The Mauritian Experience[1]

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This paper will describe the growth pattern of a small island economy which has, over the last four decades, managed to reach the status of a middle-income country, overcoming the constraints of economies of scale posed by an exiguous local market. The Mauritian experience reveals that size *per se* is not a handicap, and that ultimately economic progress depends on the will and the commitment of the political class to development, on the mobilisation and efficient management of resources, on the right market positioning, on investment in human capital and on enough policy flexibility to adjust to changing circumstances.

For those not familiar with the island, a brief overview of the geography, history and political evolution will be made to provide the setting for understanding the constraints under which economic policies had to be elaborated. Then the initial conditions prior to independence and the development strategies over the last three decades will be explained. In the second section of the paper, the factors which contributed to economic performance from 1970 to 1990 will be examined. The concluding section will examine the new challenges facing Mauritius.

The setting

Mauritius is an island of 1865 square kilometres situated in the south-west Indian Ocean, far from its major markets and suppliers. Inhabited only since the eighteenth century, the island was a French colony for almost a century till 1810 when the British conquered the island because of its strategic importance in the Indian Ocean on the route to India. The British converted it into a monocrop economy with sugar cane as the mainstay. Since the French era, slaves had been imported from neighbouring Madagascar, Mozambique and Senegal. With the abolition of slavery, indentured labourers were brought from India and a small minority even from China. Thus, by the end of the nineteenth century, Mauritius was already a multi-racial society. It is still a melting pot of European, African and Asian cultures with a population of 1.2 million, of whom less than 1 per cent is Buddhist, while 51 per cent is Hindu, 32 per cent Christian and 16 per cent Muslim.

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The diversity of races and cultures in Mauritius has not been a source of strife since independence. This is due mainly to the spirit of peaceful co-existence which exists in the island and which has its roots in the race riots of January 1968 (a few months prior to independence) which impressed upon everybody the precarious social balance and the need to coexist so as not to sink together. Co-existence also draws strength from the democratic nature of the political system, based on the Westminster type of parliamentary democracy, and the fact that the two major parties formed a coalition at independence to preserve social harmony.

Elections to the 70-member National Assembly are held regularly – normally every five years. Annex 1 lists the different political parties that have been in power to illustrate that Mauritius enjoys a robust democracy where changes of government have not had an inordinate effect on political and social stability. Political change has not led to shifts in the economic strategy which remains firmly export-oriented.

With its limited natural resources, Mauritius had few options. Agricultural land on this volcanic island consists of 48 per cent of the total land area as compared to 57 per cent in 1985. Forest and woodland take up another 35 per cent while built-up areas claim 13 per cent. All arable land is fully cultivated and is being encroached upon by demographic pressure for housing purposes and by the demand for more factory space. However, the geography of the island provides some natural advantages which have helped the tourism sector to blossom.

Spared by major natural calamities, Mauritius nonetheless is visited by cyclones in the summer, usually between December and April, which determine to a large extent the fluctuations in the growth rate of the country. Agriculture, specially sugar cane, suffers when the cyclones pass over the island, but it also suffers when they do not come close to Mauritius since then drought conditions prevail. Consequently, the economy of Mauritius is highly vulnerable to the vagaries of the weather.

The economic situation before independence

At independence Mauritius was a textbook example of a monocrop economy with no mineral resources, no entrepot trade and, apart from sugar and its by products, few manufacturing enterprises. But already from the 1820s, the economy of the island was open and was producing the crop for which it had the best comparative advantage – sugar – which is cyclone resistant and best suited to the volcanic soil of the island. Sugar exports were enough to pay for imports needed by the population so long as the price was high and the population did not increase faster than production. This situation prevailed to the end of the 1940s when malaria was eradicated.

Thereafter the rate of population increase reached 3 per cent per annum in the 1950s and it seemed destined to suffer from chronic overpopulation.

A turning point in the economic history of Mauritius was precipitated by an exogenous factor: in 1960 Cyclone Carol devastated the island and this prompted the colonial masters to set up a commission headed by Professor Meade to report on the economic and social structure of Mauritius. The Meade Report was to influence the economic and social policies of the island during the 1970s. Meade stressed the need to control demographic expansion which posed the greatest threat to economic development. Among the key recommendations were the need to diversify away from sugar and to industrialise as fast as possible. However, he noted the following potential impediments to industrial development:

- The sugar mentality which obstructed capitalist development;
- Shortage of capital;
- Absence of financial institutions and intermediaries;
- Racial division which prevented commercial and financial co-operation between entrepreneurs of different ethnic groups;
- Lack of knowledge of manufacturing outside the sugar industry.

Therefore the initial obstacles were not only economic but also psychological and sociological. How far the latter can be attributed to insularity is open to debate. The most urgent task in the early 1960s was to attract capital, to diversify the economy away from sugar to other employment-generating sectors and to slow demographic growth. To address the demographic problem, family planning and emigration (to Brazil and British Guyana) were recommended. For the relief of unemployment a policy of wage restraint was advocated to reflect the abundance of labour and to attract foreign investors; like most least developed countries in the initial stages of development, Mauritius had no local class of dynamic entrepreneurs (except for those already involved in sugar). Moreover, there was a large pool of semi-literate labour as primary education was free and universal from 1915; in 1965 the number enrolled in primary school as a percentage of the 5–11 age group was 101 per cent and 26 per cent of the appropriate age group were enrolled in secondary school.

A choice had to be made on a strategy for economic diversification. Either market forces alone could be left to create the right conditions for capital to move from sugar to other sectors, or the government could intervene to hasten the pace of diversification, as well as to ensure a more equitable distribution of income.The Mauritian Government decided to intervene both for political and economic reasons. Politically, the country

was moving towards independence and the government felt that it had to assist the development of a class of new entrepreneurs unrelated to the sugar sector. Racial heterogeneity, and more than a century of specialisation in one crop, would delay the diversification of the economy if market forces alone were left to dictate the pace of change. On economic grounds too, intervention seemed justified since returns in other sectors were not as high as in sugar. In fact this and the imminence of independence resulted in capital outflow which reached over Rs15m in 1963 and Rs12m in 1964.

The first phase of easy import-substitution thus started as early as 1962. This does not mean that a policy of closed doors was pursued. In fact foreign investors were encouraged to invest in Mauritius. The encouragement to import substitution was embodied in Development Certificates (DCs) awarded from 1964 which provided the holders with the guarantee of quantitative restrictions on imports of competing goods so that they effectively enjoyed a monopoly situation under high tariff protection. The DCs were granted on a firm-by-firm basis. Among the main import-substituting industries set up before independence were an edible oil refinery, margarine, soap, fertiliser, matches, cosmetics and paper stationery. But the limits of import substitution were reached very fast in an island of 800,000 people with a labour force of 200,000.

Post-independence economic development

Each country has its own specific characteristics, its own cultural traits and social, political and legal institutions which mould the population's psychology and determine their reactions to policy measures. This is a fact which policy-makers and consultants often ignore at their peril. Butthis does not mean that each country should re-invent the wheel. There are lessons that can be learnt from others. The discerning and effective policy-maker will understand that, while the content remains basically the same, successful implementation resides in the packaging, timing and delivery systems. With the above caveat, what are the lessons that can be drawn from the Mauritian experience?

An overview of the economy

Unlike many newly independent countries, government intervention did not go as far as nationalisation and drastic land reforms in its bid to muster capital and industrialise. The traditional capitalist class was allowed to prosper while the state became more involved in the economy. The overall approach of fostering a mixed economy has borne fruits over the last three decades. The remarkable performance in the 1980s is due mainly to a set of policies which has restructured the economy and provided

the required stimulus to investment and savings. The growth path has not been smooth: mistakes have been made, corrective action taken, policies going against economic orthodoxy have been adopted in circumstances which luckily have not up to now created major distortions, but which will now have to be addressed if the economy is to continue to grow.

Indeed, the economic indicators (see Annex 2) show that, compared with an alarming situation at independence, a substantial improvement was registered in 1990: per capita income had risen to Rs 37,095 from Rs 1438 in 1970; real growth was a respectable 7.2 per cent; the overall budget deficit fell to 2.0 per cent of GDP; and the debt service ratio was down to 9.9 per cent from a peak of 26.8 per cent in 1985. Until recently the growth rate always fluctuated with sugar production, itself dependent on the vagaries of the weather. During the 1950s, real growth averaged 2.5 per cent annually. It was to drop significantly to 1.3 per cent in the 1960s. In the 1970s the average annual growth rate was a respectable 5.6 per cent and it remained at around 6 per cent in the 1980s, the main contributor being the manufacturing sector which grew at an average of 15 per cent between 1980 and 1990, the highest growth rates being registered between 1984 and 1987 with a peak of 35 per cent in 1986.

Demographic expansion has been controlled through a vigorous programme of family planning, as well as through emigration. Whereas the population was increasing at anannual average of around 3 per cent in the 1950s, it grew at a rate of 2.4 per cent in the 1960s and 1.4 per cent in the 1970s. During the 1980s, the rate further decreased to 0.79 per cent. Mauritius seems to have come to grips with its demographic problem though now a shortage of labour has developed and the issue of an aging population is looming. In fact unemployment has been the major problem in the island. It stood at 12 per cent in 1970 and after receding to around 6 per cent in the mid-1970s, it shot up again in the wake of the 1979 oil shock and reached 17 per cent in 1981, peaking at 21 per cent in 1982. Subsequently it fell to less than 3 per cent in 1990.

Export performance has also been quite remarkable. In 1968 sugar and its by-products made up more than 90 per cent of total exports of goods. Between 1970 and 1976, total export earnings, starting from a low base, grew by 31 per cent on average per year. The rate for the period 1976–82 was 16 per cent per year, and growth averaged 22 per cent per year between 1983 and 1990. Merchandise exports totalled only Rs 361.7 million in 1971 when the first export processing zone (EPZ) firms started operating. In 1990 they reached Rs 18,246 million, a nearly fifty-fold increase in 20 years. Sugar accounted for only 32 per cent of the total. In fact, manufacturing brought in more foreign earnings than sugar in gross

terms for the first time in 1985. The composition of exports has undergone a major change as manufactured exports, specially textiles, have gained in importance.

From boom to stagnation: macroeconomic mismanagement

From independence to 1972 the situation was not bright politically or financially. Then the price of sugar started rising from £40 to £330 per tonne. At the same time the Mauritian quota under the EEC Sugar Protocol increased from 380,000 tonnes to 505,000 at a guaranteed price of £260 per tonne. The previous price was £57. The value of sugar exports rose to Rs 1584.2 million in 1974 from Rs 321.6 million in 1971. The sugar boom cushioned the first oil shock and fuelled the illusion that the economy was on the path to sustained prosperity. Substantial wage increases, as well as end-of-year bonuses ranging from 1 to 22 months' wages in certain sectors were granted to compensate workers for the austerity endured since 1968. Meade's warning that high wages plus social security plus cost of living allowances would spell inevitable ruin was forgotten. Both food subsidies and social expenditure were increased as the government pursued a policy of income redistribution and consolidation of the welfare state. Government budgetary expenditure as a percentage of GDP went up from 22 per cent in 1975 to 29 per cent in 1976 (election year) to 32 per cent in 1978.

The sense of economic euphoria clouded the recession which had already hit the world. The government launched an ambitious investment programme in infrastructure (a bulk sugar terminal, harbour development, roads and a hydro-electric plant), estimated at Rs 7.2 billion for the Plan period 1975–80. Moreover, since official development assistance was not forthcoming because of the international economic decline, the Mauritian authorities borrowed on the Euromarket at commercial rates in the belief that the recession would be short-lived. This expansionist policy showed a disregard for macroeconomic management and was to have dire consequences for the economy. The heavy injection of money resulted in double digit inflation – 14 per cent in 1973, 29 per cent in 1974 and 15 per cent in 1975. The balance of trade deficit widened, the government budget deficit expanded, workers were laid off (567 in 1976, 3581 in 1978, 4234 in 1980) and the unemployment rate soared.

Thus, even before the second oil shock, economic conditions had worsened to their 1968 level. In response, the government contracted more eurodollar loans, controlled imports and regulated prices, but allowed the real interest rate to remain negative. Taxes were increased. In fact, the tax rate was 70 per cent and company tax was 65 per cent. The tariff struc-

ture did not give the right signals to firms whose products were not intended for direct export. The overvaluation of the rupee, which had been linked to the SDR since 1975, did not help to improve the situation. The deterioration, partly due to mismanagement under political pressure, was compounded by external factors – the rise in oil prices, cyclones, strikes and interest rate hikes on the international financial markets, leading to a heavy debt-service burden. So, at the end of the 1970s the catastrophic economic situation brought home once again to the people of Mauritius the need to break away from the tyranny of sugar and engage forcefully in industrialisation and economic diversification.

Stabilisation and adjustment: getting prices right

Because of its worsening external situation, Mauritius negotiated its first standby agreement with the IMF in 1979 with the immediate objective of stabilising the economy. Emphasis was laid on demand management schemes to reduce the budget and the balance of payments deficits, and to curtail consumption and imports. The rupee was devalued in October 1979 by about 23 per cent vis-à-vis the SDR and in 1981 by another 20 per cent. At the same time the country embarked in 1980 on a structural adjustment programme (SAP) with the help of the World Bank. The aim was to lay the foundations for renewed growth by promoting export-oriented industries, by encouraging tourism and by diversifying agriculture.

A series of measures were taken to curtail consumption and encourage investment: a sales tax of 5 per cent was introduced; interest rates were liberalised; subsidies on rice and flour were reduced. Most important of all was the decision to de-link the local currency from the SDR and to attach it to a trade-weighted basket of currencies reflecting the trade patterns of Mauritius. This was intended to restore the competitiveness of domestic products which had been partially eroded by the wage increases in the second half of the 1970s. Since March 1983 the rupee has been on a crawling peg, floating downward to maintain the real exchange at a competitive level. Further, a policy of wage restraint has been vigorously followed whereby workers were given compensations lower than the inflation rate.

The tax structure was reformed and the highest marginal rates were brought down to 35 per cent. Company tax was also reduced to 35 per cent while new companies holding export certificates were charged 15 per cent for their whole lifetime. To encourage local companies to export, a graduated tax structure was set up whereby a 2 per cent rebate was given for every 10 per cent of output exported. Hence, a firm exporting 100 per cent of its products would pay only 15 per cent taxes. Tariffs were rational-

ised to be more in line with export-oriented industrialisation, quotas were removed and price controls were eliminated on all except eight basic products.

In addition to the monetary and fiscal policies adopted, some institutional reforms have been implemented and have played a significant role in the economic recovery of the country. A basic weakness in the industrial strategy was identified in marketing and investment promotion. A parastatal organisation, the Mauritius Export Development and Investment Authority (MEDIA), comprising members of the private sector, was set up in 1984 to search for new markets and to attract investors. It is responsible for ensuring the participation of local firms in international fairs. It has also organised successful investment promotion campaigns to the Far East. Many of these missions were headed by government ministers to indicate clearly to investors that the government was serious about the industrialisation of Mauritius.

Government, unions and the private sector

The government has played a key role in institution-building, infrastructure development and in creating the environment within which economic agents could function effectively to promote growth. Of course, this does not imply that all the policies it followed were necessarily the correct ones . It has been an active agent in fostering the economic growth of the island. It secured guaranteed prices and markets for sugar; it adhered to international conventions which gave Mauritian goods access to the EEC; it negotiates quotas for its textile exports with the US Government; it has provided free primary and secondary education to create a literate and adaptable labour force; it has invested heavily in physical infrastructure without neglecting social overheads. Inspired by Fabian socialism, the Labour government in the 1960s and 1970s built a welfare state which provided free health care and education and cheap housing, as well as subsidies on imported staple foodstuffs (rice and flour). In fact, the priority objective of satisfying the basic needs of the population laid the necessary social foundations which allowed the people to respond to changing external conditions relatively fast. But it also laid a shaky economic foundation which would have collapsed without the SAP of 1980.

Government intervened positively in the early stages of development to mobilise domestic and foreign capital for infrastructure development. Domestic resources can be mobilised by the private sector if the income distribution is such that savings may be made. But the major constraint facing a new state is obtaining enough foreign exchange. It can be overcome by either exporting more or by obtaining grants/loans from other

countries/institutions. Mauritius did not have any strategic or ideological importance at independence It had to ensure that the flow of foreign exchange from sugar exports would be stable so as not to handicap investment efforts. The Commonwealth Sugar Agreement guaranteed a favourable price but was due to expire when the UK joined the EEC.

Government had to negotiate stable prices and preferential treatment from the EEC. This could be achieved by enlisting the support of EEC member countries. Therefore, foreign policy takes on a dimension of its own in the economic development of a small country. Mauritius joined the Non-Aligned Movement and the Organisation of African Unity, as well as the Organisation Commune Africaine et Malgache (the French equivalent of the Commonwealth) which disintegrated in the late 1970s. In June 1973 Mauritius signed the Yaoundé Convention which gave preferential tariffs to EEC goods and duty-free and quota-free access to EEC markets. This treaty also enabled the island to benefit from financial aid from the European Development Fund and the European Investment Bank. The Lomé Convention provided Mauritius with sufficient market openings for its growing textile industry. In addition it guaranteed a market for the sugar industry under the EEC-ACP Sugar Protocol at a price usually higher than the world price. During the sugar boom the guaranteed price was lower than the world price but Mauritius respected the clauses of the convention in violation of the profit-maximising motive and it was thus able to increase its share of the sugar quota to 505,000 tonnes per year, which represents on average about four-fifths of its annual sugar production.

A more debatable area of government intervention is the labour market. The comparative advantage of small labour-rich countries lies in keeping down its labour costs – the only costs which can be effectively controlled domestically. This can be done by crushing all militant trade unions, outlawing them or recognising only pro-government unions as was the case in some countries in the Far East. In Mauritius this course of action was not possible because of a strong trade union tradition and because of its democratic system. Instead a quite repressive law (the Industrial Relations Act) was passed in 1973, mading all strikes effectively illegal. At the same time various institutions were set up to prevent industrial relations from becoming explosive. A tripartite committee, consisting of the government, the private sector and the trade union federations, has met annually since 1977 before the Budget is presented, to discuss cost of living allowances in both the public and private sectors. A special body, the National Remuneration Board (NRB), set up under the IRA, is responsible for fixing minimum wages and conditions of service in the private sector. If employers and workers cannot reach an agreement, they

take their case to the Industrial Relations Commission which has powers to settle conflicts. The Ministry of Labour also performs a conciliatory role in disputes.

The mechanisms for wage-dispute settlements and collective bargaining have contributed significantly to social stability. There has been no major strike since 1979. Moreover, government intervention did introduce rigidities in the labour market, especially in the agricultural sector. Similarly, the fixing of lower minimum wages for women than for men in manufacturing did have negative repercussions until corrected under the SAP in the early 1980s. More flexible labour regulations obtained in the EPZs which were then considered as enclaves. Nonetheless, from an economic viewpoint, the system does not satisfy either efficiency or equity criteria: it is not dynamic nor flexible enough to reward productivity and scarce skills; although it is meant to compensate employees for cost of living increases, it has been guided by the principle of tapering compensation, with the lowest paid receiving the full increase. This has led to a reduction in wage differentials, especially in the public sector which has become more 'bottom weighted'. To redress the situation, the salary structure is reviewed every five years, resulting in sudden massive increases in the salary bill and in the money supply, with its concomitant pressure on the government budget and on inflation.

Yet the tripartite committee, even with its imperfections, has served a very useful purpose in consensus-building, the cornerstone of the Mauritian success. It provided a critical forum for the major social and economic players to air their views and their discontent. Of even greater importance has been the very effective collaboration between the government and the private sector. It is this collaboration (at times on a very informal basis) which has led to certain key initiatives being taken, like the setting up of the EPZ, the first hotels being built, the successful negotiations on the Sugar Protocol, the creation of the national airline, the establishment of a stock exchange and a freeport, investment in Mozambique, the implementation of a value-added tax, etc. It happens also that this proximity between individuals in the private sector and politicians may also lead to what Bhagwati calls DUPS (directly unproductive profit seeking activities). Nonetheless, in the case of Mauritius, the public-private sector partnership has had a positive overall balance. How did it happen?

The private sector in Mauritius has always been well organised. Already in the last century, institutions like the Chamber of Commerce and Industry and the Chamber of Agriculture were set up to defend the interests of their members. The private sector was then made up mostly of

Franco-Mauritians who had to deal with the British colonialists. The racial homogeneity must surely have played an important part in the strength of the institutions. They maintained their relevance after independence by opening up gradually and here the advantages of smallness stand out. The government, and especially the Prime Minister, had to trust the private sector and vice versa. The private sector, therefore, two years after independence established a Joint Economic Committee to coordinate a private sector macroeconomic position and appointed as coordinator Mr Paturau, who had been a government minister before independence, to fulfil the role of interface between the private sector and government. This facilitated high-level talks with the government as the private sector could speak through (and with) one voice. Confidence-building and consensus-seeking could be carried out in a structured, constructive way to ensure that frictions did not develop into full-blast conflicts.

While there was still a high level of mistrust between the private sector and the civil service in the 1970s, the relationship improved in the 1980s when private sector representatives were appointed as members and chairmen of various Boards of Administration of parastatal bodies. These much maligned institutions have directly helped to bridge the communication gap between civil servants and business operators. It must, however, be pointed out that this change in attitude occurred in the 1980s in the wake of the structural adjustment programme which compelled policy-makers to think more in terms of efficiency than control. This approach was further encouraged by the business-friendly attitude of the government in 1983.In fact, the single most important measure adopted to kick-start the economy in 1984 was the drastic reduction of the income and corporate tax rates from 65–70 per cent to 35 per cent. This was a powerful signal on the part of government to which the private sector responded positively with the economic results that have led to Mauritius being touted as another miracle.

Key lessons

The World Bank, in a momentary lapse of inspiration, entitled a book *The East Asian Miracle* (the expression Mauritian miracle has also been used in the international press). Miracles in popular belief are attributed to supernatural forces, to a completely exogenous factor. The economic evolution of Mauritius, as described above, has certainly benefited from a fair dose of externalities. The interesting question is why Mauritius is one of the rare ACP countries to have succeeded when all enjoyed the same exogenous factors, viz oil price hikes and a world economic recession in the early 1970s and 1980s, the Sugar Protocol, the Lomé Convention,

absence of quotas on the US market. There is no doubt that Mauritius enjoyed a fair amount of luck – the sugar boom which blurred the impact of the first oil crisis; the EPZ which started at a time when there was not much competition around but plenty of protectionism (why then did others not set up EPZs ?); no major cyclone hit Mauritius in the 1980s when the economy was recovering. But Mauritius was also unlucky when unfavourable weather conditions in 1979 and 1980 hit the first SAP and could have derailed it. In any case, luck comes to those who are prepared, to the practitioner with the gut feelings (or animal spirits in Keynesian terminology) who can identify and seize opportunities.

The key elements in the Mauritian example, then, are endogenous and can be summarised under the following main headings:

◆ *Outward-looking strategy*

The success of Mauritius rests on its adoption of an outward-looking strategy since it became independent. The Export Processing Zone Act was passed in 1970, two years after independence. It should be noted that, unlike EPZs in other countries, the zone in Mauritius did not refer to a specific geographical area. It was a legal entity which provided the holder of an export enterprise certificate with generous incentives: tax holidays, duty free import of raw materials and equipment, free repatriation of capital, flexible labour regulations.

The essential element, however, is not the legislation, but rather the attitude of welcome. Foreign direct investment was actively encouraged, sought out and there was a consensus among the population as a whole that FDI was in the interest of the country. The environment is business friendly, and the people are not at all xenophobic as all have their roots in a foreign land. The cultural diversity has also been a major plus for the tourism industry. Mauritian nationality was even offered to Hong Kong investors when the fate of the colony was still being discussed by the British and the Chinese in preparation for the handing over in 1997. This second surge of investment from Hong Kong was at the basis of the remarkable growth of the textile and clothing sector in the 1980s.

If there is no general consensus on the need to promote export-oriented policies and no involvement of local entrepreneurs, then any outward looking strategy is doomed to failure. An important feature is the presence of local entrepreneurs during the early phases of industrialisation. In Mauritius foreign firms brought in new technology and an element of competition necessary to induce efficient production and enhance quality. But if the EPZ had been grafted on to an economy not yet ready to receive it through lack of infrastructure or unpreparedness of the labour force,

then it would most probably have been rejected by the system. This seems to be borne out by the fact that, while a lot of EPZs have been set up recently all around the world, there has been no rush of investors. The EPZ can only be an instrument of export-oriented industrialisation and is certainly not a panacea. Without the proper enabling environment and the combination of factors highlighted by the Mauritian example, its chances of success are quite limited.

◆ *Governance*

The state played different roles in different phases of industrialisation – initiator, promoter, protector, arbiter. But it was overall a developmental state, i.e. a state committed to the development of the country and not to sectarian interests The rule of law prevails in Mauritius. Political leaders have generally respected the institutions and have ensured that there is social stability. Political vision was demonstrated when Mauritius joined OCAM which opened the door to the Yaoundé Convention and when it stuck to the Sugar Protocol although market prices were higher than the guaranteed price.

The civil service has also played an important role in implementing the various economic and social programmes. Without a proper public administration, without competent cadres in the economic ministries and the Central Bank, it is doubtful whether the adjustment programmes could have been as successful.

The close public-private sector collaboration forms part of good governance as it shows a commitment on the part of political leaders to dialogue and a sense of responsibility on the part of captains of industry to participate constructively in the process of policy-making. There are two meetings a year, chaired by the Prime Minister, where all the economic ministers and their officials are present on the one side, and all the members of the Joint Economic Commission on the other. An agenda is agreed and notes of the meeting are kept. The precondition for such effective dialogue is the existence of a structured private sector. In fact, one of the advantages of a small economy is that proximity makes communications easier, change of policies can be explained faster and turnaround time is shorter.

◆ *Social stability*

An unquantifiable outcome of this collaboration has been the relative social stability that ensued as the fruits of economic growth trickled down to the population at large. Social stability has been, and still is, a major attractive factor for FDI and tourism. This was arguably achieved at the expense of optimal economic policies. But in a multiethnic society the

premium on social peace is always very high.

Care has to be taken, however, not to make temporary concessions which become permanent distortions. Without economic progress and a perceptible continuous improvement in the standard of living, the social fabric can be easily torn asunder. In the final analysis, moreover, only productive employment creation can guarantee social peace in the long run.

◆ *Political stability*

An important factor in the sustained growth of the economy has been political stability – not in terms of the political landscape, which has seen some turbulence (see Annex 1). The stability is rather in terms of a shared belief and adherence to the basic economic strategy of outward orientation, to market-driven development and the rejection of nationalisation and inward-looking policies, and of continuity in broad objectives.

Thus, although a Labour government had already started implementing the policies underlying the SAL in 1980, the accession of a strong, unopposed coalition to power in 1982 ensured that the proper psychological shock was created to sell the idea of austerity to the people. And the fact that the Mouvement Socialiste Mauricien (MMM) had been closely associated with the labour movement made it easier for the government to control trade unions and impress upon the latter the urgency to take strict steps to redress the economic situation. Finally, the MMM, which for years had been clamouring for nationalisation of some sugar estates and for self-reliant development, espoused the existing development strategy and reassured the capitalist class that its objective was no longer social revolution but economic growth, readjustment and tight financial management of the affairs of the country. This change in ideology explains, to a large extent, the fact that Mauritius was one of the rare countries where a SAP did not give rise to street demonstrations and riots. Even though the ruling coalition split and fresh elections were held in 1983, the same steady rigorous economic management continued. Successive governments have helped in creating a business environment that is stable and in managing public opinion with respect to the need for economic discipline.

◆ *Macroeconomic stability*

The importance of an appropriate incentive structure consistent with overall macroeconomic objectives cannot be stressed enough. In spite of the above elements, the Mauritian economy did not really take off before the mid-1980s. The main reason was the failure to get prices right, i.e. the exchange rate, interest rates, tariffs and tax policies have to be geared towards a clear-cut goal – development through the adoption of an outward-looking strategy.

Before the structural adjustment programmes of 1980 and 1982, fiscal policy was characterised by high government expenditure, financed by high taxes and external borrowing (short-term Eurodollar loans were taken to finance long term infrastructure development projects). The fiscal and exchange rate reforms undertaken in the context of the SAP ensured more efficient fiscal governance (the overall budget deficit as a proportion of GDP remained at around 3 per cent between 1985 and 1995), removed the distortions of a dual exchange rate policy and ensured that the rupee was not overvalued.

◆ *Human resource development*

The design and implementation of a given strategy requires competent cadres and a productive labour force. Another precondition is a literate and adaptable workforce, as well as an efficient administrative system which is development-oriented and not bent on enlarging its bureaucratic precinct. Human capital investment becomes a necessary prerequisite for growth.

Since Mauritius has only its human resources as its major asset, human capital development was considered crucial to any sustainable growth, as well as to an equitable distribution of income. Though the private sector contributed significantly to education, standards were not the same in all secondary schools. Primary education was free and almost entirely public even before independence. Free secondary schooling was only granted in 1976, as a result of Labour's commitment to education as an instrument of social progress. The College of Agriculture, which was set up in 1925, became part of the University of Mauritius at the latter's inception in 1967 and World Bank assistance was sought to develop the education sector further, especially the secondary and vocational sectors. The heavy investment in human capital formation provided the required semi-literate labour force for the initial phase of industrialisation.

◆ *Adequate infrastructure*

Without investment in basic physical infrastructure (roads, harbour, electricity, telecommunications, etc.) no industrial take-off is possible. Even though mistakes were made in the late 1970s with respect to financial management, particularly in mobilising commercial funds for massive infrastructure development, yet there is no doubt that this facilitated the take-off in the 1980s. Thus, a potential economic doomsday was averted because funds were used for development projects and were not siphoned off. This is another good point for governance – the objectives were right but the economic means were not appropriate. It can be argued that the government did not have much choice as official development assistance

flows were dry and the investment was needed for future growth. There may be a case for revisiting the policies of official development assistance to small economies when they are in a transitory phase.

◆ *Labour market*

The labour market should function properly so that strife is minimised and wages are allowed to rise in line with productivity. The labour situation will vary from country to country, depending on the political and social structure. Government intervention, in the form of arbitration institutions, may smooth relations between employer and employees and promote a productive work environment. In Mauritius the imperfections in the labour market did not prevent growth from taking place because there was a consensus on the direction and nobody wanted to return to a situation of high unemployment. If there had not been that tacit social contract, the market imperfections could have been a major obstacle.

◆ *Collaboration with donors*

Compared to many countries, Mauritius has generally well-utilised foreign assistance from donor countries and institutions. This has been possible thanks to the combination of the various factors mentioned above. Still, it is important to highlight the technical assistance provided by UN agencies, the Commonwealth Secretariat and the EU amongst others. Many of the programmes have been implemented successfully because there was concertation in the conception and design. Without the technical assistance (often on a grant basis) it is doubtful whether Mauritius, with its limited human resource base, would have moved so fast. The flexible attitude of foreign institutions has also helped (though we should not forget that it takes two to tango); this attitude has been described by an outside observer as 'the willingness of international interlocutors like the World Bank to backstop with financial assistance a transition involving policy reform, structural adjustment and economic transformation without requiring Mauritius to suffer excessive social and political dislocation'. Mauritius was perhaps lucky to be faced with interlocutors who believed in local ownership of development programmes and not in universal blueprints.

New challenges

Economic success is never definite; economic development is similar to riding a bicycle or, using another simile from the world of sports, it is a 'marathon without a finish line'. Mauritius is a country in transition, an economy at the cross-roads, and the challenge today is to find the right development path to attain the same objectives as in the 1970s, namely

to attract FDI and to diversify its economic base. But the context has changed. The pressures on the economy are both endogenous and exogenous. Internally, the shortage of labour, as well as of skilled manpower, has led to an increase in labour costs. Therefore, the major comparative advantage of Mauritius, on which its early industrialisation was based, no longer obtains as a major pull for foreign direct investment. In fact, it is not so much the costs as the unavailability of manpower itself that has served as a brake. Mauritius has to re-think its industrial strategy and the product it wishes to sell. Externally, the new international scene and rules of the game, with the advent of new low labour-cost garment producers, the WTO and globalisation, and the dispersion of foreign assistance with the opening up of Eastern Europe have created a situation of heightened uncertainty.

It is not surprising that around 1990 the economic indicators started flashing warning signals: EPZ firms started closing down and employment started decreasing in the EPZ (though total employment still was increasing); the unemployment rate has been on an upward trend since 1991 to reach 6 per cent in 1997; the fiscal deficit has surged from an average of 2.2 per cent in the period 1991–93 to 5 per cent in 1994–96; inflation has been kept in check at around 7 per cent but will certainly increase with the introduction of VAT and the sharp depreciation of the rupee during the last two years.

The response of the government in the early 1990s was to push for a strategy of consolidation, modernisation of the textile and agricultural sectors, and diversification into financial services with the setting up of a freeport and offshore business activities. The garment sector is still going through a phase of restructuring but it has consolidated itself through modernisation and increased productivity. The attempts at diversification have not been successful, mainly because of a lack of skills, a mismatch between the output of the education system and the needs of the country and an absence of critical mass. The industrial structure still lacks depth, essentially because the industrial approach has up to now concentrated on building pillars instead of searching for clusters.

The necessary condition for continued growth is a new mindset at the decision-making level (both in the public and private sectors), a mindset that is more geared towards taking risks than to preserve past gains – indeed a new class of entrepreneurs, of innovators, is needed. Hence there are some decisions that will have to be taken urgently in the coming years with respect to the reform of the education and training system, public sector reform, productivity, an integrated economic system, flexible labour market, the development of an export oriented service sector (not

only financial services), a strategy of regional integration (expansion through strategic alliances), as opposed to simple de-localisation. The areas where action will have to be taken are sketched below.

The role of government

Government's role is evolving more towards that of a regulator, an arbitrator and a facilitator. Given the lack of critical mass, it may still have to be a catalyst in some sectors. Nonetheless, the public sector will have to put in place the proper legal and regulatory framework for the private sector to operate. The emphasis will have to be less on control, more on creating a business-friendly environment, less bureaucracy and more efficient delivery of services. The civil service will have to be streamlined and overhauled to acquire this new mindset of facilitator. This is a politically difficult and sensitive issue but one which is fundamental to future growth. It is extremely important that the public service attracts and retains the best brains who can identify potential bottlenecks fast and can take remedial action. There should be a move towards decentralisation. At the same time, a re-engineering of the parastatal sector is required so that efficiency criteria prevail over political expediency. It must be conceded that, in practice, this will amount to a Herculean task as in a small country almost everybody knows somebody and it becomes very difficult to take action for social reasons. This is a challenge to the ingenuity of Mauritian politicians and policy-makers as the social implications are far-reaching.

Human Capital

The reform of the education and training system is underway after almost a decade's delay. The outcome of this reform will be felt only after another decade or so. In the meantime there is need to obtain skilled manpower. Therefore, a policy for the import of highly skilled manpower, of knowledge workers, will have to be elaborated.

Microeconomic reform

Whilst macroeconomic stability is necessary to create the conditions and environment for growth, microeconomic reform has to be addressed once the fundamentals are right. Production is done at the level of the firm and measures must be taken to increase productivity and efficiency. The structural adjustment programme helped to put the Mauritian economy back on course at the expense of optimal economic policies in some cases. Now the time has come to correct certain distortions which, if left unchecked, could jeopardise the competitiveness of Mauritius. The main points on the agenda should be:

Anti-monopoly regulations. A major handicap of being small is the absence of critical mass and the concentration of wealth. This creates a situation where monopolies and cartels develop quite rapidly, and where invisible barriers to entry are erected by the links that exist among players in the manufacturing and financial circles. A thorough reform of the financial sector will be needed. The best prescription for fighting monopolistic behaviour is to open the economy up to global service providers; this will also enable a faster pace of technology transfer and upgrade local skills.

Labour market reforms. The mechanisms for wage fixing, cost of living compensation and salary restructuring must be reviewed to make labour market more flexible and open and to encourage mobility of labour to efficient sectors. These reforms, which could not be carried out in 1982–83 when the unemployment rate was around 17–20 per cent, should now be put in motion.

Social services and the ability to pay. Food and housing subsidies were justified as circulating capital at a time when the majority of the population lived at poverty level. With the increase in standard of living, pockets of poverty can be identified more easily. It makes more sense from both equity and efficiency considerations to provide social services on an ability-to-pay basis and subsidies on a needs basis. This would reduce government expenditure, keep down tax rates and ensure better social justice.

Regional co-operation

Regional co-operation is one of the avenues open to small countries for economic progress. The Lomé Convention is a vivid example. If Mauritius did not have access to a guaranteed market, it would most probably not have fared well in spite of implementing the right policies. Small countries who find themselves in direct competition with labour-rich countries may find it difficult to sustain growth if they cannot depend on secure markets. These markets may be geographically regional. However, if a country finds itself in a crawling growth region (not in ASEAN) then the limits to its own growth will be rapidly reached. Regional co-operation alone will not help small countries, but it is certainly the surest way of expanding their markets – provided there is regional integration. In the case of Mauritius, there is need for a planned de-localisation such that the right strategic decisions taken at the firm level do not lead to de-industrialisation. The last five years have witnessed an increase in the number of firms which have relocated to Madagascar. Many of the foreign-owned enterprises have transferred their production while Mauritian-owned ones have tended to expand in the region, i.e. they have relocated the labour-intensive components. Some 20 per cent of enterprises in the

Malagasy EPZ have Mauritian capital. A similar phenomenon of outward investment has also been noted towards Mozambique where 100,000 hectares of land have been put at the disposal of Mauritius for development. Mauritians have already bought a sugar estate. These new developments in regional co-operation hold much promise for the future – provided that the right framework is put in place.

In conclusion, it can be safely argued that good policies work. But small economies are more vulnerable than big countries as they do not have enough resource endowments (both natural and human) to be able to tide over unexpected calamities and prolonged international recession. If two cyclones like Mitch were to visit Mauritius and the world entered a recession at the same time, it would not be difficult to visualise doomsday. Even mighty Singapore has been badly bruised by the Asian crisis. The international community should, therefore, be aware of the specific disadvantages of small islands and not use per capita income as the sole criterion for judging economic success. Rather, the complexity of the economic structure, its depth and spread, the ability and willingness to implement policies which respond to development needs, the level of foreign exchange reserves, *inter alia*, could be used as more appropriate indicators of success. Above all, small economies like that of Mauritius should not be allowed to be caught in the web of their own success.

Annex 1. Political Parties in Government in Mauritius 1967–98

Year	Parties in Government	Prime Minister
1967(E)	LP/IFB/CAM	Sir Seewoosagur Ramgoolam
1969	LP/PMSD/CAM	Sir Seewoosagur Ramgoolam
1973	LP/CAM	Sir Seewoosagur Ramgoolam
1976 (E)	LP/PMSD/CAM	Sir Seewoosagur Ramgoolam
1982 (E)	MMM/PSM/OPR	Sir Aneerod Jugnauth
1983 (E)	MSM/LP/PMSD/OPR	Sir Aneerod Jugnauth
1987 (E)	MSM/LP/PMSD/OPR	Sir Aneerod Jugnauth
1990	MSM/MMM/OPR	Sir Aneerod Jugnauth
1991	(E)MSM/MMM/OPR	Sir Aneerod Jugnauth
1993	MSM/RMM/OPR	Sir Aneerod Jugnauth
1996 (E)	LP/MMM/OPR	Dr. N. Ramgoolam
1997	LP/OPR	Dr. N. Ramgoolam

(E): Election Year
LP: Labour Party
CAM: Comité d'Action Musulman
PMSD: Parti Mauricien Social Démocrate
MMM: Mouvement Militant Mauricien
PSM: Parti Socialiste Mauricien
MSM: Mouvement Socialiste Mauricien
OPR: Organisation du Peuple Rodriguais
RMM: Renouveau Militant Mauricien

Annex 2. Selected Economic Indicators 1970–1998

	1970	1976	1982	1985	1990	1996	1997	1998
Population (mid-year) *(000)*	829	904	993	1020	1059	1134	1148	1160
National Income								
GDP at current market prices *(Rs mn)*	1192	4704	11725	16618	39275	77187	85892	95750
Per Capita GDP at market prices *(Rs)*	1438	5206	11808	16284	37095	68073	74827	82543
Annual real growth rate *(%)*	–0.2	16.7	5.8	6.9	7.2	6.1	5.3	5.6
Growth rate EPZ *(%)*	—	16.0	-2.9	30.0	7.0	7.0	6.0	6.5
Share in GDP at current factor cost								
Sugar *(%)*	23.0	23.3	16.1	14.3	10.3	7.6	7.2	7.0
EPZ *(%)*	—	2.6	5.0	9.6	12.0	12.0	12.3	12.3
Tourism *(%)*	—	1.8	2.7	2.4	3.2	4.5	4.6	4.6
Savings rate *(%)*	14.0	23.9	15.4	21.6	23.6	23.8	24.2	24.0
Investment rate *(%)*	12.0	27.4	17.9	18.7	30.6	26.1	27.3	23.3
Overall budget balance as a % of GDP	1.6	–4.9	–9.5	–3.5	–1.7	–5.7	–4.6	–3.6
External trade								
Total exports *(Rs mn)*	399	1835	4363	7018	18086	32313	33618	37300
o/w Sugar *(Rs mn)*	341	1322	2462	2867	5212	8347	7495	
EPZ *(Rs mn)*	—	309	1236	3272	11474	21001	23049	25200
o/w textile and clothing *(Rs mn)*	_	203	966	2615	9583	17634	19451	21000
Total imports *(Rs mn)*	420	2408	5048	8119	24019	40893	46093	46500
o/w EPZ *(Rs mn)*	—	280	742	2530	7348	12106	13880	
Visible trade balance *(Rs mn)*	-21	-573	-685	-1101	-5933	-8770	-12475	-9200
Current a/c balance as % of GDP	1.8	–6.1	–3.9	–2.8	–4.5	0.7	–1.5	2.1
Balance of payments *(Rs mn)*	94	-500	-643	258	3442	859	-647	
Debt service ratio *(%)*			22.0	20.0	10.0	9.0	6.9	
Import cover *(weeks)*	38	14	6	6	24	25	24	21

	1970	1976	1982	1985	1990	1996	1997	1998
Inflation rate %	1.5	13.4	11.4	6.7	13.5	6.6	6.6	7.0
Labour								
Total Labour force (Dec)	214.9	284.3	355.0	399.0	433.2	492.8	505.5	
Total employment (*000*)	189.6	260.7	282.0	340.0	421.0	466.0	475.7	
o/w imported labour (*000*)					1.0	8.0	9.0	
Unemployment (*000*)	25.3	23.6	73.0	59.0	12.2	26.8	29.8	
Unemployment rate (*%*)	11.8	8.4	20.6	14.8	2.8	5.5	6.0	
EPZ								
No. of firms (*no.*)	—	85	115	290	568	481	480	485*
o/w textile and clothing (*no.*)	—		65	187	371	267	269	267
Employment (Dec) (*no.*)	—	17171	23476	53951	89906	79793	82083	87057*
o/w textile and clothing (*no.*)	—		20421	48351	80500	69710	73364	76873
Tourism								
Tourist arrivals (*000*)	28	93	118	149	292	487	536	580
Gross tourism earnings (*Rs mn*)	27	184	450	845	3500	9048	10068	11000
Hotel rooms (*no.*)		1881	2204	2630	4,603	6668	6781	