction and Medium-Term Challenges

1. **Over the past two decades, Mauritius has made impressive gains in the macroeconomic and social areas.** Real output growth averaged nearly 6 percent per year, leading to a more than doubling of per capita income and a marked improvement in social indicators. Mauritius has also succeeded in fostering an enviably stable and democratic political system, which has drawn its strength from the country's ethnic diversity and succeeded in ensuring social harmony.

2. **Over this period, the country enjoyed substantial resource transfers from very favorable trade preferences in the sugar sector.** Appropriate macroeconomic policies, supported by a dynamic and entrepreneurial private sector, were instrumental in ensuring that these resources were intermediated domestically by a relatively efficient financial system. This enabled the previously sugar-dependent economy to diversify and expand into three new sectors—textiles, tourism, and offshore financial services—which, together with the sugar industry, constitute the so-called four pillars of the economy.[1] These new sectors, in turn, provided important and much-needed outlets for domestic employment, particularly during the 1980s.

3. **Since the early 1990s, however, unemployment has risen steadily, despite continued robust growth.** This trend appears to reflect an underlying structural mismatch between the qualifications of the labor force and the skills demanded by the workplace, as well as labor market rigidities. In the export processing zone (EPZ), firms have resorted to recruiting labor from overseas.

4. **The main medium-term challenge is to develop new sources of economic growth and reduce unemployment, while improving the country's ability to compete in a global environment.** Two of the key pillars of the economy—sugar and textiles—are likely to see their preferential export arrangements eroded over the medium term (Box 1). With this prospect looming on the horizon, the sugar industry has taken the initiative to restructure under the so-called Sugar Sector Strategic Plan. Similarly, and with a potentially larger impact on economic growth and labor dislocation, the textile industry is facing increased competition from low-cost producing countries. Finally, the tourism sector, which still has growth potential, remains inherently vulnerable to developments outside Mauritius.

5. **Mauritius is a small-island economy with few natural resources, and its ability to address these challenges is constrained by the limited opportunities for further diversification, particularly in the short run.** Nonetheless, the economy is being transformed from one characterized by labor-intensive industries using largely unskilled labor to one of more capital-intensive industries requiring higher-skilled labor. The

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[1] The textile sector also benefited from preferential trade arrangements with the European Union and the United States.

government is moving rapidly to implement an ambitious plan to establish an information technology sector as a fifth pillar that can sustain rapid growth over the medium term. To this end, it is investing heavily to provide the infrastructure for a new technology park and improve the country's education system, in order to strengthen labor skills. It is also investing in free port activities to take advantage of Mauritius's strategic location between Asia and Africa. The new growth sectors (information and communications technology, and free port and financial services), taken together, are however, unlikely to create a significant number of jobs.

Box 1. Prospects for Trade Preferences

Sugar

Under the **African, Caribbean and Pacific/European Union (ACP/EU) Sugar Protocol**, the sugar industry has enjoyed preferential access to the EU market for agreed quantities at guaranteed high prices over the past quarter century. This preferential trade regime is being challenged in three ways. First, in line with the process of reform of the EU Common Agricultural Policy that is under way, Mauritius, together with other ACP countries, is likely to face lower prices for its sugar exports over the medium term. This tendency will probably be reinforced by the Doha round of multilateral trade negotiations. Second, international competition will increase owing to the **Everything But Arms (EBA) initiative** of the EU. The EBA initiative, which was introduced in March 2001, provides 49 least-developed countries with duty-free and quota-free market entry for all products except for arms and munitions. Trade liberalization of sugar, which is one of three "sensitive" products, is not an immediate threat. However, the customs duty will be gradually reduced from mid-2006 onward, and eliminated completely by July 2009. Third, two large sugar-producing countries, Australia and Brazil, lodged a complaint at the World Trade Organization (WTO) in September 2002, alleging that EU exports of sugar are subsidized. Depending on how this issue is resolved, it could lead to the EU's reducing the price paid to sugar imports from the ACP countries. With Australia and Brazil producing large amounts of sugar at much lower costs than the small ACP producers, an abolition of the ACP/EU Sugar Protocol could have severe effects on Mauritius's sugar industry.

Textiles

Mauritius benefited from duty-free quotas for its apparel exports under the **Multifibre Agreement (MFA)**, which regulated international trade in textiles (cotton, wool, and man-made fiber products) between 1973 and 1994. In 1994, the MFA was replaced by the **Agreement on Textiles and Clothing (ATC)**, which specified a phasing out of the MFA trade restrictions over a period of ten years and a full integration of the textiles sector into WTO rules by end-2004. Mauritius's main product lines (T-shirts, shirts, pullovers, and jeans) are among the products most sensitive to quotas. The quotas for these products will be removed at end-2004. Competition from low-cost producers, such as China, India, Bangladesh, and Sri Lanka, is therefore likely to increase significantly. The adverse effects of the phasing out of the MFA might be softened by the improved market access for Mauritius's textiles exports to the U.S. market in the context of the **African Growth and Opportunity Act (AGOA)**. With the completion of the vertical integration process, the Mauritian textile industry will be able to take full advantage of the provisions of AGOA since it will satisfy the rules-of-origin criteria. Furthermore, several amendments to AGOA, signed into law in August 2002, substantially improve the export conditions for beneficiary sub-Saharan African countries.

6. **Against this background, the success of the transformation of the economy hinges critically on undertaking necessary structural reforms, while maintaining social cohesion, macroeconomic stability, and external competitiveness.** The Mauritian economy's openness in terms of trade and capital flows underscores the need for sound macroeconomic policies to protect the country from the risks associated with sudden and potentially large swings in investor confidence. In particular, medium-term fiscal consolidation is essential to preserve price stability, prevent an erosion of external competitiveness, and avert unsustainable debt dynamics that could jeopardize the economy's growth prospects. On the structural side, the authorities need to strengthen their efforts to reduce the government's involvement in key economic activities, while pushing ahead with tax and trade reforms. Undertaking these policies will require concerted political will on the part of the authorities (Box 2).

Box 2. Political Developments in 2003

Important political developments that are expected to unfold during 2003 may affect the authorities' willingness to implement major policy reforms. In line with an agreement signed two-and-a-half years ago by the Mouvement Socialiste Militant (MSM) of Prime Minister Sir Anerood Jugnauth and the Mouvement Militant Mauricien (MMM) of Deputy Prime Minister and Minister of Finance Mr. Paul Raymond Bérenger, a number of amendments will be made to the Constitution to confer greater power on the office of the president (currently a ceremonial post). In September 2003, Sir Anerood Jugnauth is scheduled to resign from the National Assembly to become President, handing over the prime ministership to Mr. Bérenger, who will eventually relinquish his finance portfolio. Mr. Bérenger would then complete as Prime Minister the final two years of the five-year term of office. In October 2003, a by-election would be held to fill the seat vacated by Sir Anerood Jugnauth. It is expected that if the coalition's candidate in that election wins, he will become the next Minister of Finance. If he loses, the future minister is likely to be chosen from among the current MSM members of the National Assembly.

7. **Over the last year, the authorities have made some progress in addressing the challenges identified by Executive Directors during the 2002 Article IV consultation. Overall, the policy response to improving Mauritius' resilience to external economic shocks has been positive.** This is best exemplified by the government's attempt to enhance prospects for medium-term fiscal consolidation. In particular, the budget for 2002/03 (July to June) introduced a number of revenue measures. These included a hike in the value-added-tax (VAT) rate from 12 percent to 15 percent, a broadening of the VAT tax base, and increases in the excise tax on diesel and in several license fees. The authorities were also relatively successful in containing capital spending through the prioritization of projects.

8. **However, less progress was made in structural reforms, which has slowed the process of making the economy more flexible and adaptable to global challenges.** Although the government announced in the 2002/03 budget its intention to implement an automatic and transparent pricing mechanism for petroleum products, this mechanism was not introduced. The authorities have also been slow in addressing issues related to the

inflexibility of the labor market, so as to reduce unemployment, which is likely to increase further in the early phases of the economy's restructuring process. They have asked the World Bank to conduct an assessment of the Mauritian labor market, but this project has been moving slowly, and the final report is not expected until end-2003. Separately, a report was prepared last year by an external consultant on the pay-setting process containing specific proposals for reform, but the government has yet to act on the recommendations.

II. Recent Economic Developments

9. **After expanding at a robust pace of 4 percent in 2001/02, real GDP growth is expected to slow in 2002/03 to about 3½ percent (Table 1).** Following cyclone Dina, which ravaged the island in January 2002, sugar output is forecast to fall by about 16 percent. The EPZ and tourism sectors continue to be adversely affected by the weak global environment, and prospects remain uncertain in the aftermath of the war in Iraq. The unemployment rate rose to 9.8 percent at end-2002, compared with 9.4 percent in 2001.

10. **The budget deficit (including grants) widened to 5.9 percent of GDP in 2001/02 from 5.7 percent of GDP a year earlier, mainly owing to an increase in capital spending (see table below).** The fiscal deficit is expected to remain at close to 6 percent of GDP in 2002/03.[2] While the outturn is expected to be slightly better than the budget target (of 6.1 percent of GDP), it nevertheless represents a setback vis-à-vis the fiscal consolidation path recommended at the conclusion of the 2002 Article IV consultation.[3]

Selected Economic and Financial Indicators, 1998/99-2002/03 1/

	1998/99	1999/00	2000/01	2001/02 Prov.	2002/03 Proj.
	(Annual percentage changes)				
GDP at constant market prices	5.4	2.7	7.0	4.0	3.3
Consumer prices (period average)	7.9	5.3	4.4	6.4	5.1
Unemployment rate (in percent)	7.1	8.1	8.9	9.4	9.8
Real effective exchange rate 2/	-1.9	5.7	2.7	-1.9	0.1
	(In percent of GDP at market prices)				
Overall fiscal balance (including grants)	-3.3	-3.8	-5.7	-5.9	-5.9
External current account balance (including transfers)	-1.5	-1.6	3.4	5.2	4.6
Total public debt	64.7	64.3	63.8	69.2	69.7

Sources: Mauritian authorities; and IMF staff estimates and projections.

1/ Fiscal year from July to June

2/ Trade-weighted period averages.

11. **Public finances face further risks in the short term as a result of the worsening financial position of some state-owned enterprises.** While the overall financial situation of public enterprises improved somewhat in 2001/02, the deteriorating position of the State Trading Corporation (STC) and the Central Electricity

[2] This is expected to lead to a modest increase in the public debt of ½ of 1 percentage point of GDP to 69.7 percent of GDP at end-2002/03.

[3] The 2002 Article IV consultation resulted in the Fund's advocating a fiscal deficit of about 5.5 percent of GDP this year as part of the medium-term adjustment path.

Board (CEB) poses a short-term threat to the budget (see table below).[4] Consequent on the nonimplementation of an automatic and transparent pricing mechanism for petroleum products, and given the sharp rise in the international price of oil in 2002 and early 2003, the STC accumulated significant losses on its current operations. Similarly, the CEB, which imports part of its fuel oil at world market prices, has incurred losses as a result of the nonadjustment of electricity tariffs in 2002/03.[5]

12. **Monetary policy was somewhat loose in 2001/02.** Broad money expanded by 13 percent in 2001/02 (year on year) from about 10 percent the previous year (Table 4 and Figure 1). This contributed to an increase in inflation to 6.4 percent in 2001/02 from 4.4 percent in the previous year. Other factors were nonetheless important. These included the transitory effect of a 2 percentage point increase in the VAT rate, increases in electricity tariffs and other administered prices, the effect of cyclone Dina, and the depreciation of the Mauritian rupee. Monetary policy has generally been tighter in 2002/03; however, in view of the widening interest rate differential between domestic and foreign interest rates and the

Central Government Finances, 1999/2000 - 2002/03 1/
(In percent of GDP)

	1999/00	2000/01	2001/02	2002/03 Proj.
Total revenue and grants	20.9	18.1	18.4	20.8
Tax revenue	18.1	16.1	15.7	17.7
Nontax revenue and grants	2.8	2.0	2.7	3.0
Total expenditures and net lending	24.7	23.9	24.4	26.7
Of which: current expenditures	24.7	23.9	24.4	26.7
capital expenditures	3.0	3.1	3.7	5.0
Overall balance	-3.8	-5.7	-5.9	-5.9
Primary balance	-0.4	-1.3	-2.6	-1.6

Sources: Ministry of Finance; and IMF staff projections.
1/ Fiscal year from July to June.

[4] The authorities recently agreed to take over that portion of the STC's debts that had been accumulated prior to June 2002, during a similar period of a rise in international oil prices. As a result, a transfer of MUR 300 million (about 0.2 percent of GDP), which had not been initially budgeted for in 2002/03, will be necessary to clear part of the STC's liabilities in the coming months.

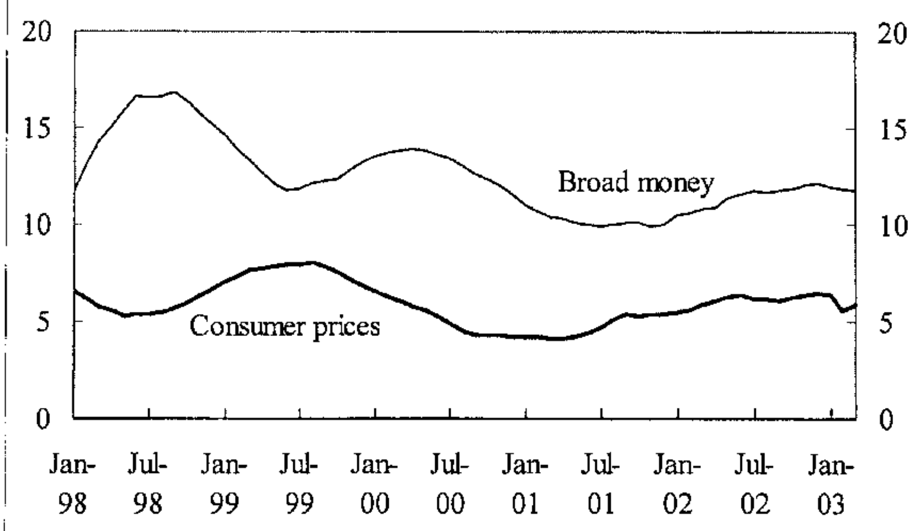
[5] Although the recent fall in oil prices should stem the current losses of the STC, accumulated losses through end-April 2003 for the fiscal year are estimated at about MUR 65 million (equivalent to about 0.04 percent of GDP). Losses at the CEB were running at about MUR 15 million per month through end-March on account of the previous high prices of oil but should have moderated in the last three months.

Nonfinancial Public Sector Corporations, 1999/00-2001/02 [1]
(In percent of GDP)

	1999/00	2000/01	2001/02
Current balance	-0.8	-0.4	0.6
Capital expenditure	5.5	2.6	2.9
Overall balance	-6.3	-3.0	-2.3

Sources: Ministry of Finance; and IMF staff estimates.
[1] Air Mauritius, the Central Electricity Board, the Central Water Authority, Mauritius Telecom, the State Trading Corporation, and nine smaller corporations.
Fiscal year from July to June.

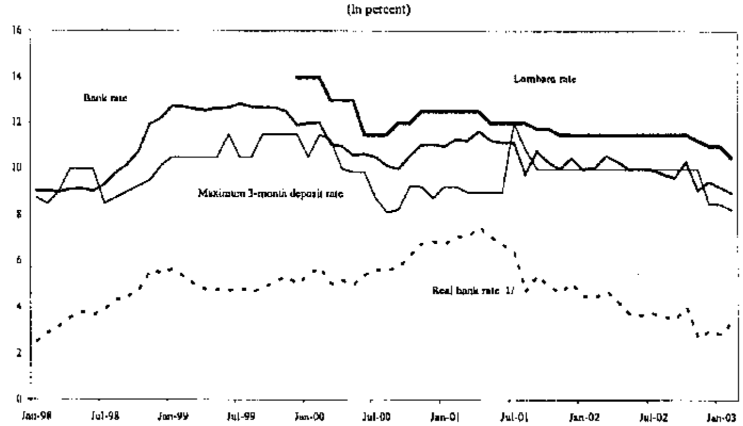
Figure 1. Mauritius: Broad Money and Inflation, January 1998-March 2003
(Annual average percentage change)



Sources: Bank of Mauritius; and Central Statistics Office.

slowdown in economic activity, the Bank of Mauritius (BOM) has reduced the Lombard rate since the beginning of the fiscal year by a total of 125 basis points (Figure 2). The last reduction of 25 basis points in May 2003 brought the rate to 10.25 percent. Inflation has recently shown signs of stabilizing and is forecast to fall to about 5 percent by end-June 2003.

Figure 2. Mauritius: Principal Interest Rates, 1998-2003
(In percent)



Source: Bank of Mauritius.

1/ Discounted by the annual average consumer price inflation rate.

13. **Despite the significant budget deficit, the external current account surplus increased during 2001/02 to about 5.2 percent of GDP from 3.4 percent (Table 2) in the previous year.** While public investment growth has been strong, it has not been sufficient to outweigh the significant decline in private investment, thus leading to weak domestic absorption. In 2001/02, private savings were estimated at 29 percent of GDP, almost a 4 ½ percentage point of GDP increase since 1999/2000, the most recent year with a current account deficit. As a result of the BOM's intervention policy, the net international reserves (NIR) of the central bank rose by US$228 million to about US$1 billion (six months of import cover) at end-June 2002.

14. **The current account balance is expected to remain strong in 2002/03 as tourism earnings seem to be largely unaffected by the war in Iraq.** The current account surplus is, nonetheless, likely to narrow to about 4½ percent of GDP, as the rebound in imports will override the anticipated recovery in exports. It is projected that the BOM will experience a further significant increase in NIR to US$1.3 billion, equivalent to 7.3 months of imports in 2002/03. This buildup in net foreign assets has not translated into a sharp increase in money supply, as the authorities have managed to sterilize the inflows. Notwithstanding the absence of capital controls, this sterilization was rendered possible by capital market imperfections and the limited knowledge about Mauritius as a portfolio investment option.

III. Report on Policy Discussions

15. **The policy discussions centered around the key medium-term challenge of developing new sources of growth and reducing unemployment.** To further enhance medium-term growth prospects, the staff discussed the importance of maintaining prudent monetary and exchange rate policies, strengthening the financial sector, and introducing important trade and other structural reforms to foster private sector investment and employment growth. The focus of the discussions for the immediate period was on the need

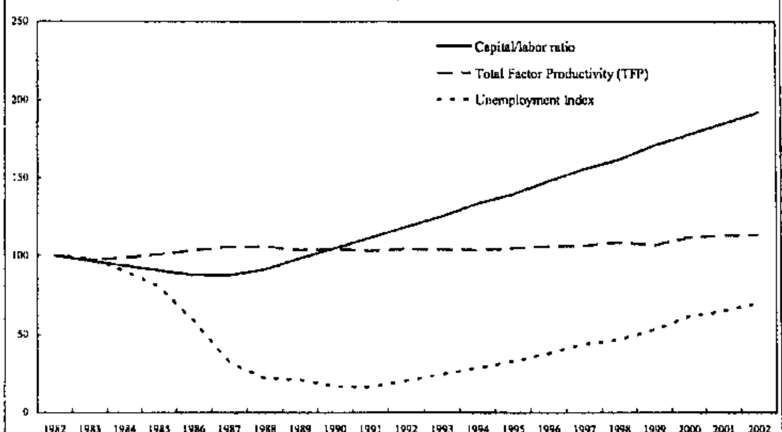
to accelerate the path of fiscal consolidation to contain the growth of public debt and to facilitate a fall in real interest rates.

A. Medium-Term Growth Prospects

16. **Growth should recover in 2003/04 to about 5½ percent, largely led by a sharp rebound in sugar production and exports from the EPZ (Table 6).** Sugar production should return to normal levels, assuming good weather, and the output in the EPZ is expected to increase on account of improved access to the U.S. market under AGOA, and stabilization of the political situation in neighboring Madagascar, a major outlet for EPZ output. Other sectors that should contribute to a rebound in growth include construction, transport, information and communications technology, and financial services. However, the authorities and the staff agreed that downside risks continued to dominate the near-term outlook. The most significant risks stem from uncertainties related to the effects of the war in Iraq and the strength and sustainability of the global recovery. Assuming the implementation of structural and institutional reforms, medium-term growth could average about 5 percent per year, which is somewhat below Mauritius's historical trend. This prospect reflects the decline or stagnation of the traditional pillars of the economy—sugar and textiles—and the relatively small base from which the new growth sectors start.

17. **Over the medium term, the staff stressed the need for the government's growth strategy to rely more on productivity growth rather than capital deepening, as has been the case over the last two decades (Figure 3).** In particular, the loss of preferential access would likely reduce domestic savings, thus limiting domestic investment. Furthermore, given rising labor costs, Mauritian firms have been increasingly relocating to low-cost countries, such as Madagascar, with the result that domestic investment growth rates have been negative in the last few years. Also, foreign direct investment is almost nonexistent, partly owing to these rising labor costs. In addition, growth through further significant capital accumulation is not likely to create job opportunities for low-skilled Mauritian workers. However, the success of the strategy of raising growth through higher total factor productivity depends on whether the Mauritian economy and its institutions—including those institutions governing the labor market—can become more competitive, flexible, and adaptable to the challenges of the global economy. The authorities

Figure 3. Mauritius: Capital-Labor Ratio, Total Factor Productivity (TFP), and Unemployment, 1982-2002
(1982 = 100)



Sources: Central Statistics Office and IMF staff estimates generally agreed with the mission's assessment, but emphasized that structural and institutional reforms would have to take into account the need to preserve social harmony.

18. **The mission and the authorities agreed that the sugar and textile sectors were unlikely to make a significant contribution to future output growth and employment creation.** However, the authorities and private sector firms are implementing far-reaching reforms in these sectors. The authorities indicated that the Sugar Sector Strategic Plan was already yielding results. The sugar industry has reduced significantly its average production costs from about US$0.20 per pound in 2000 to US$0.14. Although this is still somewhat above the world market price of about US$0.08 per pound, the authorities are confident that further reductions in production costs are possible over the medium term. The principal reforms being pursued include the consolidation of milling operations and the shedding of excess labor, primarily through voluntary retirement and attrition. The textile sector is being transformed into an industry that is increasingly capital intensive, high skill, and targeted at high-end-product markets. With the setting up of spinning mills that will complete the vertical integration process within the textile industry in Mauritius, the EPZ is likely to take greater advantage of the provisions of AGOA, since it will satisfy the rules-of-origin criterion. However, the rising unit labor costs for domestic workers and high (by international standards) electricity prices pose a major challenge for Mauritian firms to remain competitive.

19. **The authorities have given the emerging information and communications technology (ICT) sector their highest priority and are hopeful that this sector can underpin sustained growth in GDP over the medium term.** The mission commended the authorities for their efforts to develop this new pillar of economic activity (Box 3); however, while acknowledging that the sector can contribute significantly to future growth, it cautioned that global spending on ICT was likely to remain weak in light of uncertainties in the global technology sectors.[6] The mission also noted that expectations may be too high that the sector will be able to contribute significantly to growth in the next few years. The authorities agreed that there are inherent risks in the diversification strategy, but argued that Mauritius had few options given prospects in its traditional sectors.

B. Structural Reforms

20. **The mission stressed that medium-term growth prospects would be enhanced by undertaking significant structural reforms, including those aimed at creating new opportunities for private sector investment and improving labor market flexibility.** The

[6] Central government involvement in the ICT sector has mainly consisted of net lending of about 1 percent of GDP over three years to the state-owned agency, Business Park of Mauritius Limited (BPML). This corresponds to half the credit line granted by the government of India for its investment in that sector.

Box 3. ICT Sector Outlook and Its Impact on Medium-Term Growth

- The Mauritian authorities are confident of the successful development of the information and communications technology (ICT) sector and its contribution to medium-term growth for the following reasons:

Competitive advantages

- **Strong political commitment and social consensus**. The vision of the government and the public is to transform Mauritius into a "cyber island."

- **Knowledge spillover from India**. The successful experience of the Indian ICT sector is being transferred to Mauritius. Representatives of the Indian ICT sector are advising the Mauritians on a development strategy, and will also be subcontracting some of their operations to Mauritius and investing in the domestic sector.

- **Bilingual nature of the labor force**. The ability of the Mauritian labor force to speak both English and French is a competitive advantage.

- **Infrastructure improvement**. The government is embarking on substantial capital outlays to set up the physical and communication infrastructure. As a springboard, the Ebene Cyber City is due to start operating as of December 2003, with much of its space for private investors already taken up by global ICT firms.

Market niche and industrial development strategy

- The government believes it has formulated a realistic development strategy. The initial focus of ICT operations will be on the lower end, such as call centers, and data processing and disaster recovery centers. Given the country's strength in financial services, back-office services outsourcing is also promising. In the longer term, improvements in the supply of skilled labor through the ongoing education reforms and knowledge accumulation through "learning by doing" would help the sector to move into more sophisticated ICT product lines.

The fifth pillar of the economy 1/

- The government does not view the ICT sector as simply the "fifth" pillar of the economy. Rather it sees the sector as becoming the foundation of the economy. Thus, although the initial contribution of the ICT sector to growth will come from capital deepening, the expectation is that, over time, gains from ICT-related investments will lead to increases in overall productivity in the economy. Parallel reforms are taking place in the telecommunications sector with the termination of Mauritius Telecom's monopoly in 2003. A range of incentives for private investment is also in place, including full tax exemptions for start-ups until 2008 and generous depreciation allowances on ICT hardware.

Impact on medium-term growth and employment

- As ICT production accounts for a larger share of total output, the ICT sector will play a greater role in driving Mauritian medium-term growth. The contribution to overall growth might reach one-fourth in 2006/07. However, job creation in the ICT sector is expected to be limited.

Baseline Projection of the ICT Sector, 2002/03-2007/08 2/
(In percent, unless otherwise indicated)

	2002/03	2003/04	2004/05	2005/06	2006/07	2007/08
Share of nominal GDP	2.1	2.3	2.6	2.9	3.2	3.5
ICT real growth	10.0	17.0	20.0	16.0	15.0	15.0
Overall GDP growth	3.3	5.5	5.1	4.9	4.6	4.6
Contribution to growth	6.4	7.1	10.2	9.5	10.4	11.4
Total employment (thousands of persons) 3/	2	5	8	9	10	11

1/ The other four pillars are sugar, textiles, tourism, and offshore financial services.

2/ Fiscal year from July to June.

3/ Total labor force is estimated at 537,400 in 2002/03.

government was encouraged to allow greater private sector participation in commercial activities, such as the importation and sale of rice, flour, cement, and petroleum products, and in the utilities and transport sectors. To enhance private sector participation in the telecommunications sector, the government was urged to offer licenses to the private sector and allow the establishment of multiple fixed-service providers. In response, the government indicated its intention to explore public-private sector partnerships in infrastructure investments, such as in transportation. The mission welcomed this initiative as a means of not only facilitating greater foreign direct investment flows, but also relieving the burden on the budget to finance large infrastructure investment projects.

21. **Given the pressing problem of unemployment and the potential of some existing sectors, like tourism, to create significant employment, the staff encouraged the government to review and eliminate obstacles to private sector investment in these sectors.** In particular, the government should review its work permit policy concerning expatriate professionals in tourism, as well as investments in new hotels and tourism. The authorities acknowledged the potential for further growth in the tourism sector but emphasized that this possibility would have to be balanced against environmental concerns.

22. **The mission agreed with the authorities that the problem of unemployment in Mauritius was complex (Box 4).**[7] On the demand side, average compensation has tended to grow faster than labor productivity (Figure 4) because the wage-setting institutions described in Box 4 have had a dampening impact on employment, whereas, on the supply side, there is a serious skills mismatch. The staff expressed the view that reforms of the institutions governing the labor market could improve its flexibility. The authorities were urged to consider the recommendations of the most

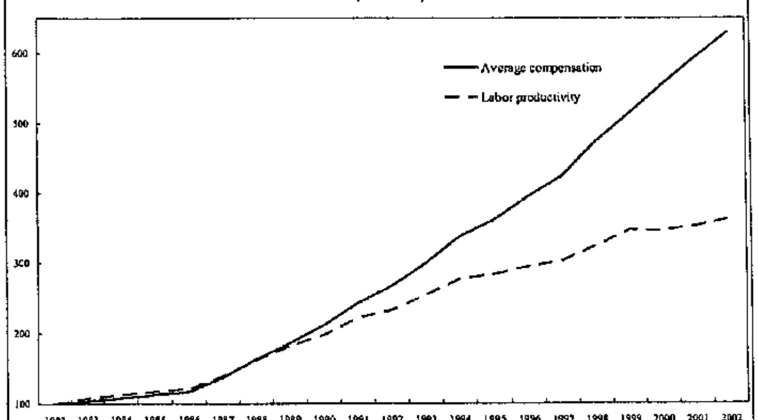


Figure 4. Mauritius: Average Compensation and Labor Productivity, 1982-2002
(1982 = 100)

Source: Central Statistics Office

[7] See also the accompanying Selected Issues paper entitled "Mauritius: Unemployment and the Role of Institutions: A Simple Analytical Framework."

Box 4. Unemployment and the Labor Market

Against a background of profound structural change and strong growth performance, the unemployment rate in Mauritius has been steadily rising, reaching 9.8 percent in 2002. According to the 2000 census, the majority of the unemployed were young, had never held a job, had failed primary or secondary education, had no technical or vocational training, and were single and family supported. The principal causes of rising unemployment can be found in the characteristics of both the labor supply side and the labor demand side of the Mauritian labor market.

Labor market institutions

The Mauritian institutional arrangements governing the functioning of the labor market are as follows: First, a centralized, tripartite system involving the government, trade unions, and the private sector, generates an annual minimum wage increase based on the projected inflation rate. This system tends to drive up real wages throughout the economy at a faster rate than productivity growth. Second, quasi-judicial labor review bodies, principally the National Remuneration Board and the Permanent Arbitration Tribunal for the private sector and the Pay Research Bureau and the Civil Service Arbitration Tribunal for the public sector regulate working times and conditions, and establish minimum wage adjustments that can be above those agreed upon at wage negotiations. Decisions are based on both economic and noneconomic factors. Third, the Termination of Contracts of Services Board (TCSB) settles layoff disputes. The TCSB process is slow, taking typically more than one year to resolve disputes. However, firms in the EPZ are not subject to the jurisdiction of the TCSB.

Demand-side causes of unemployment

The trend-rising unit labor cost has had a dampening impact on job creation and competitiveness and also may have caused some degree of substitution of capital for labor. In addition, the rising minimum wages in the EPZ have constrained domestic labor demand and created labor demand for foreign contract workers, even though the continuous depreciation of the rupee in recent years has kept unit labor cost in nominal effective exchange rate terms fairly constant. Lengthy and costly layoffs appear to have hindered firm-level job creation.

Supply-side causes of unemployment

The rapid structural changes during the 1990s increased demand for skilled workers in the financial service and tourism sectors relative to the low-skilled textile and sugar sectors. However, the Mauritian education system failed to transform the low skills of the labor force into the higher skills that were needed by the emerging sectors, resulting in a skills mismatch. There is a low progression rate from primary to secondary schools. In particular, of the total number of students enrolled at standard 1 in primary schools, about 35 percent fail to pass the completion of primary education (CPE) examination and drop out of the school system at the age of 11 - 12 years. In addition, 83 percent of those remaining in the system never reach advanced levels in secondary schools, and there is little opportunity for vocational training. At the same time, the rising minimum wages and extensive job protection elsewhere have increased the reservation wages of domestic workers in the EPZ and in other sectors.

Ongoing education reform and future labor market reforms

The Mauritian government has taken bold and comprehensive measures to overhaul the education system, aiming at increasing access, quality, and relevance at all levels, especially the secondary level. These reforms would alleviate the mismatch on the supply side in the medium term. However, it is equally important to tackle the demand-side shortcomings by improving the labor market institutions' flexibility.

recent study carried out by an external consultant on this subject.[8] This study essentially comes to the same conclusion as previous reports, namely, that the current highly centralized wage-bargaining system discourages labor productivity growth and the reassignment of labor in the workplace, and makes the laying off of workers cumbersome, lengthy, and costly for producers. Furthermore, the decisions made by quasi-judicial labor review bodies on wage increases and conditions of employment are not always based on the need to safeguard the country's competitiveness and to increase the overall level of employment.

23. **The authorities were in agreement with the staff on the need to reform the institutions governing wage policy, and they pledged to work to address the issue, although they acknowledged that there would be political resistance to carrying out reforms.** The authorities also agreed with the mission's suggestion to take steps immediately to amend the legislation governing the Civil Service Arbitration Tribunal, in order to prevent the Pay Research Bureau (PRB) awards from being referred to the tribunal after they have been accepted. They, nonetheless, stressed that the present institutions governing wage policy reflect years of evolution of a social contract in the society. Reform of the pay policy institutions will therefore have to be gradual. Fiscal Policy

C. Fiscal Policy

24. **The mission encouraged the authorities to take adjustment measures for the remainder of 2002/03 to maintain macroeconomic stability and avert a possible unsustainable debt situation.** Stressing that the projected fiscal deficit of 5.9 percent of GDP for the whole year would delay the necessary adjustment over the medium term, the mission recommended that the government seek to reduce the deficit further to about 5.5 percent of GDP by restraining expenditure, including by curtailing transfers and subsidies and prioritizing capital projects. If the fiscal deficit were not contained below its projected level in 2002/03, a more substantial adjustment would be required in the 2003/04 budget. The authorities indicated that there was little room for adjusting the fiscal stance in 2002/03, and that any correction would be difficult to implement in only a few months.

25. **Further adjustment in 2003/04 will be critical to putting the fiscal situation back onto a track consistent with medium-term fiscal sustainability.** Based on current policies, the fiscal deficit could reach 6.5 percent of GDP in 2003/04. In this context, the mission recommended limiting the deficit to no more than 4.9 percent of GDP as an important step

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[8] In particular, the introduction of a simplified, two-tier wage determination system to replace the current complex institutional setup was recommended by the consultant. On the first tier, the authorities should consider introducing a new national body, representing the three social partners: the government, the employers, and the unions. The body should provide yearly guidelines on general wage increases. However, these guidelines should be nonmandatory for the second tier, namely, the company level, in order to allow for flexibility in implementation and for firm-level collective bargaining.

toward the medium-term objective. The proposed adjustment would be based on a number of key revenue measures, equivalent to 1.6 percent of GDP, including (i) broadening the income tax base; (ii) applying the VAT to some items that are currently exempted or zero rated; and (iii) limiting some exemptions on customs duties (Box 5).

26. **On the expenditure side, the main challenge to the authorities will be to absorb the impact of a potentially substantial civil service wage award by the PRB.** The mission proposed that consideration be given to phasing the increase over two years. At the same time, the authorities should continue prioritizing capital projects to ensure that fiscal prudence is maintained and the quality of public expenditures protected.

27. **While the preparation of the new budget was still at an early stage, the authorities confirmed that their target for the deficit was broadly in line with the mission's recommendation.** The fiscal adjustment would be helped by a planned moderation of capital spending and further efforts to strengthen tax administration. Although the authorities pledged to give full consideration to the proposed tax policy recommendations, they were skeptical about the feasibility of some of the measures for political, social, or administrative reasons. In this regard, they indicated that the political cycle was not propitious for introducing an ambitious plan of new tax measures in 2003/04. The authorities also raised some concern about the social implications of broadening the VAT base to include some basic products and services.

28. **To mitigate the impact on low-income groups of applying the VAT rate to certain basic items, the mission encouraged the authorities to consider developing well-targeted transfers that would protect the consumption levels of these groups.** This approach is more equitable (and cost effective) than the present policy of exemptions or zero rating, since under the latter practices higher-income groups may actually benefit more than low-income groups from the lower prices. The mission proposed that about half of the additional VAT revenues be devoted to this purpose (equivalent to about 0.5 percent of GDP). The authorities were open to the suggestion, but indicated that putting an efficient system of direct transfers in place would take time and be administratively challenging. It was agreed that technical assistance from the Fund or Bank may be useful in this area.

29. **In order to address the financial situation of the STC and CEB, the mission reiterated its recommendations to introduce an automatic and transparent pricing mechanism for petroleum products and to adjust electricity rates.** It appears that the authorities have been delaying the introduction of the mechanism in the hope that international petroleum prices would moderate, and that the implementation of the pricing mechanism would coincide with a lowering of domestic prices. However, the present may be the most appropriate time to introduce the measure since consumers are well aware of the volatility in international crude oil prices, given the impact of the war in the Persian Gulf. A transparent mechanism would demonstrate to consumers that there would be symmetric changes in prices. The government should also consider adjusting electricity tariffs and introducing an element of automaticity to the pricing regime. The authorities agreed, in principle, to implement the pricing mechanism for petroleum products in the near future.

Box 5. Tax Policy Recommendations for 2003/04

The mission's recommendations for 2003/04 are as follows:

Personal income taxes

- Basic deductions should not be further increased in 2003/04. The present complicated regime of special allowances for personal expenditures should be replaced by a more generous basic allowance for the taxpayer and his/her dependent(s).
- Fringe benefits at market value should be included in taxable income (for example, the use of a corporate car, meal allowances, and refunds for petroleum expenses). The estimated revenue impact is 0.08 percent of GDP.
- On investment income, interest and dividend income paid to individuals should be subject to a final withholding tax of at least 5 percent. The estimated revenue impact would be 0.12 percent of GDP.

Corporate income taxes

- The generous treatment of capital investments should be reviewed. For 2003/04, the investment allowance for machinery should be cut to 20 percent from 25 percent. The estimated revenue impact is 0.08 percent of GDP.
- Loss carry forwards should be limited to five years, except for new enterprises.

Value-added tax (VAT)

- The VAT should be applied to the following categories of goods and services, all of which are currently taxed at a zero rate or exempted: (i) cereals, flour, wheat, and rice; (ii) animal and vegetable oils and fats; (iii) live animals and meat; (iv) milk, cream cheese, and butter; (v) fish and fish preparations; (vi) agricultural and horticultural produce; (vi) medical services; (vii) pharmaceutical products; (viii) education; and (ix) water and electricity. The estimated revenue impact is 1.2 percent of GDP.

Customs tariffs

- The customs tariffs should continue to be lowered over the medium term in accordance with Mauritius's international obligations. For 2003/04, this will result in an estimated revenue loss of 0.03 percent of GDP.
- The exemption benefits granted to civil servants should be cut by one-third (an estimated revenue impact of 0.03 percent of GDP).

Careful review of the fee scheme

- An increase in the fee for the lease of land and real estate owned by government would have an estimated revenue impact of 0.03 percent of GDP.
- An increase in the civil aviation charges in relation to the upgrading of the air traffic control system would have an estimated revenue impact of 0.06 percent of GDP.

However, lingering concerns about the social implications may delay the reforms. The authorities indicated that further consultations within the government will be needed.

30. **The authorities were encouraged to continue making efforts to enhance tax administration and strengthen public expenditure management.** In this regard, the mission welcomed the ambitious reform of the customs administration that was under way.[9] On the expenditure side, the authorities were urged to strengthen the effectiveness of their expenditure policies, and to accelerate the development of a medium-term expenditure framework with the assistance of the World Bank.

31. **An illustrative medium-term adjustment scenario was presented to the authorities that would bring the fiscal deficit down to 2-3 percent of GDP and the public debt-to-GDP ratio to just over 60 percent by 2006/07 (Box 6 and Table 6).** The mission cautioned, however, that this scenario would be feasible only if (i) substantial efforts were made on the revenue side, starting in 2003/04; (ii) there was no significant deterioration in the financial situation of state-owned enterprises; and (iii) the authorities continued to carefully phase their capital spending plans. The authorities were in broad agreement with the proposed adjustment path.

32. **The proposed medium-term fiscal path will help ensure debt sustainability.** Stress tests show that sustainability (as indicated by a debt ratio falling to about 60 percent of GDP) is achieved under the baseline scenario and is robust to a series of plausible shocks (Appendix I). Nonetheless, a combination of large shocks could temporarily but significantly increase the debt-to-GDP ratio. The baseline scenario assumes that to further reduce Mauritius' vulnerability to shocks, the fiscal balance should approach zero over the longer term. This would reduce the public debt ratio to near 40 percent of GDP by 2011/12. The mission encouraged the authorities to stay on this adjustment path. In the absence of fiscal adjustment over the medium term, the debt dynamics could become unsustainable.

D. Monetary and Financial Sector Policies

33. **The current stance of monetary policy is considered to be appropriately tight.** The mission warned, however, that, while inflation seemed to be falling, the bias should be against further cuts in interest rates, given the current fiscal position. The mission urged the authorities to continue to monitor liquidity conditions, and, while acknowledging the BOM's desire to lower rates, stressed that the main avenue for achieving a lasting reduction in real interest rates was the implementation of a substantial fiscal adjustment effort. The authorities agreed with the emphasis placed on the need for fiscal adjustment and indicated that they would be cautious in lowering interest rates in the immediate future.

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[9] The reform plan, which will likely take two to three years to be fully implemented, will mainly aim at (i) enhancing revenue performance; (ii) reducing economic distortions associated with smuggling and commercial fraud; (iii) increasing transparency; and (iv) reducing discretion and corruption.

Box 6. Illustrative Medium-Term Adjustment

The mission presented an illustrative medium-term scenario consistent with fiscal consolidation. Limiting the fiscal deficit to 4.9 percent of GDP in 2003/04 would allow the stabilization of the public debt at 68 percent of GDP by June 2004. On the revenue side, the set of tax measures recommended by the mission, which is assumed to be fully implemented by the authorities in 2003/04, would provide momentum for stronger revenue performance over the next few years, despite the gradual loss in customs revenue associated with trade liberalization. At the same time, the authorities would strengthen tax administration and their fight against tax evasion. On the expenditure side, the scenario rests on a number of key assumptions: (i) following the phasing of the PRB award over 2003/04 and 2004/05, the wage bill would gradually decline in terms of GDP as a result of a moderate wage policy; (ii) interest payments on domestic debt would gradually fall as interest payments on treasury bills issued by the central bank solely for monetary purposes would be limited over time; (iii) addressing the financial situation of the public enterprises would help curtail transfers, subsidies, and net lending; and (iv) capital spending, after peaking at 5 percent of GDP in 2002/03, would be contained at below 4 percent by 2006/07, as most major projects in the priority sectors of education, sewage, housing, and health care would be near completion. The fiscal deficit would then gradually decline to about 2.6 percent of GDP by 2006/07, which would help bring the debt-to-GDP ratio down to about 61½ percent.

Illustrative Adjustment Scenario, 2001/02-2006/07 1/

	2001/02 Prov.	2002/03 Proj.	2003/04 Proj.	2004/05 Proj.	2005/06 Proj.	2006/07 Proj.
	(Annual percentage changes)					
GDP at constant market prices	4.0	3.3	5.5	5.1	4.9	4.6
Consumer prices (period average)	6.4	5.1	5.0	4.5	4.0	4.0
	(In percent of GDP at market prices)					
Overall fiscal balance (including grants)	-5.9	-5.9	-4.9	-4.3	-3.2	-2.6
Revenue and grants	18.4	20.8	21.6	21.3	21.1	20.9
Expenditure and net lending	24.4	26.7	26.5	25.6	24.3	23.6
External current account balance (including transfers)	5.2	4.6	3.5	2.7	2.0	1.1
Total public debt	69.2	69.7	68.0	66.4	64.1	61.6

Sources: Mauritian authorities; and IMF staff estimates and projections.

1/ Fiscal year from July to June.

34. **The BOM has adopted an informal inflation-targeting framework that is working well.**[10] The authorities agreed that the preconditions for a move to a formal

[10] The term "informal" is used because the current Bank of Mauritius Act does not specify price stability as a monetary policy objective and the BOM does not publicly (formally) preannounce an inflation target. However, the BOM does maintain an internal target for inflation. The actual inflation rate has consistently been close to the target set by the BOM.

inflation-targeting regime do not exist in Mauritius, given the fiscal dominance and the absence of BOM independence under the current central bank act.

35. **A Financial Sector Assessment Program (FSAP) mission visited Mauritius at the end of 2002 and concluded that Mauritius had a well-developed financial system and that the banking system was highly profitable and sound.** However, the report identified three main sources of potential risks and vulnerabilities: (i) vulnerabilities to external shocks; (ii) the rollover risks of growing short-term public debt; and (iii) a potential reputation risk (Box 7). The authorities have made significant strides in addressing the issue of anti-money laundering and the combating of the financing of terrorism (AML/CFT). These efforts have included the enactment of the Financial Intelligence and Anti-Money-Laundering Act of 2002 and the Financial Services Development Act of 2001. In March 2003, a joint Fund/Bank technical assistance mission provided additional advice on strengthening the legal and administrative capacity in the area of AML/CFT.

36. **The staff was encouraged by the efforts of the authorities to adopt further measures to enhance banking supervision and improve financial regulations.** The authorities responded positively to the main recommendations of the FSAP report. They were urged to press ahead and implement the FSAP recommendations, as well as those of the technical assistance mission on AML/CFT.

37. **The mission highlighted weaknesses in the process for issuing government securities by auction.** Notwithstanding the authorities' claims that the auction process is a market-based system, the BOM, on occasions, selectively rejects certain bids in order to influence the yield curve. The mission urged the BOM to refrain from such interventions as these result in market inefficiencies, undermine confidence, and would hinder the further development of markets. While agreeing with the mission, the authorities were of the view that many market participants were inexperienced, with the result that outlandish bids are placed in the auctions. They, nevertheless, indicated their willingness to refrain from selectively rejecting bids. The mission also stressed that transparency was lacking in the issuance of treasury bills for monetary operations as against their issuance for meeting the borrowing requirements of the government.

38. **The authorities were commended for their decision to phase out the practice of providing subsidized loans to certain sectors and companies.** Two lines of credit that had already been approved will remain operational until the balances are repaid.[11] The authorities were encouraged to channel any future scheme through the budget.

[11] An amount of MUR 1,564 million has already been disbursed to the sugar sector as part of a MUR 2 billion line of credit, and the balance of MUR 436 million will be disbursed shortly, after which the scheme will be discontinued.

Box 7. Main Findings of the Financial Sector Assessment Program

Overall, the Mauritius financial sector is in good health. Mauritius has a well-developed, large, and relatively stable domestic financial system and a fast-growing offshore sector. Banks account for over two-thirds of the financial system, and are generally well capitalized, highly profitable, and liquid. The securities markets, insurance sector, and pension and mutual funds are well developed by developing country standards. Stress tests reveal that credit risk is the main risk, although high levels of capital and profit provide relative immunity to changes in interest and exchange rates and a considerable cushion against rises in nonperforming loans and falls in collateral values. The operations of offshore banks and insurers are large relative to the economy but insulated from the domestic economy.

While the overall stability risks remain modest, the three principal risks to the financial system are the following: the possibility that significant external shocks and a downturn in the economy lead to large credit shocks; rollover risks embedded in the large and growing amount of short-term public debt; and reputation risks arising from potential money-laundering activities, primarily in the Global Business License 2 (GBL2) companies in the offshore sector.

The credit risk is largely inherent in the small size of the island economy, and in possible adverse developments in specific sectors, such as sugar, textiles, and offshore businesses. While the large size of the top two banks permits them to better diversify, it also makes them unlikely to escape the consequences of an economy-wide downturn, and the taxpayer consequences of any decline in their health could be large.

In the long run, these systemic risks can be reduced principally through international diversification and reduction of government of Mauritius's direct participation in deposit taking. This would involve encouraging further the judicious expansion of Mauritian banks abroad, a greater share of foreign banks in the domestic market, and a rethinking of parastatal and government participation in deposit-taking institutions. Simultaneously, the authorities need to take measures to strengthen banking supervision, encourage improvements in the internal audit and control of banks, strengthen provisioning, and encourage nonbank financing alternatives, specifically by removing tax disadvantages against corporate bonds and facilitating the creation of a credit bureau.

Several improvements are needed in the management of public debt, including strengthening the strategic and operational capacity of the Debt Management Unit, improving the maturity structure, clearly separating public financing- and monetary policy-related operations, and designing the auction of public securities.

Assessment of standards and codes. With IMF assistance, significant progress has been made in strengthening banking supervision and prudential regulations. However, there is still a need for further improvement in the legal authority and independence of the BOM, transparency in the governance of BOM, the strengthening of country and market risk management, and effective implementation of existing regulations. Furthermore, bank-like regulation and supervision should be applied to certain nonbank depository institutions. In the insurance area, the government should promote consolidation through higher minimum and risk-based capital requirements. Consumer protection should be enhanced and the problems posed by weak institutions resolved promptly. Regarding securities, there is a need to strengthen the regulation of mutual funds. With respect to AML/CFT, the following areas require attention: improvement of the structure of the Financial Intelligence Unit; enforcement of supervisory guidelines; and coordination of enforcement efforts. In addition, certain gaps in the legal framework should be addressed and GBL2 companies periodically relicensed. The authorities have requested and received technical assistance from MFD and the World Bank in this area.

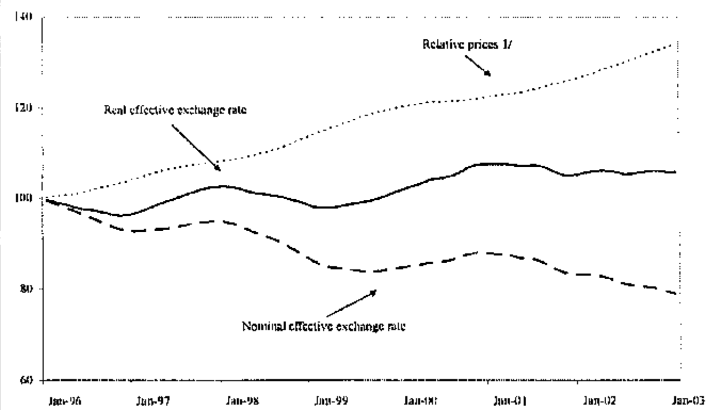
39. **The mission welcomed the BOM's announcement of the forthcoming revisions to the Bank of Mauritius Act and the Banking Act.** In particular, the mission welcomed the authorities' aim to increase the accountability of the central bank; strengthen the central

bank's supervisory capabilities; and set price stability as the primary objective of the central bank. The mission urged the authorities to pass the bills quickly, by the time of the announcement of the 2003/04 budget.

E. Exchange Rate and External Sector Policies

40. **The mission and the authorities agreed that the BOM should refrain from seeking to achieve a real exchange rate depreciation through intervention and allow the value of the Mauritian rupee to be mainly market determined (Figure 5).** Such interventions can be costly in terms of sterilizing the domestic currency injection that results from the operation and will likely lead to higher inflation over time. Intervention should be limited to smoothing short-term volatility, even if this entails a further nominal appreciation of the exchange rate in the short run. Strengthening international competitiveness is an objective better handled by fiscal restraint and structural reforms. The mission was pleased with the BOM's intention to phase out, over the coming months, the current informal surrender arrangement by which it purchased 35 percent of the foreign currency receipts of the Mauritius Sugar Syndicate at a premium over what the syndicate received from other banks.[12] In the mission's view, the BOM should move expeditiously to implement this policy, which would, among other things, promote the development of genuine interbank market transactions in foreign exchange.

Figure 5. Mauritius: Nominal and Real Effective Exchange Rates, Jan 1996-Jan 2003
(Index: Average for 1995 = 100)



1/ defined as the ratio of the price level of Mauritius to that of its main trading partners.
Source: IMF, Information Notice System.

41. **The authorities were encouraged to consider a further gradual liberalization of the country's trade system (Box 8).** Mauritius still maintains some nontariff barriers, although they are not very significant, including import bans or import quotas for some products, and import controls by means of permit. Most importantly, petroleum and some other sensitive products are mainly or exclusively imported and distributed under a monopoly state trading and price control regime. The mission urged the government to rationalize the current tariff regime by reducing the number and extent of exemptions and concessions.

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[12] As it is the authorities' policy to cap the premium such that any spread over the prevailing rate would not exceed 2 percent, this measure does not give rise to a multiple currency practice.

Furthermore, the discriminatory excise taxes on imported alcoholic beverages and tobacco products should be addressed. The authorities, while acknowledging these concerns, expressed reservations about opening up the importation of petroleum products to competition, citing previous instances of price gouging and shortages that had ensued when such products had been imported by the private sector. Regarding tariff reforms and discriminatory excises, they agreed to address these issues, particularly in the context of ongoing regional trade negotiations.

Box 8. WTO Trade Policy Review of Mauritius

In November 2001, the second World Trade Organization (WTO) review of Mauritius's trade policies was concluded. The report criticized the discrimination of imports on the basis of source; the average most-favored-nation tariff rate, which was still high; the low coverage of tariff bindings; a less-than-satisfactory liberalization effort with regard to nontariff measures; the extensive use of incentives for export production; and the inadequate compliance in including services under the General Agreement on Trade in Services. It recommended the elimination of nontariff barriers in order to enhance the transparency of the trade regime. It also urged the authorities to streamline and rationalize existing incentives, so as to lessen the aspects of duality and improve resource allocation.

In its policy statement, the government of Mauritius stressed that the country will continue to rely on secure and enhanced preferential access to export markets and international assistance to meet adjustment costs and to improve competitiveness. The authorities pointed to the vulnerability of Mauritius as a small-island developing economy that suffered from (i) remoteness and insularity; (ii) susceptibility to natural disasters; (iii) limited opportunities for diversification; and (iv) inadequate access to external capital.

Box 9. Regional Trade Integration

Mauritius is one of nine members of the COMESA Free Trade Area (FTA). Goods originating from COMESA member states and covered by proper certificates of origin are imported duty free, while goods from other COMESA states not participating in the FTA enjoy a 90 percent tariff reduction. Presently, the adoption of a common external tariff (CET) and the establishment of the COMESA Customs Union by end-2004 are under negotiation. A tariff schedule with four tariff bands is proposed: 0 percent (capital goods); 5 percent (raw materials); 15 percent (intermediate goods); and 30 percent (finished goods). Rules of origin will specify a domestic content threshold of 35 percent (except for Egypt, with a threshold of 45 percent). COMESA trade links are only of minor importance for Mauritius and presently make up around 5 percent of imports and 7.4 percent of exports—most of which are accounted for by trade with Madagascar.

Mauritius signed the **SADC Trade Protocol** in September 2000. According to the protocol, 85 percent of intra-SADC trade will be liberalized by 2008. The treaty distinguishes three categories of products: raw materials and production equipment (category A), which underwent immediate liberalization; revenue-sensitive products (category B), which will be phased out within the eight-year period to 2008; and sensitive products (category C), which would have the tariff barriers gradually reduced between 2008 and 2012. At present, Mauritius grants trade preferences to the 11 countries that have implemented the SADC Trade Protocol.

42. **The staff commended the authorities for their efforts to encourage regional economic integration (Box 9).** The timetable to eliminate most tariffs on intra-Southern African Development Community (SADC) trade was particularly welcome. The mission commended the authorities for moving ahead to reduce the number of tariff bands, as well as the maximum tariff rate, as part of their negotiations within the Common Market for Eastern and Southern Africa (COMESA) customs union.

F. Technical Assistance

43. **Fund technical assistance to Mauritius has generally been well targeted and successful in achieving the expected outputs.** This was confirmed by a recent assessment carried out by the Fund in collaboration with the Mauritian authorities (Box 10). The assessment found that the technical assistance had properly integrated with macroeconomic and capacity building objectives and had benefited greatly from the authorities' high level of ownership and commitment. Going forward, technical assistance is expected to be modest relative to past efforts, and will focus primarily on tax reforms, financial sector vulnerabilities, and the further strengthening of the country's statistical system.

IV. Staff Appraisal

44. **Following a slowdown in economic activity in 2002/03, growth should recover in 2003/04 to about 5½ percent.** This recovery, however, faces several near-term risks. Chief among these are the possible lingering effects of the war in Iraq on tourism and uncertainty regarding the pace and durability of economic recovery in the economies of Mauritius's main trading partners. In addition, while its ultimate effects are unclear, the recent outbreak of Severe Acute Respiratory Syndrome around the world has already had an impact in Mauritius. Travel and tourism services may be negatively affected, as Air Mauritius has suspended flights to Singapore, Hong Kong SAR, and Malaysia.[13]

45. **The effort to raise medium- to long-term growth in Mauritius faces a double challenge:** how to develop new sources of growth, and how to reduce unemployment. The Mauritian economy has had an enviable record of performance in the last two decades. Over this period, Mauritian entrepreneurs successfully took advantage of generous trade preferences in sugar and textiles. The resource transfers from these trade preferences played a crucial role in sustaining high levels of investment, and in part explain why domestic rather than foreign savings have made the dominant contribution to growth. The institutional arrangements—a democratic government, and respect for the rule of law and property rights—governing economic activity facilitated strong economic growth and engendered social harmony.

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[13] The government has also halted the recruitment of workers from China into the EPZ. The EPZ currently employs over 16,000 Chinese workers—about 18 percent of total employment in this sector.

Box 10. Assessment of IMF Technical Assistance

In response to interest expressed by Executive Directors at the conclusion of the 2002 Article IV consultation with Mauritius, the African Department (AFR) and the Office of Technical Assistance Management (OTM) prepared an assessment of the effectiveness of the IMF's technical assistance (TA) program for Mauritius. The review covered fiscal years 1998-2002 and focused primarily on whether individual project objectives had been achieved. The review was carried out in collaboration with the Fiscal Affairs, Monetary and Exchange Affairs, and Statistics Departments, as well as with the Mauritian authorities.

TA was provided by the IMF in the financial, fiscal, and statistics areas through missions, visits by short-term experts, resident advisors, and peripatetic experts. By international comparison, the volume of TA provided to Mauritius in the financial sector over the period reviewed was substantial, whereas in the fiscal and statistics areas it was relatively limited. As the assistance was focused on the IMF's core areas of expertise, it was supplemented only in the financial sector by TA from the World Bank, especially in the areas of payments systems and debt management.

TA in the financial sector helped to modernize the banking sector and build capacity at the Bank of Mauritius, in particular in the areas of monetary management and bank supervision. Regarding tax policy and administration, the IMF assisted the authorities in introducing a value-added tax (VAT) and in establishing a revenue authority. In the area of statistics, TA supported the authorities' efforts to meet the requirements for participation in the General Data Dissemination System (GDDS), and to improve the quality and timeliness of data for economic analysis.

Overall, IMF TA to Mauritius was found to be well targeted and successful in achieving the expected outputs. The assistance was properly integrated with macroeconomic and capacity-building objectives and benefited greatly from the authorities' exceptionally high level of ownership and commitment. While TA in the fiscal and statistics areas was considered generally effective, the review concluded that the assistance provided in the financial sector could have been achieved with fewer resources.

The review suggested that a greater involvement of other TA providers in supplementary and complementary TA to Mauritius could have better leveraged the IMF's resources. The effectiveness of TA delivery could have also benefited from greater involvement by the authorities, including the appointment of more trained counterparts, a greater emphasis on the transfer of skills, and a better balance of resident advisors, regional advisors, short-term experts, and advisory missions.

Future IMF TA to Mauritius is expected to be modest and to focus on continuing tax reforms, ensuring sustained bank soundness, addressing financial sector vulnerabilities, as identified by the recent Financial Sector Assessment Program missions, and further strengthening the country's statistics systems.

46. **Given the challenges of rapid globalization and the potential loss of trade preferences, Mauritius will need to focus increasingly on institutional reform to make the economy more competitive, flexible, and adaptable.** Growth in the Mauritian economy has been characterized by capital deepening, rather than by an increase in total factor productivity. Furthermore, the existing labor market institutions, while facilitating social harmony, have widened the gap between productivity growth and unit labor costs in rupee terms. Because the rupee has depreciated in nominal effective terms in the past, there has been no loss of international competitiveness. However, with the currently very strong balance of payments and the recent strengthening of the rupee, the EPZ sector should not rely on further depreciation in the future. The expected erosion of trade preferences as well as the continued structural weaknesses in the education sector and labor market pose additional threats to the maintenance of external competitiveness.

47. **Going forward, Mauritius will need to transform its economy in order to remain competitive and address the growing unemployment problem.** The success of this strategy hinges on whether Mauritius can (i) implement critical labor market reforms to link wage growth more closely to productivity increases; and (ii) create more opportunities for private sector investment and growth through structural reforms, including the reduction of the state sector in the economy. With regard to labor market rigidities, in particular, the government should take advantage of its tradition of consensus building to develop a program of reforms of the current wage-setting institutions.

48. **The government should be commended for its efforts to support the development of new "pillars" of economic growth, in particular, in financial services, free port activities and information and communications technology.** There is, however, the risk that this attempt to "pick winners" may not be successful. Given the small base from which these sectors are starting, their contribution to economic growth over the medium term is expected to be modest, even assuming rapid growth in the sectors. For example, the staff calculates that, under the baseline scenario, the contribution of the information and communications technology sector to medium-term growth is unlikely to be more than 0.5 percentage point of GDP. The sector, however, has the potential to ultimately raise overall productivity levels in the economy. The staff is therefore of the view that while the government's diversification strategy is praiseworthy and goes in the right direction, the expectation may be too high for the new sectors to have a major impact in the next few years. However, in the longer term, the impact could be substantial. Furthermore, the diversification strategy would be strengthened by other structural reforms as mentioned previously.

49. **The level of public debt in Mauritius is moderate but rising.** An assessment of medium-term fiscal sustainability shows that, in the absence of a substantial fiscal adjustment, the public debt-GDP ratio could rise to 72 percent by 2006/07 from its current level of 69 percent. If the economy were to be affected by certain shocks, such as real interest rate increases, lower GDP growth, or a significant real exchange rate depreciation, the debt burden could very quickly worsen.

50. **To ensure fiscal sustainability, Mauritius should move expeditiously to reduce its budget deficit to less than 5 percent of GDP in 2003/04 from the projected outturn of nearly 6 percent in 2002/03.** This reduction should be achieved principally by broadening the domestic tax base while restraining capital expenditures. Over the medium term, the government should aim to reduce the deficit further to 2-3 percent of GDP. This would allow the public debt-GDP ratio to fall to about 62 percent by 2006/07. Stress tests carried out by the staff indicated that this medium-term path would be resilient to a range of shocks.

51. **To strengthen the overall financial position of the public sector, the government should, without further delay, implement an automatic and transparent mechanism for setting domestic petroleum prices; it should also adjust electricity tariffs.** The losses being experienced by the STC represent a contingent liability of the budget and risk delaying the needed fiscal adjustment. Use of an automatic pricing mechanism for petroleum product prices would depoliticize the process of price adjustment and would ensure that the STC operates on a commercial basis. The staff also considers it appropriate to adjust electricity tariffs in light of the losses being experienced by the CEB.

52. **Monetary policy is appropriately tight, and the falling tendency of inflation is welcome.** The BOM should continue to monitor liquidity conditions carefully, in light of the present expansionary fiscal stance, in order to prevent an emergence of inflationary pressures. In this context, the staff considers that further reductions in interest rates at this time would be premature. The present informal inflation-targeting regime is an appropriate framework for monetary policy. Use of a more formal framework may be feasible when the central bank achieves greater independence and the size of the government's borrowing requirement has been reduced. In this regard, the government should move quickly to pass the draft laws to revise the Bank of Mauritius Act and the Banking Act.

53. **Despite the appreciation of the Mauritian rupee against the U.S. dollar in recent times, the real effective exchange rate has remained relatively stable, and the exchange rate does not appear to be significantly misaligned.** The staff supports the BOM's policy of allowing the exchange rate to be market determined, even at the risk of allowing a modest appreciation in the short run. In this regard, the BOM should move expeditiously to discontinue the current informal surrender requirement whereby foreign exchange earnings of the Mauritius Sugar Syndicate are purchased at a premium by the central bank.

54. **The government's participation in the Financial Sector Assessment Program (FSAP) is welcome.** The government should implement the recommendations of the FSAP to address potential vulnerabilities in the financial sector, in particular, in the area of banking supervision, and by developing alternatives to bank lending to reduce portfolio risk and encouraging greater participation by foreign banks in the domestic market.

55. **The government is advised to adopt a preannounced medium-term tariff reform program to reduce the number of tariff bands from eight to no more than three nonzero bands.** The staff commends the government for moving ahead to reduce the maximum tariff rate as part of its discussions within COMESA. The government should also

adhere to its plans to reduce the tariff rates on consumer goods to zero by 2005 within the context of the SADC, and to accelerate the current plans to reduce tariff rates on import-substituting goods. The principal nontariff barriers in Mauritius are with respect to the state trading and monopoly imports of petroleum products. These barriers should be eliminated in line with the structural reforms to further liberalize the economy that were discussed earlier.

56. It is proposed that the next Article IV consultation with Mauritius be held on the standard 12-month cycle.

Table 1. Mauritius: Selected Economic and Financial Indicators, 1998/99-2002/03 1/

	1998/99	1999/00	2000/01	2001/02 Est.	2002/03 Proj.
	(Annual percentage changes, unless otherwise indicated)				
National income, prices, and employment					
Real GDP 2/	5.4	2.7	7.0	4.0	3.3
GDP deflator 2/	6.9	3.4	3.8	5.5	5.2
Domestic demand at current prices 3/ 4/	12.8	8.8	5.9	6.8	9.8
Consumer prices (period average)	7.9	5.3	4.4	6.4	5.1
Unemployment rate (in percent)	7.1	8.1	8.9	9.4	9.8
External sector (in U.S. dollar terms)					
Exports, f.o.b.	4.7	-9.4	7.6	-3.4	5.9
Imports, f.o.b. 4/	1.6	3.6	-6.4	-6.8	8.8
Nominal effective exchange rate 5/	-8.0	2.3	0.5	-6.2	-5.0
Real effective exchange rate 5/	-1.9	5.7	2.7	-1.9	0.1
Terms of trade	-0.8	-5.1	-1.9	1.4	0.3
Central government budget					
Revenue and grants	15.3	10.2	-3.4	11.4	22.4
Of which: tax revenue	14.1	13.8	-0.9	6.6	22.9
Expenditure and net lending 6/	12.3	11.9	7.3	12.0	19.0
	(Contribution to changes in broad money, unless otherwise indicated)				
Money and credit					
Net foreign assets	1.7	3.3	7.4	9.0	5.1
Domestic credit	13.1	13.2	5.3	7.7	6.6
Net claims on government	-2.2	3.2	-1.1	1.3	1.6
Credit to private sector	15.3	10.0	6.4	6.3	5.0
Broad money	13.2	10.9	9.9	13.0	11.0
Interest rate (one-year term deposits, in percent) 7/	12.0	10.8	11.4	11.8	10.5
Income velocity of broad money (GDP/M2)	1.4	1.3	1.3	1.2	1.2
	(In percent of GDP at market prices)				
Central government budget					
Current balance (including grants)	-0.5	0.1	-3.3	-1.9	-0.3
Overall balance (including grants) 6/	-3.3	-3.8	-5.7	-5.9	-5.9
Domestic financing	3.9	3.1	4.5	5.2	5.9
Of which: banking system (net)	-1.5	2.3	-0.8	1.0	1.2
External financing	-1.1	-0.5	-2.9	0.8	0.0
Domestic debt	38.6	40.2	42.4	48.6	50.7
External debt	9.5	8.8	5.4	6.2	7.0
Gross domestic investment	25.4	26.2	23.3	21.8	22.7
Public	6.2	6.5	6.4	6.8	9.2
Private	19.2	19.7	16.9	15.0	13.5
Gross national savings	23.9	24.6	26.7	27.0	27.3
Public	-0.6	0.0	-3.4	-2.1	-0.6
Private	24.5	24.7	30.1	29.1	27.8
External current account balance 8/	-1.5	-1.6	3.4	5.2	4.6
Total external debt	28.7	25.5	22.4	21.6	20.9

Table 1. Mauritius: Selected Economic and Financial Indicators, 1998/99-2002/03 (continued) 1/

	1998/99	1999/00	2000/01	2001/02 Est.	2002/03 Proj.
	(In percent of exports of goods and nonfactor services)				
Total external debt	45.6	42.3	34.5	35.7	38.0
Of which: government	15.0	14.5	8.4	10.2	12.8
Total external debt service	7.6	7.9	9.8	8.5	7.3
Of which: interest payments	2.1	2.1	1.8	1.4	1.5
	(In millions of U.S. dollars, unless otherwise indicated)				
Net international reserves of the Bank of Mauritius	625.4	688.0	789.3	1,017.0	1,328.3
In months of prospective imports, c.i.f. 4/ 9/	3.5	4.1	5.0	6.0	7.3
Net international reserves of the banking system	893.7	966.0	1,085.9	1,352.8	1,611.3
In months of prospective imports, c.i.f. 4/	5.0	5.7	6.9	7.9	8.9
Memorandum item:					
GDP at current market prices (in millions of Mauritian rupees)	106,079	112,685	125,123	137,312	149,101

Sources: Bank of Mauritius; Central Statistics Office; Ministry of Finance; and IMF staff estimates and projections.

1/ Fiscal year from July to June.

2/ Sugar crops and milling included in fiscal year harvested; otherwise, averages of calendar-year data.

3/ Excluding changes in stocks.

4/ Excluding the acquisition of aircraft and ships.

5/ Trade-weighted period averages (a negative sign signifies a depreciation). Data for 2002/03 are for July 2002-January 2003.

6/ In 1998/99 and 2000/01, net lending includes the repayment of US$33 million and US$117 million of the international floating rate note (FRN) issue of US$150 million respectively

7/ End-of-period maximum interest rate offered by banks on time deposits with maturities of between six and twelve months. Data for 2002/03 are for February 2003.

8/ Including transfers.

9/ The reserves of the Bank of Mauritius are not pledged as collateral for short-term liabilities, nor are they sold forward.

Table 2. Mauritius: Balance of Payments, 1998/99- 2002/03 1/
(In millions of U.S. dollars, unless otherwise indicated)

	1998/99	1999/00	2000/01	2001/02 Prov.	2002/03 Proj.
Current account balance	-65.3	-68.7	154.3	238.2	234.8
In percent of GDP	-1.5	-1.6	3.4	5.2	4.6
Trade balance	-365.5	-483.9	-252.9	-219.2	-266.4
Exports, f.o.b.	1,680.2	1,522.6	1,639.0	1,582.9	1,676.4
Percentage change	4.7	-9.4	7.6	-3.4	5.9
Of which : export processing zone (EPZ)	1,135.4	1,171.2	1,177.1	1,105.6	1,186.8
sugar	371.7	213.5	272.9	292.7	288.2
Imports, f.o.b.	-2,045.7	-2,006.5	-1,891.9	-1,802.0	-1,942.8
Percentage change	1.5	-1.9	-5.7	-4.8	7.8
Of which : EPZ	-651.7	-620.7	-607.9	-557.7	-598.7
petroleum products	-108.8	-177.5	-213.5	-184.3	-209.0
aircraft and ships	-108.8	0.0	-14.4	-52.3	-39.3
Services (net)	232.5	354.2	332.0	400.0	432.8
Of which: tourism	327.4	376.5	387.5	411.3	443.0
Credit	514.3	562.2	562.8	632.8	638.8
Debit	-186.8	-185.8	-175.3	-221.5	-195.7
Income (net)	-23.7	-35.1	12.2	-8.2	-5.5
Current transfers (net)	91.4	96.0	63.0	65.6	73.8
Capital and financial account	11.7	-103.6	-95.6	-257.8	-234.8
Capital account	-0.6	-0.5	-1.4	-1.0	-2.0
Financial account	12.4	-103.1	-94.2	-256.8	-238.5
Direct investment	18.8	12.7	197.3	48.4	22.5
Abroad	-11.8	-11.8	-4.7	-1.5	-1.4
In Mauritius	30.5	24.4	202.0	49.9	23.9
Portfolio investment 2/	28.8	-23.1	-139.0	-19.9	-6.8
Other investment	-8.0	-7.8	33.3	-39.7	4.1
Government	-15.0	-20.0	-16.6	35.6	2.1
Other public sector	54.6	-42.4	37.2	-51.6	-51.1
Other 3/	-47.5	54.6	12.7	-23.6	53.0
Reserve assets of the Bank of Mauritius	-27.2	-84.9	-185.8	-245.6	-258.3
Errors and omissions 4/	53.5	172.3	-58.6	19.6	0.0
Memorandum items:					
Current account balance, excluding aircraft and ships	43.5	-68.7	168.7	290.5	274.0
In percent of GDP	1.0	-1.6	3.7	6.4	5.4
Overall balance (in percent of GDP)	0.6	1.9	4.3	5.4	5.1
Net international reserves of the banking system 5/	893.8	966.0	1,085.9	1,352.9	1,611.3
Net international reserves of the Bank of Mauritius 5/	625.4	688.0	789.3	1,017.0	1,328.3
In months of prospective imports, c.i.f. 6/	3.5	4.1	5.0	6.0	7.3
Total debt-service ratio (in percent of exports of goods and services)	7.6	7.9	9.8	8.5	7.3
Mauritian rupees per U.S. dollar (period average) 7/	24.82	25.51	27.59	30.09	29.30
Mauritian rupees per U.S. dollar (end of period) 7/	25.24	26.09	29.24	29.96	28.63

Sources: Bank of Mauritius; Ministry of Finance; Mauritius Sugar Syndicate; and IMF staff estimates and projections.

1/ Fiscal year from July to June.
2/ In 2000/01, portfolio investment outflows include the repayment of the balance (US$117 million) of the floating rate note.
3/ Including movements in international reserves of commercial banks.
4/ Including valuation adjustments.
5/ End of period.
6/ Excluding the acquisition of aircraft and ships.
7/ Market rate.

Table 3. Mauritius: Summary of Government Finances, 1998/99-2002/03 1/

	1998/99	1999/00	2000/01	2001/02 Prov.	2002/03 Budg.	2002/03 Proj.
	(in millions of Mauritian rupees)					
Total revenue and grants	21,329	23,500	22,707	25,286	30,318	30,949
Tax revenue	17,900	20,373	20,189	21,519	26,004	26,442
Nontax revenue	3,294	2,966	2,318	3,451	4,039	4,133
External grants	135	161	199	317	275	375
Total expenditure and net lending	24,851	27,810	29,846	33,438	39,595	39,803
Current expenditure	21,847	23,379	26,786	27,888	31,002	31,400
Wages and salaries	7,457	7,763	8,181	8,787	9,434	9,269
Other goods and services	2,180	2,354	2,735	2,984	3,396	3,147
Interest payments	3,626	3,856	5,527	4,541	6,484	6,451
External interest	501	453	401	207	297	244
Domestic interest	3,125	3,403	5,125	4,334	6,187	6,207
Current transfers and subsidies	8,584	9,406	10,342	11,576	11,688	12,532
Capital expenditure	2,834	3,381	3,899	5,061	7,676	7,464
Net lending 2/	-705	167	-1,574	490	917	939
Expenditure by the Privatization Fund	875	883	735	0	0	0
Overall balance after grants	-3,522	-4,310	-7,139	-8,152	-9,276	-8,854
Overall balance, excluding exceptional factors 3/	-4,830	-4,810	-8,853	-8,915	-9,664	-8,568
Financing	3,522	4,310	7,139	8,152	9,276	8,854
External (net)	-1,170	-510	-3,584	1,070	1,332	62
Disbursements	464	410	349	1,778	2,162	910
Amortization	-1,634	-920	-3,932	-708	-830	-848
Domestic	4,009	3,547	5,606	7,082	7,944	8,792
Banking system (net)	-1,571	2,579	-959	1,314	3,000	1,800
Nonbank	5,580	968	6,565	5,768	5,129	6,983
Sale of equity in state-owned enterprises	0	0	7,100	0	0	0
Residual	684	1,274	-1,983	0	0	0
	(In percent of GDP, unless otherwise indicated)					
Total revenue and grants	20.1	20.9	18.1	18.4	19.9	20.8
Of which: tax revenue	16.9	18.1	16.1	15.7	17.1	17.7
Of which: taxes on imports	5.6	6.2	5.1	4.3	4.5	4.7
sales tax/value-added tax (VAT)	4.4	5.0	4.7	5.1	6.3	6.7
income tax	2.5	2.6	2.4	2.5	2.5	2.6
Total expenditure and net lending	23.4	24.7	23.9	24.4	26.0	26.7
Current expenditure	20.6	20.7	21.4	20.3	20.4	21.1
Of which: wages and salaries	7.0	6.9	6.5	6.4	6.2	6.2
interest payments	3.4	3.4	4.4	3.3	4.3	4.3
Capital expenditure	2.7	3.0	3.1	3.7	5.1	5.0
Net lending 2/	-0.7	0.1	-1.3	0.4	0.6	0.6
Overall balance after grants	-3.3	-3.8	-5.7	-5.9	-6.1	-5.9
Overall balance, excluding exceptional factors 3/	-4.6	-4.3	-7.1	-6.5	-6.4	-5.7
Primary balance (overall balance, excluding interest) 4/	0.1	-0.4	-1.3	-2.6	-1.8	-1.6
Financing	3.3	3.8	5.7	5.9	6.1	5.9
External	-1.1	-0.5	-2.9	0.8	0.9	0.0
Domestic	3.8	3.1	4.5	5.2	5.2	5.9
Of which : banking system	-1.5	2.3	-0.8	1.0	2.0	1.2
Sale of equity in state-owned enterprises and residual	0.6	1.1	4.1	0.0	0.0	0.0
Memorandum items:						
Central government domestic debt	38.6	40.2	42.4	48.6	49.1	50.7
Nominal GDP (in millions of Mauritian rupees)	106,079	112,685	125,123	137,312	152,000	149,101

Sources: Ministry of Finance; Bank of Mauritius; and IMF staff estimates and projections.

1/ Budgetary central government, Government Finance Statistics basis, unless otherwise indicated; fiscal year from July to June.
2/ In 1998/99, 2000/01, and 2001/02 net lending includes the repayment of US$33 million, US$111 million,
and US$6 million of the international floating rate note (FRN) of US$150 million, respectively.
3/ Exceptional factors include the on-lending of the proceeds from the FRN equivalent to 0.1 percent of GDP in 1997/98.
They also include the repayment of the FRN on-lending equivalent to 0.8 percent of GDP in 1998/99, 1.4 percent of GDP in 2000/01, and 0.1 percent of GDP in 2001/02, as well as the proceeds from the sale of fixed assets equivalent to 0.5 percent of GDP in 1998/99 and 0.4 percent of GDP in 1999/2000.
4/ Overall balance after grants, excluding interest payments.

Table 4. Mauritius: Monetary Survey, 1999-2003

	1999 June	2000 June	2001 June	2002 June	2003 June Proj.
	(In millions of Mauritian rupees; end of period)				
Net foreign assets	22,556	25,204	31,748	40,531	46,137
Monetary authorities	15,784	17,950	23,077	30,469	38,034
Commercial banks	6,772	7,254	8,671	10,062	8,103
Domestic credit	77,541	88,128	92,821	100,323	107,636
Claims on government (net)	15,924	18,503	17,544	18,858	20,613
Monetary authorities	4,476	2,980	2,329	-3,227	-11,349
Commercial banks	11,448	15,522	15,215	22,085	31,962
Claims on private sector 1/	61,618	69,626	75,277	81,465	87,023
Broad money (M2)	80,172	88,910	97,720	110,440	122,588
Money (M1)	10,905	11,065	12,711	15,131	17,166
Quasi money	69,267	77,846	85,009	95,308	105,422
Money market instruments	0	0	0	0	0
Other items (net)	19,925	24,421	26,849	30,414	31,185
	(Annual change in millions of Mauritian rupees)				
Net foreign assets	1,197	2,648	6,544	8,783	5,606
Monetary authorities	674	2,166	5,128	7,391	7,565
Commercial banks	523	482	1,417	1,392	-1,959
Domestic credit	9,262	10,587	4,693	7,502	7,313
Claims on government	-1,571	2,579	-959	1,314	1,800
Claims on private sector 1/	10,832	8,008	5,651	6,188	5,558
Broad money (M2)	9,335	8,739	8,809	12,720	12,149
Money (M1)	755	160	1,646	2,421	2,035
Quasi money	8,581	8,579	7,163	10,299	10,114
	(Annual change in percent)				
Domestic credit	13.6	13.7	5.3	8.1	7.3
Claims on government	-9.0	16.2	-5.2	7.5	9.3
Claims on private sector 1/	21.3	13.0	8.1	8.2	6.8
Broad money (M2)	13.2	10.9	9.9	13.0	11.0
Money (M1)	7.4	1.5	14.9	19.0	13.4
Quasi money	14.1	12.4	9.2	12.1	10.6
	(Annual change in percent of beginning-of-period broad money)				
Net foreign assets	1.7	3.3	7.4	9.0	5.1
Domestic credit	13.1	13.2	5.3	7.7	6.6
Claims on government (net)	-2.2	3.2	-1.1	1.3	1.6
Claims on private sector 1/	15.3	10.0	6.4	6.3	5.0
Broad money (M2)	13.2	10.9	9.9	13.0	11.0

Sources: Bank of Mauritius; and IMF staff estimates and projections.

1/ Including claims on public enterprises.

Table 5. Mauritius: Indicators of External Vulnerability, 1998/99-2002/03 1/
(In percent of GDP, unless otherwise indicated)

	1998/99	1999/00	2000/01	2001/02 Prov.	2002/03 Proj.
Financial indicators					
Total public sector debt	64.7	64.3	63.8	69.2	69.7
Broad money (percent change; 12-month basis)	13.2	10.9	9.9	13.0	11.0
Private sector credit (percent change; 12-month basis)	21.3	13.0	8.1	8.2	6.8
Interest rate (one-year term deposits) 2/	12.0	10.8	11.4	11.8	11.8
External indicators					
Exports (percentage change; in U.S. dollar terms)	4.7	-9.4	7.6	-3.4	5.9
Imports (percentage change; in U.S. dollar terms) 3/	1.6	3.6	-6.4	-6.8	8.8
Terms of trade (percentage change)	-0.8	-5.1	-1.9	1.4	0.3
Current account balance	-1.5	-1.6	3.4	5.2	4.6
Capital and financial account balance	0.3	-2.3	-2.1	-5.7	-4.6
Net international reserves of the Bank of Mauritius					
(in millions of U.S. dollars) 4/	625.4	688.0	789.3	1,017.0	1,328.3
In months of prospective imports, c.i.f. 3/	3.5	4.1	5.0	6.0	7.3
Net international reserves of the banking system					
(in millions of U.S. dollars)	893.7	966.0	1,085.9	1,352.8	1,611.3
In months of prospective imports, c.i.f. 3/	5.0	5.7	6.9	7.9	8.9
Total external debt	28.7	25.5	22.4	21.6	20.9
In percent of exports of goods and nonfactor services	45.6	42.3	34.5	35.7	38.0
Total short-term public debt on a remaining-maturity basis	3.4	5.0	3.8	3.1	2.5
In percent of exports of goods and nonfactor services	5.5	8.5	6.2	5.1	4.4
In percent of gross reserves of the central bank	23.4	32.3	20.9	14.2	9.8
Total external debt service (in percent of exports of goods					
and nonfactor services)	7.6	7.9	9.8	8.5	7.3
Interest payments	2.1	2.1	1.8	1.4	1.5
Principal repayments	5.5	5.8	8.0	7.0	5.8
Exchange rate (Mauritian rupees per U.S. dollar; period average)	24.82	25.51	27.59	30.09	29.30
Financial market indicators					
Mauritius stock exchange index (SEMDEX; July 1989 = 100) 5/	409.8	407.8	387.9	358.6	454.5
Change in percent 5/	-10.2	-0.5	-4.9	-7.6	26.7
Foreign currency long-term debt rating by Moody's 6/	Baa2	Baa2	Baa2	Baa2	Baa2

Sources: Mauritian authorities; and IMF staff estimates and projections.

1/ Fiscal year from July to June.
2/ End of period; maximum interest rate offered by banks on time deposits with maturities of between six and twelve months.
3/ Excluding the acquisition of aircraft and ships.
4/ The reserves of the Bank of Mauritius are not pledged as collateral for short-term liabilities, nor are they sold forward.
5/ End of period. For 2002/03, as of end-April 2003.
6/ Bonds rated "Baa2" by Moody's are considered as medium-grade obligations. For 2002/03, as of May 2003.

Table 6. Mauritius: Medium-Term Projections, 2001/02-2006/07 1/

	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07
		Projections				
	(Annual percentage changes, unless otherwise indicated)					
National income and prices						
Real GDP 2/	4.0	3.3	5.5	5.1	4.9	4.6
GDP deflator 2/	5.5	5.2	4.7	4.2	4.0	4.0
Domestic demand at current prices 3/ 4/	6.8	9.8	12.4	10.9	10.3	9.9
Consumer prices (period average)	6.4	5.1	5.0	4.5	4.0	4.0
External sector (in U.S. dollars terms)						
Exports, f.o.b.	-3.4	5.9	3.9	1.2	0.8	0.6
Imports, f.o.b. 4/	-6.8	8.8	6.4	4.2	4.5	4.7
Terms of trade	1.4	0.3	-0.1	-0.1	0.0	0.1
	(In percent of GDP at market prices)					
Central government budget						
Revenue and grants	18.4	20.8	21.6	21.3	21.1	20.9
Of which: tax revenue	15.7	17.7	19.1	19.0	18.9	18.8
Expenditure and net lending	24.4	26.7	26.5	25.6	24.3	23.6
Current balance (including grants)	-1.9	-0.3	0.3	0.4	1.0	1.4
Overall balance (including grants)	-5.9	-5.9	-4.9	-4.3	-3.2	-2.6
Total public debt	69.2	69.7	68.0	66.4	64.1	61.6
Gross domestic investment	21.8	22.7	21.3	21.3	21.7	22.0
Public	6.8	9.2	8.6	8.1	7.6	7.2
Private	15.0	13.5	12.7	13.3	14.0	14.7
Gross national savings	27.0	27.3	24.8	24.0	23.7	23.0
Public	-2.1	-0.6	0.2	0.3	0.9	1.3
Private	29.1	27.8	24.6	23.8	22.8	21.8
External current account balance	5.2	4.6	3.5	2.7	2.0	1.1
	(In millions of U.S. dollars, unless otherwise indicated)					
External sector						
Current account balance	238	235	199	165	131	73
Exports, f.o.b.	1,583	1,676	1,742	1,763	1,777	1,787
Imports, f.o.b.	-1,802	-1,943	-2,026	-2,111	-2,206	-2,308
Services (net)	400	433	418	419	432	455
Factor income (net)	-8	-5	-12	15	46	54
Current transfers (net)	66	74	76	79	82	84
Net international reserves of the Bank of Mauritius	1,017	1,328	1,580	1,752	1,896	1,985
In months of prospective imports, c.i.f. 4/	6.0	7.3	8.4	8.9	9.2	9.1
Memorandum item:						
GDP at current market prices (in millions of Mauritian rupees)	137,312	149,101	164,693	180,511	196,891	214,250

Sources: Bank of Mauritius; Central Statistics Office; Ministry of Finance; and IMF staff estimates and projections.

1/ Fiscal year from July to June.

2/ Sugar crops and milling included in fiscal year harvested; otherwise, averages of calendar-year data.

3/ Excluding changes in stocks.

4/ Excluding the acquisition of aircraft and ships.

Mauritius: Assessing Fiscal Sustainability

This analysis shows that fiscal sustainability (indicated by falling or stable debt ratios over the medium term) is achieved under the baseline scenario, and is robust to a series of plausible shocks. Nonetheless, a combination of large shocks could lead to a substantial increase in the debt-to-GDP ratio. At its current level, Mauritius's public sector debt is moderate, but could become unsustainable if the authorities fail to address forcefully the fiscal situation over the coming years.

1. **Under the staff's baseline projections, Mauritius's public sector debt ratio declines over the medium term (Appendix 1 Table 1).** After peaking at an estimated 69.7 percent at end-June 2003, the debt-to-GDP ratio is projected to fall gradually to about 61½ percent by 2006/07, a decrease of about 7½ percentage points of GDP compared with the ratio at end-2001/02. The decline in the ratio would be mainly driven by the gradual cut in the fiscal deficit in coming years, while assuming no further deterioration of the financial situation of key public enterprises.

2. **Under the first standard sensitivity test, which sets key parameters to their historical averages, Mauritius's public sector debt burden remains sustainable over the medium term (Appendix 1 Table 1, first item in bottom panel).** With real GDP growth set at 5.4 percent (the growth performance in the past ten years), a primary deficit at 1 percent of GDP, and the real interest rate set at its historical average, the debt ratio declines gradually to 63 percent by end-2006/07. This result indicates that the debt sustainability path would be robust to poor fiscal performance and high interest rates. However, given the transition Mauritius's economy is expected to undergo, the first standard sensitivity test needs to be interpreted with caution.

3. **In several of the second set of sensitivity tests, which assume adverse temporary shocks to the key parameters, the public sector debt ratio declines over the medium term (Appendix 1 Table 1, items 2-7 in bottom panel).** The main results of these sensitivity tests are as follows:

- **Lower economic growth would not by itself derail medium-term debt dynamics.** In a scenario where real GDP growth is set at only 1.2 percent in 2003/04 and 2004/05, the debt-to-GDP ratio would still decline to 66.8 percent by 2006/07 after temporarily peaking at 72 percent. This result is particularly significant in view of the challenges to growth that Mauritius is likely to face in the medium term.

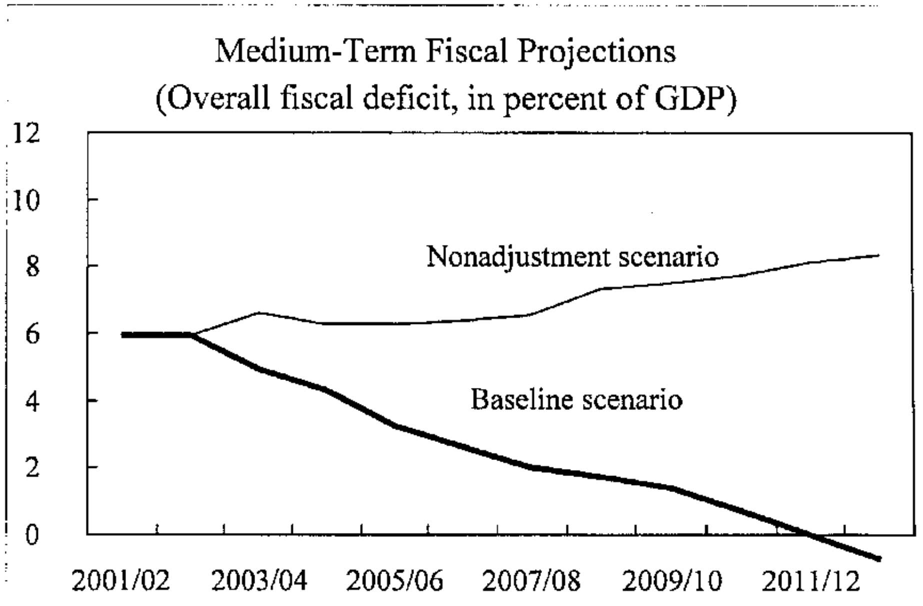
- **Public sector debt would remain sustainable in the case of high real interest rates continuing for two years.** Temporary high real interest rates would not affect the debt path. With real interest rates set at 4.6 percent in 2003/04 and 2004/05, the debt-to-GDP ratio would broadly follow the same path as in the baseline scenario (Appendix 1 Figure 1).

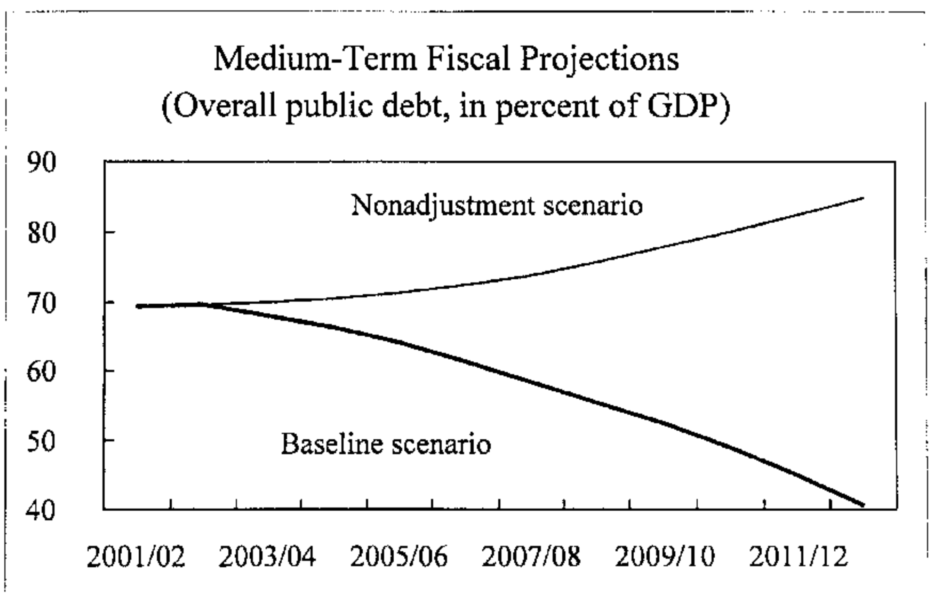
- **A two-year shock to the primary deficit would lead to a modest increase in the debt ratio in the medium term.** With a primary deficit set at 4.5 percent of GDP in 2003/04 and 2004/05, the debt-to-GDP ratio would rise to above 75 percent in 2004/05 and subsequently fall to 70 percent. This result indicates the sensitivity of the evolution of public debt to fiscal performance.

- **The combination of large shocks would lead to a substantial increase in the public debt level and could possibly jeopardize medium-term sustainability**. Unlikely two-year shocks of a magnitude of two standard deviations affecting interest rates, real economic growth and the primary deficit would cause the debt ratio to temporarily jump to 83½ percent of GDP, but public sector debt would decline subsequently, albeit remaining at around 75 percent of GDP by the end of the period.

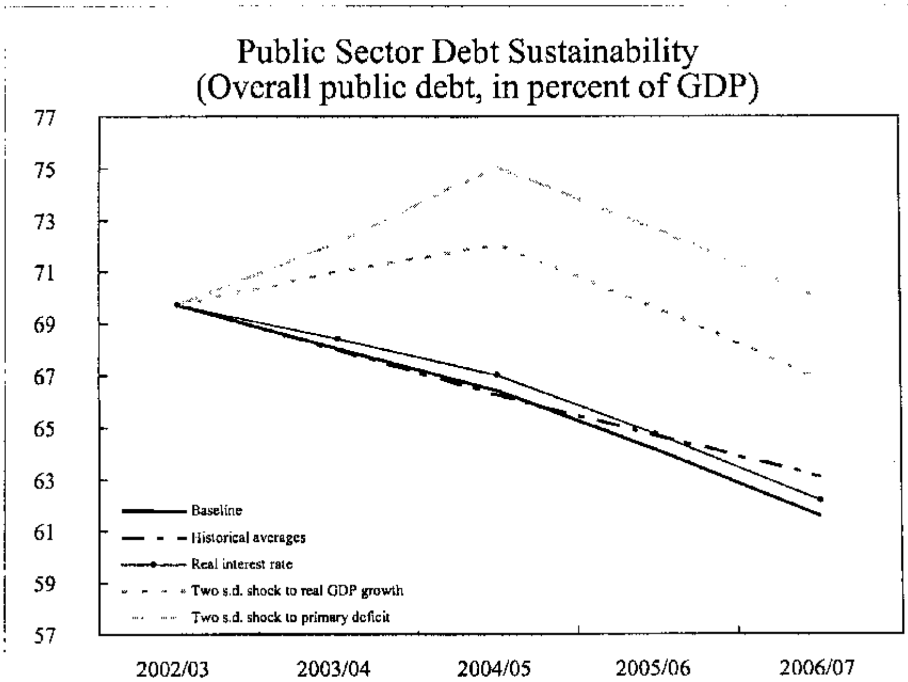
- **In the absence of fiscal adjustment over the medium term, the debt dynamics would become unsustainable (Appendix 1 Table 2).** In the no fiscal adjustment scenario, the fiscal deficit would rise to 6.5 percent in 2003/04, and then remain above 6 percent during the period. This would be associated with unfavorable debt dynamics, as the debt ratio would increase to about 72½ percent over the medium term (Appendix 1 Figure 1). Moreover, the debt path would also become increasingly vulnerable to various shocks, including to lower economic growth.

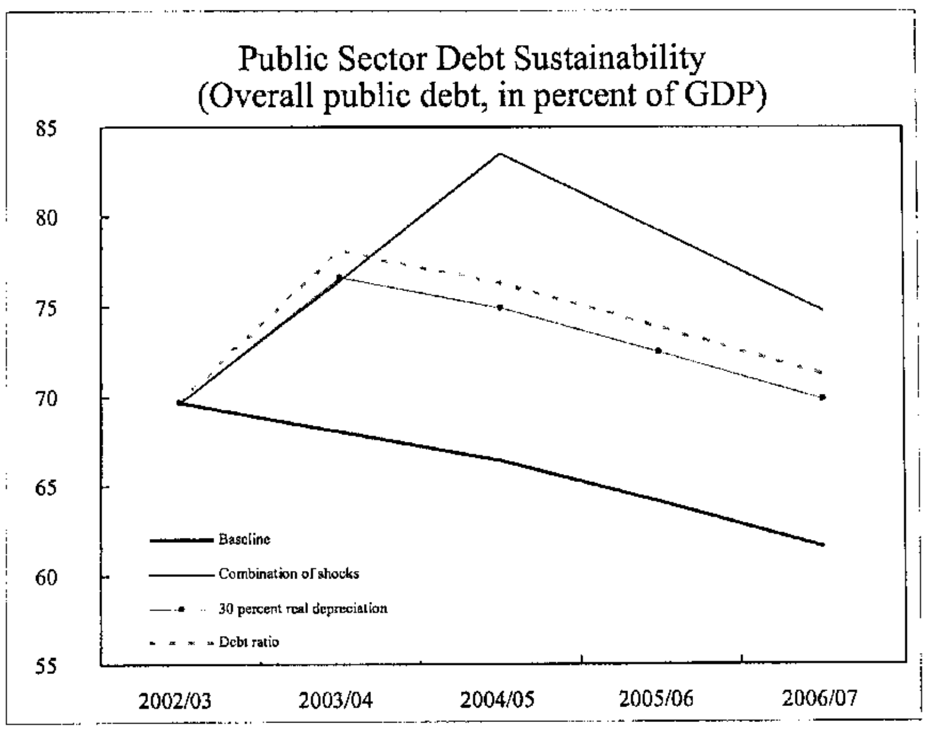
Appendix 1 Figure 1. Mauritius: Medium-Term Fiscal Projections 2001/02-2012/13





Appendix 1 Figure 2. Mauritius: Public Sector Debt Sustainability 2002/03-2006/07





Appendix 1. Table 1. Mauritius: Public Sector Debt Sustainability Framework, 1998/99-2006/07
(In percent of GDP, unless otherwise indicated)

	Actual					Projections			
	1998/99	1999/00	2000/01	2001/02	2002/03 est.	2003/04	2004/05	2005/06	2006/07
I. Baseline Medium-Term Projections									
Public sector debt 1/	64.7	64.3	63.8	69.2	69.7	68.0	66.4	64.1	61.6
o/w foreign-currency denominated	27.6	25.2	22.4	21.5	19.3	17.3	16.7	15.4	14.2
Change in public sector debt	0.6	-0.4	-0.5	5.4	0.5	-1.7	-1.6	-2.3	-2.5
Identified debt-creating flows (4+7+12)	-2.2	0.9	7.6	0.7	-0.4	-1.4	-1.2	-2.0	-2.2
Primary deficit	-0.1	0.4	1.3	2.6	1.6	0.4	-0.1	-1.1	-1.6
Revenue and grants	20.1	20.9	18.1	18.4	20.8	21.6	21.3	21.1	20.9
Primary (noninterest) expenditure	20.0	21.3	19.4	21.0	22.4	22.0	21.1	20.0	19.3
Automatic debt dynamics 2/	-2.8	0.5	0.6	-1.9	-2.0	-1.8	-1.1	-0.9	-0.6
Contribution from interest rate/growth differential 3/	-3.8	-0.4	-2.0	-2.4	-1.1	-2.1	-1.5	-1.2	-0.9
Of which contribution from real interest rate	-0.7	1.3	2.1	0.0	0.9	1.4	1.7	1.8	1.8
Of which contribution from real GDP growth	-3.1	-1.7	-4.1	-2.3	-2.1	-3.5	-3.2	-3.0	-2.7
Contribution from exchange rate depreciation 4/	1.0	0.9	2.6	0.5	-0.8	0.3	0.5	0.3	0.3
Other identified debt-creating flows	0.7	0.0	5.7	0.0	0.0	0.0	0.0	0.0	0.0
Privatization receipts (negative)	0.7	0.0	5.7	0.0	0.0	0.0	0.0	0.0	0.0
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Residual, including asset changes (2-3)	2.8	-1.3	-8.1	4.7	0.8	-0.3	-0.5	-0.3	-0.3
Public sector debt-to-revenue ratio 1/	321.9	308.4	351.7	376.0	335.8	315.6	312.3	303.6	294.4
Gross financing need 5/	6.3	7.0	10.2	9.4	8.8	7.2	6.6	5.1	4.5
in billions of U.S. dollars	0.3	0.3	0.5	0.4	0.4	0.4	0.4	0.3	0.3
Key Macroeconomic and Fiscal Assumptions									
Real GDP growth (in percent)	5.4	2.7	7.0	4.0	3.3	5.5	5.1	4.9	4.6
Average nominal interest rate on public debt (in percent) 6/	6.0	5.6	7.6	5.7	6.8	7.1	7.2	7.1	7.3
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-0.9	2.2	3.9	0.2	1.6	2.5	2.9	3.1	3.3
Nominal appreciation (increase in US dollar value of local currency, in percent)	-3.8	-3.3	-10.8	-2.4	4.6	-1.8	-2.7	-2.2	-2.2
Inflation rate (GDP deflator, in percent)	6.9	3.4	3.8	5.5	5.2	4.7	4.2	4.0	4.0
Growth of real primary spending (deflated by GDP deflator, in percent)	6.6	9.1	-2.2	12.6	9.7	3.8	1.0	-0.6	0.7
II. Stress Tests for Public Debt Ratio									
1. Real GDP growth, real interest rate, and primary balance are at historical averages in 2003/04-2006/07					69.7	**68.0**	**66.3**	**64.6**	**63.1**
2. Real interest rate is at historical average plus two standard deviations in 2003/04 and 2004/05					69.7	**68.4**	**67.0**	**64.7**	**62.1**
3. Real GDP growth is at historical average minus two standard deviations in 2003/04 and 2004/05					69.7	**71.0**	**72.0**	**69.6**	**66.8**
4. Primary balance is at historical average minus two standard deviations in 2003/04 and 2004/05					69.7	**72.1**	**75.1**	**72.6**	**70.0**
5. Combination of 2-4 using two standard deviation shocks					69.7	**76.5**	**83.5**	**79.2**	**74.8**
6. One time 30 percent real depreciation in 2003/04 7/					69.7	**76.6**	**74.9**	**72.5**	**69.8**
7. 10 percent of GDP increase in other debt-creating flows in 2003/04					69.7	**78.0**	**76.3**	**73.8**	**71.2**

Historical Statistics for Key Variables	Historical Average	Standard Deviation	Average 2004-07
Primary deficit	1.0	1.8	-0.6
Real GDP growth (in percent)	5.4	2.1	5.1
Nominal interest rate (in percent) 6/	6.4	0.8	7.2
Real interest rate (in percent)	1.3	1.7	2.9
Inflation rate (GDP deflator, in percent)	5.5	1.9	4.2
Revenue to GDP ratio	20.0	1.5	21.2

1/ Gross debt of the nonfinancial public sector (central government and parastatal entities).
2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi(1+g)$ and the real growth contribution as -g.
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.
5/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
6/ Derived as nominal interest expenditure divided by previous period debt stock.
7/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Appendix 1. Table 2. Mauritius: Public Sector Debt Sustainability Framework, 1998/99-2006/07
(In percent of GDP, unless otherwise indicated)

	Actual					Projections			
	1998/99	1999/00	2000/01	2001/02	2002/03 est.	2003/04	2004/05	2005/06	2006/07
	III. No Adjustment Medium-Term Scenario 8/								
Public sector debt 1/	64.7	64.3	63.8	69.2	69.7	**69.9**	**70.4**	**71.3**	**72.4**
o/w foreign-currency denominated	27.6	25.2	22.4	21.5	19.3	17.8	17.3	16.2	15.2
Change in public sector debt	0.6	-0.4	-0.5	5.4	0.5	0.2	0.5	0.9	1.2
Identified debt-creating flows (4+7+12)	-2.2	0.9	7.6	0.7	-0.4	0.5	1.0	1.2	1.5
Primary deficit	-0.1	0.4	1.3	2.6	1.6	2.1	1.6	1.5	1.5
Revenue and grants	20.1	20.9	18.1	18.4	20.8	20.0	19.6	19.4	19.2
Primary (noninterest) expenditure	20.0	21.3	19.4	21.0	22.4	22.0	21.3	20.9	20.7
Automatic debt dynamics 2/	-2.8	0.5	0.6	-1.9	-2.0	-1.6	-0.6	-0.3	0.0
Contribution from interest rate/growth differential 3/	-3.8	-0.4	-2.0	-2.4	-1.2	-1.9	-1.1	-0.6	-0.3
Of which contribution from real interest rate	-0.7	1.3	2.1	0.0	0.9	1.4	1.8	2.1	2.2
Of which contribution from real GDP growth	-3.1	-1.7	-4.1	-2.3	-2.1	-3.3	-2.9	-2.7	-2.5
Contribution from exchange rate depreciation 4/	1.0	0.9	2.6	0.5	-0.8	0.3	0.5	0.3	0.3
Other identified debt-creating flows	0.7	0.0	5.7	0.0	0.0	0.0	0.0	0.0	0.0
Privatization receipts (negative)	0.7	0.0	5.7	0.0	0.0	0.0	0.0	0.0	0.0
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Residual, including asset changes (2-3)	2.8	-1.3	-8.1	4.7	0.8	-0.3	-0.5	-0.3	-0.3
Public sector debt-to-revenue ratio 1/	321.9	308.4	351.7	376.0	335.8	350.2	358.5	366.6	376.5
Gross financing need 5/	11.7	17.5	25.0	24.5	22.6	8.9	8.5	8.2	8.3
in billions of U.S. dollars	0.5	0.8	1.1	1.1	1.2	0.5	0.5	0.5	0.6
Key Macroeconomic and Fiscal Assumptions									
Real GDP growth (in percent)	5.4	2.7	7.0	4.0	3.3	5.3	4.5	4.1	3.8
Average nominal interest rate on public debt (in percent) 6/	6.0	5.6	7.6	5.7	6.8	7.2	7.2	7.3	7.4
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-0.9	2.2	3.9	0.2	1.6	2.5	3.0	3.4	3.5
Nominal appreciation (increase in US dollar value of local currency, in percent)	-3.8	-3.3	-10.8	-2.4	4.6	-1.8	-2.7	-2.2	-2.2
Inflation rate (GDP deflator, in percent)	6.9	3.4	3.8	5.5	5.2	4.6	4.2	4.0	4.0
Growth of real primary spending (deflated by GDP deflator, in percent)	6.6	9.1	-2.2	12.6	9.7	3.8	0.9	2.4	2.7
						IV. Stress Tests for Public Debt Ratio			
1. Real GDP growth, real interest rate, and primary balance are at historical averages in 2003/04-2006/7					**69.7**	**67.9**	**66.2**	**64.6**	**63.0**
2. Real interest rate is at historical average plus two standard deviations in 2003/04 and 2004 /05					**69.7**	**70.4**	**71.2**	**72.1**	**73.3**
3. Real GDP growth is at historical average minus two standard deviations in 2003/04 and 2004/05					**69.7**	**72.7**	**75.7**	**76.7**	**78.0**
4. Primary balance is at historical average minus two standard deviations in 2003/04 and 2004/05					**69.7**	**72.3**	**75.7**	**76.5**	**77.7**
5. Combination of 2-4 using two standard deviation shocks					**69.7**	**76.5**	**83.5**	**82.9**	**82.6**
6. One time 30 percent real depreciation in 2003/04 7/					**69.7**	**78.5**	**78.9**	**79.8**	**80.9**
7. 10 percent of GDP increase in other debt-creating flows in 2003/04					**69.7**	**79.9**	**80.3**	**81.1**	**82.3**

Historical Statistics for Key Variables	Historical Average	Standard Deviation	Average 2004-07
Primary deficit	1.0	1.8	1.7
Real GDP growth (in percent)	5.4	2.1	4.4
Nominal interest rate (in percent) 6/	6.4	0.8	7.3
Real interest rate (in percent)	1.3	1.7	3.1
Inflation rate (GDP deflator, in percent)	5.5	1.9	4.2
Revenue to GDP ratio	20.0	1.5	19.6

1/ Gross debt of thenonfinancial public sector (central government and parastatal entities).
2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator;
g = real GDP growth rate; α = share of foreign-currency
denominated debt; ande = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi(1+g)$ and the real growth contribution as -g.
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.
5/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
6/ Derived as nominal interest expenditure divided by previous period debt stock.
7/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).
8/ Assuming a downward GDP growth correction in the absence of fiscal adjustment

Mauritius: Relations with the Fund
(As of March 31, 2003)

I. Membership Status
Joined on September 23, 1968; Article VIII.

II. General Resources Account	SDR Million	Percent of Quota
Quota	101.60	100.00
Fund holdings of currency	87.12	85.75
Reserve position in Fund	14.48	14.25
Financial Transaction Plan transfers (net)	3.00	2.95

III. SDR Department	SDR Million	Percent of Allocation
Net cumulative allocation	15.74	100.00
Holdings	17.04	108.21

IV. Outstanding Purchases and Loans
None.

V. Latest Financial Arrangements

Type	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
Stand-By	3/1/85	8/31/86	49.00	49.00
Stand-By	5/18/83	8/17/84	49.50	49.50
Stand-By	12/21/81	12/20/82	30.00	30.00

VI. Projected Obligations to Fund
None.

VII. Implementation of HIPC Initiative
Not applicable.

VIII. Safeguards Assessments
Not applicable.

IX. Exchange Rate Arrangement
The currency of Mauritius is the Mauritian rupee and the exchange rate regime is a managed floating with no preannounced path for the exchange rate. The exchange rate is currently determined in the interbank foreign exchange market. The exchange arrangement is free from multiple currency practices and restrictions on the making of payments and transfers for current

international transactions. Mauritius also maintains a liberal capital account. On April 25, 2003, the US$1 was equivalent to MUR 27.69.

X. Article IV Consultation

Mauritius is on the standard 12-month cycle. The last Article IV consultation discussions were held during January 30-February 15, 2002. The staff report (SM/02/125; 4/23/02) was considered by the Executive Board on May 24, 2002. Joint IMF/World Bank discussions on a Financial Sector Assessment Program were held during October-December 2002.

XI. Technical Assistance (1998–2003)

FAD advisor on introduction of a value-added tax system, October 1997–June 1999.

MAE mission on monetary operations, banking supervision, and payment system structures, January–February 1998.

MAE missions on bank supervision: the first of three in April–June 1998; the second in September-December 1998; and the third in February–April 1999.

MAE mission on monitoring of the financial system under Article IV surveillance and on monetary operations, January 1999.

STA mission on quarterly national accounts, February–March 1999.

MAE mission on monetary operations, May 1999.

MAE missions on bank supervision: the first of three in June–August 1999; the second in October–December 1999; and the third in February–March 2000.

MAE missions on monetary operations: the first of two in August–September 1999; and the second in November 1999.

MAE general advisor to the Governor of the Bank of Mauritius, February 2000–February 2002.

STA mission on quarterly balance of payments statistics, March 2000.

STA mission on quarterly national accounts and General Data Dissemination System (GDDS), June 2000.

MAE missions on bank supervision: the first of three in August 2000; the second in November–December 2000; and the third in February–March 2001.

MAE/LEG joint mission on the revision of the Bank of Mauritius Act and the Banking Act, March-April 2001.

FAD mission on tax reform, May 2001.

MAE missions on bank supervision during 2001: the first of three in May–June 2001; the second in September 2001; and the third in November-December 2001.

STA mission on the Coordinated Portfolio Investment Survey 2001, May 2001.

STA mission to prepare a Report on the Observance of Standards and Codes (ROSC) for data compilation and dissemination, July 2001.

STA mission on government finance statistics, January 2002.

STA mission on monetary and financial statistics, March–April 2002.

MAE missions on general central banking during 2002: the first of three in February-April 2002; the second in June 2002; and the third in October-November 2002.

MAE missions on bank supervision during 2003: the first of four in February-March 2002; the second in May-June 2002; and the third in September-October 2002; and the fourth in November-December 2002.

MAE missions on bank supervision during 2003: the first of three in February-March 2003.

Joint MAE/World Bank mission on anti-money laundering and combating the financing of terrorism, February-March 2003.

Resident Representative: None.

Mauritius: Relations with the World Bank Group
(As of April 28, 2003)

Mauritius has been a World Bank borrower for the past 22 years, the last IDA credit having been made in July 1974. In the 1980s, the World Bank supported macroeconomic and sectoral policy reforms through quick-disbursing loans. With the success of the structural adjustment effort, the need for such lending declined, and the country turned to more traditional project lending.

Given Mauritius's strong track record in economic management the World Bank approved a Country Assistance Strategy (CAS) on May 7, 2002, which shifts from traditional project support to analytical and advisory services coupled with program support. The new CAS supports the government's five-year *New Economic Agenda*, with advice and direct budget assistance in critical areas. The CAS presents options for Mauritius to draw on up to three single-tranche Public Expenditure Reform Loans (PERLs), during the CAS period, which spans 2001/02 through 2003/04. Under the CAS, analytical and advisory services are provided in a variety of forms, ranging from just-in-time advice to formal reports.

The first PERL of US$40 million was approved by the Board on May 7, 2002, along with the CAS. The PERL was disbursed fully on June 25, 2002, and closed on September 30, 2003. The PERL directly supported the government's reform agenda, based on actions taken through 2001/02. Specifically, it supported education reform, poverty reduction and expenditure allocations on the island of Rodrigues, environment and transport reforms, and economic management. The government is mostly on track in achieving its own anticipated milestones for the implementation of the *New Economic Agenda* in FY02/03.

Analytical and advisory services in 2002/03 are focusing on (i) education reform, particularly in the areas of reform costing, curriculum development, and vocational training, (ii) pension reform; (iii) labor market assessment; (iv) reform of social assistance; (v) development of a medium -term expenditure framework; (vi) debt management; (vii) fiscal risk assessment; (viii) port management; (ix) institutional framework for public-private partnerships; (x) waste management and water policy; (xi) financial sector reform; (xii) transportation; and (xiii) capacity building at the Central Statistical Office. In 2002/03, the World Bank is producing the first phase of a Public Expenditure Review, with an emphasis on fiscal risks and public expenditure management; an education sector note; and a transport sector action plan. A labor market review is currently scheduled for 2003/04. The World Bank has also recently completed two reports on Mauritius, namely *Modernizing an Advanced Pension System (2000/01)* and *Country Procurement Assessment Review (2001/02).*

World Bank Portfolio in Mauritius

(In millions of U.S. dollars, unless otherwise indicated)

	Approval Date	Effective Date	Closing Date	Net Commit-ment	Undis-bursed Amount
Environment,. Sewerage, and Sanitation	2/12/98	2/3/99	6/30/05	12.4	6.9
Financial Sector Infrastructure	4/4/00	7/24/00	6/30/03	4.8	0.8
Financial Sector Supervisory Authority	12/4/01	4/10/02	9/30/04	1.8	1.8
Total				19.0	9.5

The IFC made four loans—in 1971, 1981, 1990, and 1992, respectively—for tourism development; two loans—in 1986 and 1990—for textile projects; and one loan in 1991 for transport and storage. In 1992, the IFC made a loan for capital market development, and in 1993 and 1996 it also invested in fund and venture capital companies. The IFC has a total portfolio in Mauritius of US$1.6 million, consisting of two projects: a steel project and a venture capital fund. No new investments have been made since 1996.

The IFC's main focus for future activity is support for the deepening of the financial market, as well as advisory work and investments in the area of private infrastructure. These focus areas complement the World Bank's strategy. First, the IFC's connections would increase private firms' access to foreign term finance, thus reducing demand on domestic savings and alleviating upward pressure on domestic interest rates. Second, they allow the government to move gradually out of sectors it has traditionally been involved in and improve efficiency in the provision of infrastructure. Thus, the IFC's involvement is expected to contribute to the competitiveness objective. In addition, domestic interest rates are expected to be reduced, thereby relieving the government budget in two ways: (i) lower interest payments; and (ii) lower subsidies and transfers to state-owned enterprises.

Questions may be referred to Mr. Christos Kostopoulos (email: Ckostopoulos@worldbank.org).

Mauritius: Statistical Issues

The quality and timeliness of Mauritius's reporting of core minimum data, as well as of other economic and financial statistics to the IMF are, in general, satisfactory. Efforts are under way to improve the frequency and quality of fiscal data, particularly regarding their consistency with monetary sector data. The authorities already publish economic data on Mauritius, including a *Monthly Bulletin* published by the Bank of Mauritius and a number of statistics reports published by the Central Statistics Office (CSO), which is accessible via the Internet. Mauritius started participating in the IMF's General Data Dissemination System (GDDS) in September 2000. The authorities have shown interest in subscribing to the Special Data Dissemination Standard (SDDS), but improvements in the periodicity and timeliness of several data series are required before subscription can take place.

Real sector

Mauritius's annual national accounts are based on the concepts and definitions recommended by the *System of National Accounts 1993*. National accounts data are prepared by the CSO on a calendar-year basis and cover all transactions categories except financial transactions. In general, GDP by the production approach is compiled by using the ratios of the 1997 Census of Economic Activities (CEA). However, for enterprises not covered by the CEA (agriculture, fishing and forestry) the technical ratios may have been presumed unchanged for more than twenty years. Annual surveys rely on enterprise accounts that do not reflect calendar years and underreport output. Most government operations and external transactions other than goods are recorded on a cash basis rather than on an accrual basis. GDP estimates by expenditure are not derived independently as household final consumption expenditure is determined as a residual. Although the five-yearly Household Budget Survey generates an independent estimate, this estimate is considerably lower than the one resulting from the commodity flow approach. National accounts at constant prices use 1992 as a base year. GDP volume change is measured using annual change indices. Following IMF technical assistance in 1999 and 2000, the CSO started to compile national accounts on a quarterly basis for past years. However, the CSO has not yet compiled quarterly national accounts for the current year, and improvements are still needed regarding the timeliness and quality of domestic production indicators and foreign trade statistics.

The consumer price index is calculated on the basis of actual prices and is regularly rebased as consumption patterns and relative prices change (most recently to July 1996-June 1997 = 100, using weights from a 12-month 1996/97 household budget survey). As from July 2002, a new series of the consumer price index has been introduced (July 2001-June 2002=100). A new basket of goods and services is used for the computation of this index following the 2001/02 Household Budget Survey. The commodities in the basket are classified according to the UN Classification of Consumption Expenditure According to Purpose. Producer price indices of agriculture and manufacturing, input costs of construction, external trade unit value, wage rate, and employment have been developed but are not reported to the IMF for publication in *International Financial Statistics (IFS).*

Government finance

Mauritius continues to be a regular and timely reporter of fiscal data for surveillance, including quarterly data and annual projections. The July 2001 mission to collect data for the Report on the Observance of Standards and Codes (ROSC) highlighted needed statistical improvements in the fiscal data, especially to reduce duplication in data collection, publish quarterly central government data, and improve the timeliness of consolidated government data. The data for surveillance purposes would be enhanced significantly if it would contain information on the overall public accounts, in particular off-budget accounts and nonfinancial public sector corporations. Follow-up technical assistance was provided in January 2002 to assist the authorities with the compilation of nonfinancial public sector data. The authorities also report data for the consolidated central government for publication in the *Government Finance Statistics (GFS) Yearbook.* While the authorities produce quarterly *GFS* data, they do not report these for publication in *IFS.*

Monetary accounts

The authorities report money and banking statistics on a timely and regular basis. In March 2002, the IMF provided technical assistance to implement the *Monetary and Financial Statistics Manual.* The BOM has started the process and expects to switch to the new reporting format in June 2003.

Balance of payments

Mauritius supplies annual balance of payments and international investment position data to the Statistics Department. Data are provided on the basis of the classification system of the *Balance of Payments Manual* (5th edition). The Bank of Mauritius began disseminating quarterly balance of payments statistics in its December 2000 issue of the *Monthly Bulletin.* The data in the financial account of the balance of payments and in the international investment position statement, particularly those on direct investment and portfolio investment, have limited coverage. To address these gaps a 2001 ROSC mission recommended the establishment of a survey of enterprises, banks and other financial institutions, both onshore and offshore, to obtain data on claims on, and liabilities to, nonresidents. This survey has yet to be conducted.

Mauritius: Core Statistical Indicators

(As of May 14, 2003)

	Exchange Rates	International Reserves	Central Bank Balance Sheet	Reserve/ Base Money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Govern-ment Balance	Externa l Public Debt	GDP/ GNP
Date of latest observation	02/03 03/03	02/03 03/03	02/03 03/03	01/03 03/03	01/03 03/03	01/03 03/03	02/03 03/03	12/02	2001/02	12/02	12/02	2002
Date received	03/03 05/09/03	05/09/03	03/03 05/09/03	03/03 05/09/03	03/03 05/09/03	03/03 05/09/03	03/03 04/03	03/03	03/03	03/03	03/03	04/03
Frequency of data	M	M	M	M	M	M	M	Q	A	Q	A	A
Frequency of reporting	M	M	M	M	M	M	M	Q	A	Q	A	A
Frequency of publication	M	M	M	M	M	M	M	A	A	A	A	A
Source of update	A	A	A	A	A	A	A	N	A	A	A	N
Mode of reporting	C	C	C	C	C	C	C	E	V	V	V	V
Confidentiality	C	C	C	C	C	C	C	C	R	R	C	C

Notes: Frequency of data: M=monthly; Q=quarterly; A=annually.
Frequency of reporting and publication: D=daily; M=monthly; Q=quarterly; A=annually.
Source of update: A=direct reporting by central bank, Ministry of Finance, or other official agency; N=official publication or press release.
Mode of reporting: C=cable or facsimile; M=mail; E=electronic (e-mail or Internet); V=staff visits.
Confidentiality: C=unrestricted use; R = restricted use.

Mauritius: Social and Demographic Indicators [1]

Population		Education	
Population (thousands; 2000)	1,186	Adult illiteracy rate (percent; 1995)	15
Annual rate of growth (percent; ave. 1991-2000)	1.0	Female	19
Population under age 15 (percent; 1999)	26	Male	12
Density (per square km.; 1999)	584	Gross primary school enrollment (percent; 1999) 2/	105
Land area (square km.)	2,040	Gross secondary school enrollment (percent; 1999) 2/	58
Population characteristics		Income	
Life expectancy at birth (years; 1999)	72	GDP per capita (U.S. dollars; 2001/2002) 3/	3,870
Male	68	Poverty	
Female	76	Head count index (percent of population; 1989-94)	5
Infant mortality (per thousand; 1999)	16		
Crude birth rate (per thousand; 1999)	17		
Crude death rate (per thousand; 1999)	7		
Fertility rate (births per woman; 1998)	2		
		Health	
Labor force		Health care access (percent of population; 1991)	99
Total (thousands, including foreigners; 1999)	512	Immunization for measles (percent of population less than 12 months; 1995)	79
Of which: female (percent; 1999)	33		
Annual growth rate (percent; average 1995-99)	2	Population per physician (1999)	1,107
Sugar workers (percent of total employment; 1999)	7	Population per hospital bed (1999)	294
Export processing zone workers (percent of total employment; 1999)	18	Safe water access (percent of population; 1993)	100
		Sanitation access (percent of population; 1993)	100

Sources: Central Statistical Office; IMF, *International Financial Statistics*; World Bank, *World Development Indicators* database; and World Bank, Country Assistance Strategy of the World Bank Group for the Republic of Mauritius, 1997.

1/ The Republic of Mauritius consists of the islands of Mauritius and Rodrigues, and two very small "outer" islands. Population density varies greatly among these.

2/ Gross enrollment ratio is the ratio of total enrollment, regardless of age, to the population of the age group that officially corresponds to the level of education shown.

3/ Fiscal year July to June.

Statement by the IMF Staff Representative
June 30, 2003

This statement provides additional information that has become available since issuance of the staff report. The information does not alter the thrust of the staff appraisal.

1. On June 9, 2003, the Deputy Prime Minister and Minister of Finance presented the budget for 2003/04. The budget assumes real economic growth of 6 percent for the fiscal year, which is somewhat higher than projected in the staff report, and inflation of 5 percent, which is in line with staff projections. The overall fiscal deficit is budgeted at 5.5 percent of GDP, compared with 4.9 percent recommended by the staff. While the budget assumes continued reforms in import taxation, little effort is envisaged to broaden the domestic tax base. On the expenditure side, the anticipated Pay Research Bureau award for civil servants is larger than expected. The authorities plan a phased implementation of the award in 2003/04 (1 percent of GDP), but this would still be significantly above that projected in the staff report (0.5 percent of GDP). The larger deficit will delay the fiscal adjustment that is necessary in the medium term to preserve macroeconomic stability and reduce the level of public debt.

2. Staff also understands that the main features of the automatic pricing mechanism for petroleum products have been formulated and will be introduced shortly after the debate on the 2003/04 budget in the National Assembly is finished.

Anti-money laundering and combating financing of terrorism (AML/CFT)

3. Subsequent to the issuance of the FSSA, the Mauritian authorities have taken a number of concrete steps to further strengthen the AML/CFT regime.

- New regulations have been issued under the Financial Intelligence and Anti-Money Laundering Act 2002 (FIAML), with effect from June 21, 2003.

- The Financial Intelligence Unit (FIU) has substantially increased its technical staff, staff training, processing of Suspicious Transaction Reports (STRs), and its information technology (IT) capacity.

- The FIU has applied for membership in the Egmont Group, with the sponsorship of the US FinCen. The FIU's application for mermbership in the Egmont Group is expected to be approved at the next plenary meeting in July 2003.

- The Financial Intelligence and Anti-Money Laundering (Amendment) Bill is being prepared to incorporate recommendations of the AML/CFT and technical assistance missions, with consequential amendments to the Financial Services Development Act, the Banking Act, and the Prevention of Corruption Act. In addition, the Extradition Bill and the Mutual Legal Assistance Bill are under preparation.

- To reflect these important developments in the FSSA report and associated ROSC, the staff has issued the relevant corrections.

Banking sector

4. The Banking Bill and the Bank of Mauritius Bill have been revised to reflect FSAP recommendations. Reporting requirements for onshore and offshore banks and non-banks have been strengthened and synchronized to improve transparency. Guidelines have been issued for intervention in financial institutions. The Post Office Savings Bank and the New Co-operative Bank are being merged into The Mauritius Post and Co-operative Bank Ltd.

Securities and insurance

5. Following completion of consultations with the industry, the draft Securities Bill is being revised. Work is progressing on a Collective Investment Scheme Bill. Consultations with the insurance industry on the draft Long Term Insurance Bill and the Short Term Insurance Bill ended on May 5, 2003, and the bills will be introduced to parliament shortly. The Financial Services Commission is significantly increasing its staff.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

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FOR IMMEDIATE RELEASE
August 6, 2003

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Concludes 2003 Article IV Consultation with Mauritius

On June 30, 2003, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Mauritius.[1]

Background

After expanding at a robust pace of 4 percent in 2001/02 (July-June), real GDP growth is expected to slow in 2002/03 to about 3½ percent. Following a record sugar crop in 2001/02, sugar output will decline substantially in the current fiscal year due to cyclone damage. The export processing zone (EPZ) and tourism sectors continue to be adversely affected by the weak global environment, and prospects remain uncertain in the aftermath of the war in Iraq. Economic growth in 2002/03 will rely mainly on the continuing robust performance of the construction, financial services and other services sectors.

Since the early 1990s, unemployment has risen steadily, despite continued robust economic growth, mainly as a result of an increasingly inadequate education and training system as well as significant labor market rigidities. At end-2002, the unemployment rate stood at nearly 10 percent, compared to 9.4 percent in 2001.

The overall fiscal deficit will remain at close to 6 percent of GDP for 2002/03. Public finances face further risks in the short term as a result of the worsening financial position of some state-owned enterprises. While the overall financial situation of public enterprises improved

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

somewhat in 2001/02, the State Trading Corporation (STC) and the Central Electricity Board (CEB) accumulated significant losses in the current fiscal year due to the sharp rise in the international price of oil in 2002 and early 2003, which was not reflected in retail price adjustments for petroleum products and for electricity tariffs.

Monetary policy was tightened in 2002/03 compared to 2001/02. Nonetheless, in response to a widening interest rate differential between domestic and foreign interest rates, and the slowdown in economic activity, the Bank of Mauritius (BOM) has reduced the Lombard rate since the beginning of the fiscal year by a total of 125 basis points. Consumer price inflation has recently shown a declining trend and is estimated at about 5 percent (period average) at end-June 2003, compared with 6.4 percent a year earlier.

The external current account surplus has remained strong in 2002/03 and is estimated at about 4 percent of GDP. The coexistence of a significant fiscal deficit and a current account surplus in recent years reflect a decline in overall domestic absorption occasioned by a rise in private savings. Net receipts from services improved significantly due to a surge in gross tourism earnings, largely reflecting increases in average tourist expenditure, and imports experienced a pronounced fall in the EPZ sector. As a result of the intervention policy of the BOM, the net international reserves of the central bank increased to an estimated US$1.3 billion (7.3 months of import cover) at end-June 2003 compared with US$1 billion (6 months of import cover) at end-June 2002.

Mauritius participated in the Financial Sector Assessment Program (FSAP) during 2002. The FSAP concluded that Mauritius has a well developed financial system and that the banking system is highly profitable and sound. However, there are three main sources of potential risks and vulnerabilities: risks associated with external economic shocks and downturn in economic activity that reflect the limited diversification possibilities of a small island economy and the high concentration of credit among a few sectors; the rollover risks of growing short-term public debt; and potential reputation risk that could arise from money laundering or criminal activities of offshore funds and companies.

Executive Board Assessment

Executive Directors agreed with the thrust of the staff appraisal. They considered that generally sound macroeconomic policies have created the conditions for investment and growth and the overall strong performance of the Mauritian economy over the last two decades. Consistent real output growth made possible a more than doubling of per capita income, a narrowing of income disparities, and remarkable progress in improving social indicators, against the background of a stable political system. More recently, however, the fiscal deficit has been high, economic growth has slowed, and unemployment remains relatively high and persistent. Directors agreed that the recovery of growth to its historical level in the period immediately ahead will depend on the global economic recovery, continued good macroeconomic policies, the performance of the export processing zones and the tourism sector, and a rebound in sugar production from the cyclone-depressed level of 2002.

Directors observed that in the medium term, the authorities' key challenges will be to explore the scope for further economic diversification, address the problem of persistent unemployment despite a generally satisfactory rate of growth, and contain the budget deficit and the overall public debt level. Structural reforms to improve competitiveness, especially with respect to labor market flexibility, and to promote private sector investment, would also strengthen medium-term growth prospects.

Directors welcomed the authorities' efforts to restructure the sugar sector to reduce costs and improve competitiveness. They noted that the textile sector is positioning itself to take advantage of increased export opportunities. However, further restructuring is needed to improve overall competitiveness. High utility costs and increases in wage rates that exceed labor productivity growth, in particular, impede efforts to improve competitiveness. The current investments in information communications technology should also provide support for economic growth over the longer term, although some Directors noted that the high technology sector is especially sensitive to economic downturns.

Directors encouraged the authorities to reduce the involvement of government in commercial activities, and implement further structural reforms aimed at creating greater opportunities for private sector investment and employment. In that vein, Directors called on the authorities to eliminate remaining obstacles to foreign investment, in particular relating to permits and licensing processes.

Directors considered that the high rate of unemployment in Mauritius could be attributed to both rigidities in the wage determination process, and the mismatch between labor skills and job requirements. Directors urged the authorities to reform the pay setting mechanisms to allow for firm-level collective bargaining, and to encourage the arbitration tribunals and bodies responsible for public and private sector pay to take into account economic and competitiveness factors in handing down wage awards. They supported the government's efforts to improve the education system to eliminate the mismatch between jobs and skills.

Directors noted that Mauritius' public debt, although moderately high, is supported by the economy's track record of high growth. However, the current large fiscal deficit is not sustainable and risks compromising medium-term macroeconomic stability. Directors recommended that the authorities pursue a more ambitious fiscal deficit reduction target, with the objective of reducing the deficit to within a manageable range by 2006/07, and stabilizing public debt at a lower level.

Directors were concerned by the pressures on the public finances created by losses of the state-owned Central Electricity Board and the State Trading Corporation. To eliminate these losses, electricity tariffs should be adjusted in line with movements in the international price of fuel oil used for electricity generation. Directors also urged the authorities to implement the agreed automatic pricing mechanism for petroleum products.

Directors agreed that monetary policy in Mauritius is appropriately tight, but they cautioned that recent reductions in interest rates, in conjunction with an expansionary fiscal stance, risked a faster rate of inflation. The authorities should monitor liquidity conditions carefully before reducing interest rates further. Directors noted that the informal inflation targeting framework was working well, and encouraged the authorities to consider moving to formal inflation targeting, in the context of greater independence for the central bank. Directors considered that the exchange rate, which is market-determined, is broadly consistent with macroeconomic fundamentals. They encouraged the authorities to work to further deepen the interbank foreign exchange market.

Directors noted that the Mauritian financial system is well-developed, sound and profitable. They encouraged the authorities to further strengthen the system by implementing the key recommendations of the Financial System Stability Assessment. Directors welcomed the progress made in combating money-laundering and the financing of terrorism, including the enactment of the Financial Intelligence and Anti-Money Laundering Act of 2002. They encouraged the authorities to accept the United Nations conventions on money laundering and terrorism financing.

Directors commended the government for reducing tariff rates in the context of the regional trade agreements. They encouraged the authorities to simplify the customs tariff system over the medium term, and eliminate nontariff barriers.

Directors welcomed the staff's assessment of the effectiveness and efficiency of Fund-provided technical assistance to Mauritius. They concurred with the staff that technical assistance was well-targeted and generally effective. At the same time, they agreed that a more rigorous prioritization process could have resulted in more efficient technical assistance delivery in some areas.

It is expected that the next Article IV consultation with Mauritius will be held on the standard 12-month cycle.

Public Information Notices (PINs) are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board.

Mauritius: Selected Economic Indicators 1/

	1998/99	1999/00	2000/01	2001/02	2002/03
				Prov.	Proj.
	(Annual percentage change)				
Domestic economy					
Real GDP	5.4	2.7	7.0	4.0	3.3
Consumer prices (period averages)	7.9	5.3	4.4	6.4	5.1
Unemployment	7.1	8.1	8.9	9.4	9.8
	(In millions of U.S. dollars, unless otherwise indicated)				
External economy					
Exports, f.o.b	1,680.2	1,522.6	1,639.0	1,582.9	1,676.4
Imports, f.o.b.	-2,045.7	-2,006.5	-1,891.9	-1,802.0	-1,942.8
Current account balance	-65.3	-68.7	154.3	238.2	234.8
(in percent of GDP)	-1.5	-1.6	3.4	5.2	4.6
Capital and financial account balance	11.7	-103.6	-95.6	-257.8	-234.8
Net international reserves of the Bank of Mauritius (end of period)	625.4	688.0	789.3	1,017.0	1,328.3
(in months of prospective imports, c.i.f.) 2/	3.5	4.1	5.0	6.0	7.3
Debt service (in percent of exports of goods and nonfactor services)	7.6	7.9	9.8	8.5	7.3
Change in real effective exchange rate (in percent) 3/	-1.9	5.7	2.7	-1.9	0.1
	(In percent of GDP, unless otherwise indicated) 2/				
Financial variables					
Total revenues and grants	20.1	20.9	18.1	18.4	20.8
Total expenditures and net lending	23.4	24.7	23.9	24.4	26.7
Central government fiscal balance 4/	-33	-3.8	-5.7	-5.9	-5.9
Primary fiscal balance 4/ 5/	0.1	-0.4	-1.3	-2.6	-1.6
Change in broad money (in percent)	13.2	10.9	9.9	13.0	11.0
Interest rate (in percent) 6/	12.0	10.8	11.4	11.8	11.8

Sources: Mauritian authorities; and IMF staff estimates and projections.

1/ Fiscal year from July to June.

2/ Excluding the acquisition of aircraft and ships.

3/ Trade-weighted period averages; data for 2002/03 are for July-Feb. 2003. A negative sign signifies a depreciation.

4/ Including grants.

5/ Overall central government fiscal balance, excluding interest payments.

6/ Maximum interest rate on fixed-time deposits with maturities between six and twelve months, end of period; the future for 2002/03 is for January 2002.