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Mauritius: from Plantation to Knowledge-based Economy

The setting

Mauritius is an island of 1,865 km^2 situated in the South West Indian Ocean, far from its major markets and suppliers. Inhabited only since the 18th century, the island was a French colony for almost a century until conquest by the British in 1810 because of its strategic importance 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 to the island 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 19th century, Mauritius was already a multi-racial society. It is today a veritable melting pot of European, African and Asian cultures, with a population that stands at 1.2 million. Of these, 51 per cent is Hindu, 32 per cent Christian, 16 per cent Muslim and less than one per cent is of Buddhist faith.

Since independence in 1968, the nation's diversity of races and cultures has not been a source of major strife as the political system, based on the Westminster type of parliamentary democracy, has maintained a precarious social balance by including the concept of 'best loser', whereby each ethnic group is guaranteed representation in the national parliament. Elections to the 70-member National Assembly are held regularly, normally every five years. Mauritius enjoys a robust democracy, where changes of government have not affected political and social stability inordinately as the major political parties have all been in a coalition government at one point or another since 1982.[1] Even though there have been regular changes of government since then, there have been no fundamental shifts in economic strategy, which has remained firmly export oriented.

Spared any major natural calamities, Mauritius nonetheless is visited by cyclones in the summer, usually between December and April, which determine to a large extent fluctuations in the country's growth. For example, agriculture and especially sugar cane suffer both when cyclones pass over the island and also when they do not, because of the drought conditions that then prevail. Consequently, so long as 'king sugar' reigned, the Mauritian economy was highly vulnerable to the vagaries of the weather.

The island underwent a significant structural transformation from independence to the late-1990s, when new challenges started to appear which demanded a rethink of

the country's economic trajectory (see tables 2.1 and 2.2). This chapter provides an overview of the conditions and policies that led to a transformation of the economy.

Economic situation up until independence

At independence Mauritius was a textbook example of a monocrop (monoculture) economy. It had no mineral resources, no entrepôt trade and, except for sugar refining and its immediate by-products, few manufacturing enterprises. However, since the 1820s the economy of the island was open to international trade 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 sufficient to pay for imports to maintain the population, so long as the price was high and the population did not increase faster than sugar production. This situation prevailed to the end of the 1940s, when malaria was eradicated from the island. Thereafter the rate of population increase grew, reaching 3 per cent per annum in the 1950s. Mauritius seemed destined to become a dismal Malthusian case scenario of population outstripping the food supply/productive output needed to survive.

Table 2.1: Mauritian structural transformation 1970–98 (US$bn and %)

Economic parameters	Amounts/proportions				Growth rates (%)		
	1970	1982	1998		1970–82	1983–98	1970–98
Nominal GDP and GDP growth per annum ($bn)	0.42	0.95	4.45		1.52	19.1	17.2
Real GDP (1970$) ($bn)	0.42	0.78	2.25	GDP growth	3.2	5.9	5.1
				GNP growth	*–4.8*	*6.4*	*2.1*
Population (mn)	0.73	0.92	1.10		2.2	1.1	1.4
GNP/capita (nominal)($000)	0.57	1.03	4.05	real growth	–6.3	5.4	2.0
Agriculture as % of GDP	26.1	15.7	8.8	real growth	–1.3	–0.6	–0.7
Manufacturing as % of GDP	12.0	20.1	25.2	real growth	4.5	7.4	6.0
Other industry as % of GDP	8.1	9.0	9.9	real growth	1.1	1.2	1.5
Services as % of GDP	53.8	55.2	57.9		4.5	6.6	5.8

Source: Annual Reports 1975, 1984, 1999 (Bank of Mauritius); *Country Economic Reports* (World Bank); *Global Development Finance Reports* (World Bank) 1998, 1999; and *World Development Indicators* (World Bank) 1998 and 1999.

Table 2.2: Mauritian economic performance and change 1970–98 (US$bn and %)

Economic parameters	1970	1982	1998e	Period – averages for 1970–82	1983–98	1970–98
Investment as a % of GDP	22.4%	24.0%	28.5%	21.1%	28.5	24.0%
Savings as a % of GDP	24.1%	21.5%	24.0%	19.3%	23.6%	21.0%
Inflation (CPI)	4.2%	14.5%	7.1%	11.0%	7.2%	9.0%
Overall budget deficit	–2.5%	–8.1%	–1.0%	–2.5%	–3.5%	–2.9%
Exports as % of GDP	54.2%	53.5%	59.6%	53.8%	57.6%	55.2%
Imports as % of GDP	55.6%	57.3%	65.4%	56.1%	61.8%	58.7%
Current account balance/GDP	2.0%	–5.8%	–2.6%	–3.1%	–3.4%	–3.2%
External debt	5.0%	69.1%	55.5%	30.3%	58.3%	46.5%
Average annual real growth rates						
Exports ($bn)	0.32	0.49	2.65	3.9%	7.7%	5.3%
Imports ($bn)	0.37	0.54	2.91	–2.1%	8.5%	6.1%
Government consumption				3.4%	6.6%	5.0%
Investment				–5.2%	8.0%	4.0%

Source: As for Table 2.1.

A turning point in the economic history of Mauritius was precipitated by an exogenous factor. In 1960, cyclone Carol devastated the island. This prompted the colonial authorities to set up a commission headed by Professor Meade[2] to report on the economic and social structure of Mauritius. The Meade report was to influence the island's economic and social policies during the 1970s. Meade stressed the need to control demographic expansion, which posed the greatest threat to economic development. Among the key recommendations was the need to diversify the economy away from sugar and to industrialise as fast as possible. However, he also 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 in manufacturing outside the sugar industry

Therefore, the initial obstacles to transformation Mauritius faced were not only economic, but also psychological and sociological. The most urgent tasks in the early-1960s were to: attract capital, diversify the economy away from sugar to other employment generating sectors and to dampen demographic growth. To address the last problem, family planning and emigration (to Brazil and British Guyana!) were

recommended by Professor Meade. In order to relieve unemployment, a policy of wage restraint was advocated to reflect the abundance of labour and to attract foreign investors (in common with 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 had been free and universal since 1915. In 1965, the number enrolled in primary school as a percentage of the age group (5–11) was 101 per cent and 26 per cent for secondary school

A choice had to be made on the strategy to follow to bring about economic diversification. Either market forces alone could be left to create the right conditions for capital from sugar to move 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 new class of entrepreneurs with no connection to the sugar sector. Racial heterogeneity and more than a century of specialisation in one crop would limit and 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 outflows of over 15 million Mauritian rupees (MRs) in 1963 and MRs12m in 1964. Moreover, the market economy, such as it was, was entirely dominated by the smallest but richest ethnic group of sugar-baron landowners.

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

Post-independence economic development

An overview of the economy

The remarkable performance of the Mauritian economy in the 1980s was due mainly to a set of policies that restructured the economy and provided the necessary stimulus to investment and savings. Growth was not smooth. Mistakes were made, corrective action was taken and policies that went against economic orthodoxy were adopted

under certain circumstances, which fortunately did not create major insurmountable distortions in the short run. Indeed, moving from an alarming situation at independence in 1968 (when there was a nominal per capita income of about US$260, an unemployment rate of around 17 per cent and total dependence on sugar exports), Mauritius underwent major structural transformations over four decades to attain a nominal per capita income in 2008 of $5,250. As early as 1975, the island graduated from the International Development Association (IDA), which provides soft loans to the world's poorest countries.

Up till the late 1980s, the Mauritian growth rate always fluctuated with sugar production, which was itself dependent on the vagaries of the weather. During the 1950s, real growth averaged 2.5 per cent annually, but dropped significantly to 1.3 per cent in the 1960s. In the 1970s, the average annual growth rate was a respectable 5.6 per cent; it remained at around 6 per cent in the 1980s, before falling to around 5 per cent in the 1990s.

Population growth was brought under control through a vigorous programme of family planning, as well as through emigration. Whereas the population was increasing on average of around 3 per cent per year 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. Hence, while Mauritius did come to grips with its demographic problem, a shortage of labour developed as a result. Meanwhile, the issue of an ageing population is looming.

Employment volatility has been a major problem for the island. The rate of unemployment stood at 17 per cent in 1968. After receding to around 6 per cent in the mid-1970s, it shot up again in the wake of the 1979 oil shock, reaching 17 per cent in 1981 and peaking at 22 per cent in 1982. While progress was made, with unemployment falling to less than 3 per cent in 1990, the rate went up again to 10.2 per cent in 2003 as income increased and other low-cost garment producers emerged on the international scene as protectionist barriers were being gradually dismantled.

The island's export performance has 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, averaging 22 per cent per year between 1983 and 1990. Merchandise exports totalled only MRs361.7 million in 1971 when the first export processing zone (EPZ) firms started operating. In 1990 they reached MRs18,246 million, nearly a 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 underwent a major change as manufactured exports, especially textiles, gained in importance.

From independence to 1972, the situation for Mauritius both politically and financially was not a good one. However, then the price of sugar started rising, from 40

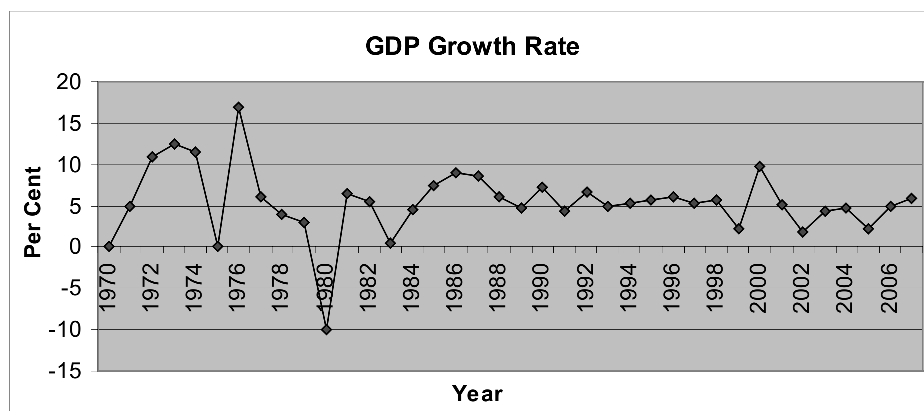

Figure 2.1: GDP growth rate

pounds sterling (£) to £330 per tonne. At the same time, the Mauritian quota under the European Economic Community (EEC) Sugar Protocol increased from 380,000 tonnes to 505,000 at a guaranteed price of £260 per tonne compared to the previous price of £57. The value of sugar exports reached MRs1584.2 million in 1974 from MRs321.6 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 month to 22 months in certain sectors were granted to compensate the 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 (an election year) to 32 per cent in 1978.

A sense of economic euphoria clouded the recession, which had already hit the rest of the world. The Mauritian government launched an ambitious investment programme in infrastructure – for example, a bulk sugar terminal, harbour development, roads and a hydro-electric plant – estimated at MRs7.2 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 Euro market at commercial rates in the belief that the recession would be short-lived. This expansionist policy betrayed a disregard for macroeconomic management, with 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 and the government budget deficit expanded. Workers were laid off (567 in 1976, 3,581 in 1978 and 4,234 in 1980) and the unemployment rate soared.

Thus, even before the second oil shock in 1979, economic conditions in Mauritius had regressed 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: the top income tax rate was 70 per cent, while the company tax rate was 65 per cent. Meanwhile the country's tariff structure 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 IMF special drawing right (SDR) since 1975, did not help to improve the situation. The economic 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. As a result, by the end of the 1970s the catastrophic economic situation brought home once again the need for the country to break away from the tyranny of sugar and engage forcefully in industrialisation and economic diversification.

Stabilisation and adjustment: getting prices right

Owing to the worsening external situation, Mauritius negotiated its first Stand-by 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 curtail consumption and imports. The Mauritian rupee was devalued in October 1979 by about 23 per cent vis-à-vis the SDR and in 1981 by another 20 per cent. In 1980 the country embarked 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 and 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 of the second half of the 1970s. Since March 1983, the rupee has been on a crawling peg, floating downward to maintain the real exchange rate at a competitive level. Further, a policy of wage restraint has been vigorously followed whereby negotiated wage increases have been lower than the inflation rate – except that every five years the salary structure of public servants is reviewed by the Pay Research Bureau, leading to a massive monetary injection.

The island's 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 rationalised 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 monetary and fiscal policies, some institutional reforms were carried out under the SAP and these 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 for the first time more members of the private sector than government representatives on its board of directors, was set up in 1984 to search for new markets to attract investors.

Government, unions and the private sector

The Mauritian government played a key role in institution building, infrastructure development and in creating an environment within which economic agents could function effectively to promote growth. Although this does not imply that all the policies followed were necessarily the correct ones, the government 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 and it negotiated quotas for its textile exports with the US government. The government also provided free primary and secondary education, creating a literate and adaptable labour force, and has invested heavily in physical infrastructure without neglecting social overheads.

During the 1960s and 1970s and inspired by Fabian socialism, the country's Labour government built a welfare state which provided free healthcare and education, cheap housing as well as subsidies on imported staple food (namely 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. However, it also laid a shaky economic foundation, which would have collapsed without the structural adjustment programme (SAP) of 1980.

The government also 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 income distribution is such that savings may be made. However, the major constraint facing a new state is obtaining enough foreign exchange. This can be overcome by either exporting more or by obtaining grants/loans from other countries/institutions. Because 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 over time so as not to handicap investment efforts. The Commonwealth Sugar Agreement guaranteed a favourable price, but was due to expire when the United Kingdom joined the EEC in 1973. So the government had to negotiate stable prices and preferential treatment

by the EEC, which could be achieved by enlisting the support of EEC member countries.

As a result, Mauritian foreign policy took on a dimension of its own. The country adhered to the Non-aligned Movement, to the Organisation of African Unity, as well as to the Organisation Commune Africaine et Malgache (the French equivalent of the Commonwealth), which was to disintegrate 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 not only provided Mauritius with sufficient market openings for its growing textile industry, but also guaranteed a market for 505,000 tonnes of sugar per year under the EEC-ACP Sugar Protocol at a price usually higher than the world price. During the sugar boom of 1974, the guaranteed price was lower than the world price, but Mauritius respected the clauses of the convention in violation of the profit-maximising motive.

A more debatable area of government intervention was in the labour market. The comparative advantage of small, labour-rich countries lies in keeping down labour costs – the only costs that can be effectively controlled domestically – which can be done by outlawing militant trade unions or recognising only pro-government unions, as was done in some countries of the Far East. In Mauritius this course of action was not possible because of the country's strong trade union tradition and because of its democratic system. Instead, a quite repressive law (the Industrial Relations Act [IRA]) was passed in 1973, which effectively made all strikes illegal.

At the same time, different institutions were set up to prevent industrial relations from becoming explosive. Tripartite salary negotiations, involving the government, the private sector and trade union federations, have been held regularly since 1977 prior to the budget being presented. After these discussions, compensation for the increase in the cost of living is arrived at and this is applied to both the private and public 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 the power to settle conflicts. The Ministry of Labour also performs a conciliatory role in disputes.

These mechanisms for wage-dispute settlements and collective bargaining have contributed to social stability. There has not been a major strike in Mauritius since 1979. However, government intervention did introduce rigidities in the labour market, especially in the agricultural sector. Similarly, fixing a lower minimum wage for women than for men in manufacturing had negative repercussions, until corrected under the SAP in the early 1980s. More flexible labour regulations were established in the export processing zones, which were then seen as enclaves. Nonetheless, from an economic viewpoint, the system did not satisfy either efficiency or equity

considerations. It was neither dynamic nor flexible enough to reward productivity and scarce skills. Although the system was meant to compensate employees for cost-of-living increases, it was guided by the principle of tapering compensation, with the lowest paid receiving the full increase. This led to a reduction in wage differentials, especially in the public sector, which became more 'bottom weighted'. To redress the situation, the salary structure was 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.

Nonetheless, the tripartite committee with all its imperfections served the useful purpose of consensus building, which has been the cornerstone of the Mauritian success. It provided a critical forum for the major social and economic players to air their views. Of even greater importance was the effectiveness of collaboration between the government and the private sector. It was this collaboration (at times very informal) which led to certain key initiatives being taken, like the EPZs being set up in 1970, the first hotels being built, successful negotiations on the Sugar Protocol, the creation of a national airline, the establishment of a stock exchange and a freeport, investment in Mozambique and the implementation of a value-added tax. The public-private partnership in Mauritius overall had a positive influence. How did it happen?

Partnership between the public and private sectors

The private sector in Mauritius has always been well organised. Institutions like the Chamber of Commerce and Industry, and the Chamber of Agriculture were set up in the 19th century 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 colonial authorities. Their racial homogeneity surely played an important part in the strength of these 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. At independence, the private sector therefore created the post of joint co-ordinator, and appointed someone who had been a minister before independence to provide an 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 conflicts.

While there was still a good deal of mistrust between the private sector and the civil service in the 1970s, the relationship improved in the 1980s as private-sector representatives were appointed as members and chairs of various boards of administration of parastatal bodies. These much-maligned institutions helped to bridge the communications gap between civil servants and business. Nonetheless, 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. The single most important measure to kick-start the economy in 1984 was the drastic reduction in the top marginal rates of income and corporation tax from 65/70 per cent to 35 per cent. This was a powerful signal on the part of government; the private sector responded positively with economic results that led to Mauritius being touted as another East Asian economic miracle.

Indeed, 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 completely exogenous factors, and the economic evolution of Mauritius has certainly benefited from a fair dose of externalities (as described above). The interesting question is why Mauritius is one of the rare ACP countries to have succeeded, when all were exposed to the same exogenous factors viz. oil price hikes, world recession in the early 1970s and 1980s, the Sugar Protocol, the Lomé Convention and 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, and the EPZ, which started at a time when there was little competition yet a great deal of protectionism. No major cyclone hit Mauritius in the 1980s when the economy was booming. Nonetheless, Mauritius was also unlucky when unfavourable weather conditions in 1979 and 1980 hit and threatened to derail the first structural adjustment programme. Luck also comes to those who are prepared, to the practitioner who acts on 'gut feelings' ('animal spirits' in Keynesian terminology), to those who can identify and seize opportunities.

In Mauritius, exogenous shocks have been a major catalyst for change, as with cyclone Carol in 1960, the fall in sugar prices at independence, the oil shocks and the dismantling of protectionist barriers. Yet Mauritius was able to respond to these challenges by taking new directions: setting up the EPZ in 1970, adopting painful structural adjustment programmes between 1979 and 1983, going for industrial modernisation, capital markets and skills development and export of services. Implementation, though not always in the most efficient and effective manner, was facilitated by the creation of support institutions in key sectors.

Thus, the National Computer Board (NCB) was established in 1989 as ICT came to be seen as a key sector for the future. Since skills shortages were anticipated to be a major constraint, the Industrial and Vocational Training Board was also set up in the same year. As the end of the Multi-Fiber Arrangement (MFA, also known as the Multi-Fiber Agreement) was heralded at the beginning of the 1990s, the Export Processing Zones Development Authority (EPZDA) was set up in 1992 to assist competitiveness of exports enterprises by improving productivity and quality. While offshore banks had been encouraged since the mid-1980s, there was no institutional support until the Mauritius Offshore Business Activities Authority (MOBAA) was established in 1992 together with the Mauritius Freeport Authority (MFA), whose mission was to

develop Mauritius as a transhipment centre in that part of the Indian Ocean. As the international trading environment changed under the aegis of the World Trade Organization (WTO), these institutional initiatives were streamlined. Thus, the investment portfolio of the MEDIA and the MFA were transferred to the Board of Investment housed in the Ministry of Finance, and the MEDIA and the EPZDA were merged to form Enterprise Mauritius in 2005.

Furthermore, since the development of the ICT sector depended on telecommunications, a Telecommunications Advisory Council was set up in 1994 to work on a telecommunications bill, which would make the sector more competitive, bringing down connection costs. The bill eventually became an Act in 1998. Mauritius set itself the target of becoming a 'cyber island', and the regulatory body, the ICT Authority, was set up in 2001.

Economy in the new Millennium

During different periods, the engines of growth of the Mauritian economy had been: sugar, textiles, to a lesser extent tourism and offshore financial services. However, by 2000 they were showing signs of running out of steam. While sugar's contribution to the national economy in terms of both job creation and value added had been declining since the 1980s, garment manufacturing also went through a downturn. The key challenge confronting Mauritius at the end of the last decade was the same one it confronted at independence and in 1980: namely, how to reduce the level of unemployment, which had been increasing steadily and stood at 10.2 per cent in 2003.

Macroeconomic indicators

An analysis of table 2.3 reveals: (i) that Mauritius enjoyed a growth rate averaging 4–5 per cent per annum; (ii) the inflation rate was under control, but steadily rising after 2004; and (iii) per capita income and (iv) total exports had been steadily increasing. On the downside, the budget deficit as percentage of GDP (around 6 per cent) was quite high and this, if not corrected, could lead to a dire financial situation, compounded by the high and growing level of public debt.

The success of the Mauritian economy, as described above, was largely dependent on preferential treatment in the main export markets for sugar and textiles. Mauritius was beneficiary of several trade preference schemes from its key trading partners, namely the EU (the Cotonou Agreement, formerly the Lomé Convention) and the United States (the African Growth and Opportunity Act [AGOA] – Wearing and Apparel Provision).[3]

According to the IMF, Mauritius was one of the economies most vulnerable to a fall in export revenues following the phasing out of preferential trade arrangements. The IMF study calculated the percentage fall in export revenues for Mauritius under three

Table 2.3: Selected economic indicators 1990, 2000–2007

Economy	Period	Unit	1990	2000	2001	2002	2003	2004	2005	2006	2007
Yearly											
GDP (market prices)	Year	MRs bn	39.4	120.3	132.1	142.5	157.4	175.6	185.3	206.3	235.5
	US$ bn	2.6	4.6	4.5	4.8	5.5	6.3	6.3	6.6	7.5	
GDP deflator (basic prices)	Year	%	+6.9	+2.1	+6.2	+4.8	+5.0	+5.7	+4.0	+6.8	+7.9
GNI per capita (market prices)	Year	MRs 000	36.9	100.7	110.4	118.0	128.0	142.0	148.9	166.0	192.8
	US$ 000	2.48	3.83	3.80	3.94	4.51	5.12	5.10	5.31	6.15	
Growth of household consumption	Year	%	+5.0	+3.7	+3.2	+3.3	+5.1	+7.8	+7.3	+5.9	+4.5
Savings rate	Year	%	25.3	26.3	28.4	27.4	25.1	22.6	17.4	17.1	21.3
Net international reserves	As at end of June	MRs bn	10.8	25.2	31.8	40.6	50.2	54.7	65.8	64.7	83.5
Net international reserves (weeks of import coverage)	As at end of June	No.	25.5	23.8	29.6	37.3	40.3	37.4	36.7	31.0	36.7
Investment rate	Year	%	30.6	22.9	22.7	21.8	22.6	21.6	21.4	24.3	25.1
Growth of investment **(GDFCF)**	Year	%	+23.3	–8.3	+4.7	–0.1	+10.3	+2.2	–1.9	+19.0	+8.6
Private investment as a % of total investment	Year	%	62.7	72.0	68.9	68.5	61.0	69.3	70.4	68.3	78.2
Foreign direct investment (FDI)	Year	MRs mn	609	7,265	936	979	1,966	1,796	2,807	7,222	11,514
Direct investment abroad	Year	MRs mn	8	333	83	278	1,156	970	1,942	1,134	1,826
Trade											
Growth of merchandise exports	Year	%	n.a	+2.7	+13.2	–11.5	–5.9	–3.5	+8.9	+10.1	–10.6

Growth of merchandise imports	Year	%	n.a	–5.6	+0.6	–2.9	–4.3	+3.9	+5.5	+11.1	–1.1
Terms of trade	Year	%	+98.0	+96.0	+90.0	+94.0	+97.0	+97.0	+88.0	+83.2	+82.7
Total exports of merchandise goods (f.o.b)	Year	MRs bn	17.9	45.7	54.8	54.0	53.0	54.9	63.2	74.0	69.7
Total imports of merchandise goods (f.o.b)	Year	MRs bn	21.8	54.4	59.0	60.2	61.4	70.9	86.7	108.6	113.7
Openness of the economy	Year	%	1.1	0.8	0.8	0.8	0.8	0.7	0.8	0.9	0.8
Growth of service exports (f.o.b)	Year	%	n.a	+6.3	+19.4	–13.0	–0.7	+4.3	+13.0	+4.6	+23.0
Growth of service imports	Year	%	n.a	+8.8	+9.4	–4.2	–0.1	+0.1	+8.4	+5.1	+8.7
Merchandise exports as a % of total exports	Year	%	70.7	55.4	52.5	61.2	59.7	57.9	57.0	58.2	50.4
Merchandise imports as a % of total imports	Year	%	76.6	73.0	71.4	71.7	70.8	71.6	71.0	72.2	70.2
Current account balance	Year	MRs bn	–1.8	–0.9	8.0	7.5	2.7	–3.2	–9.6	–19.6	–12.5
Current account balance as a % of GDP	Year	%	–4.5	–0.7	6.1	5.2	1.7	–1.8	–5.2	–9.5	–5.3
Overall balance of payments	Fiscal year	MRs bn	3.0	2.1	5.1	5.9	9.1	3.2	–3.1	–3.0	+6.6
Tourism											
Growth of 'hotels and restaurants' sector	Year	%	+11.0	+12.2	+1.2	+3.1	+3.0	+2.4	+5.6	+3.5	+14.0
Tourist arrivals increase over previous year		%	+10.9	+13.6	+0.6	+3.2	+3.0	+2.4	+5.9	+3.6	+15.1
Gross earnings per tourist	Year	MRs	12,451	21,683	27,511	26,888	27,656	32,618	33,774	40,521	44,860
Room occupancy rate (total)	Year	%	62	70	66	67	63	63	63	66	76

Agro-industry											
Growth of 'sugar' sector	Year	%	+11.9	+64.5	+9.9	−25.0	+3.7	+10.6	−9.2	−2.9	−13.6
Production of main commodities											
Sugar	Year	Metric tonnes	624,302	569,289	645,597	520,887	537,155	572,316	519,816	504,857	435,972
Sugar cane	Year	Metric tonnes	5,548,291	5,109,521	5,792,325	4,873,897	5,199,384	5,280,370	4,984,058	4,748,973	4,235,849
Tea	Year	Metric tonnes	29,868	6,440	7,440	6,870	6,973	7,229	6,798	7,649	8,027
Tobacco	Crop year ending March	Metric tonnes	799	563	556	477	426	357	296	298	327
Foodcrops	Year	Metric tonnes	65,840	114,484	129,119	103,876	103,455	111,633	96,782	106,902	99,130
Fish	Year	Metric tonnes	13,222	7,842	8,794	9,314	9,449	9,430	8,982	8,885	5,987
Export-oriented enterprises (EOE)											
Growth of EPZ/EOE	Year	%	+7.0	+6.0	+4.4	−6.0	−6.0	−6.8	−12.3	+4.6	+8.0
No. of enterprises	end of year	No.	568	518	522	506	506	501	506	434	404
Employment	end of year	No.	89,906	90,682	87,607	87,204	77,623	68,022	66,931	64,962	67,314
Investment	Year	Rs Mn	690	1,702	1,758	1,468	1,418	2,508	2,376	2,245	4,301
EPZ/EOE exports	Year	Rs bn	11.5	31.0	33.7	32.7	31.4	32.0	29.0	33.6	37.8
EPZ/EOE exports as a % of total exports of merchandise goods	Year	%	63.4	75.7	70.9	60.5	59.3	58.4	45.8	45.4	54.3

Source: CSO, Mauritius

different assumptions for export supply elasticities (e). These are summarised in table 2.4, below.

Table 2.4: Percentage loss in total export revenues

Elasticity	e=0	e=1.0	e=1.5
Mauritius	–11.5%	–19.6%	–23.7%
Mean for middle-income developing countries	–1.6%	–2.9%	–3.6%

e = elasticity of export supply

Source: IMF (2004) The Impact of Preference Erosion on Middle-Income Developing Countries. Working Paper, September 2004.

By the beginning of this millennium it became clear that Mauritius could not continue on its old trajectory, which had relied on preferential access to markets for just a few products. Diversification of the economy, which had been touted since Meade's days, had to be pursued vigorously if Mauritius was to maintain living standards.

Key lessons

As Mauritius engages on a new phase of structural transformation, key elements that facilitated its first transformation are just as relevant today.

Pursuit of an outward-looking strategy

Since it became independent, Mauritius's success depended on its adoption of an outward-looking strategy. The Export Processing Zones Act was passed in 1970, two years after independence. Unlike EPZs in other countries, the Mauritius EPZ did not refer to a specific geographical area. It was instead a legal entity that 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 and flexible labour regulations.

The essential element, however, is not the legislation, but rather the attitude of welcome. Foreign direct investment (FDI) was actively encouraged and sought out, and there was a consensus among the population as a whole that FDI was in the interests of the country. For instance, Mauritian nationality was 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. The resulting surge of investment from Hong Kong formed the basis of the remarkable growth of the textile and clothing sector in the 1980s.

Moreover, if there is no consensus on the need to promote export-oriented policies, if there is no involvement by local entrepreneurs,[4] any outward-looking strategy is doomed to failure. An important feature during the early phases of industrialisation

is the presence of local entrepreneurs. Foreign firms brought in new technology and an element of competition necessary to induce efficient production and enhance quality. However, if the EPZ had been grafted onto an economy not yet ready to receive it because of lack of infrastructure or preparation of the labour force, then it would probably have been rejected by the system.

Emphasis on good governance

The state played different roles in different phases of Mauritius's transformation: as initiator, promoter, protector and arbiter. Yet it was a developmental state, a state committed to development of the country and not to sectarian interests. The rule of law prevails in Mauritius. Political leaders generally respect the country's key institutions and ensure social stability. For example, political vision was demonstrated when Mauritius joined the Organisation Commune Africaine et Malgache (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 country's 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 island's close public-private sector collaboration also forms part of good governance as it shows willingness on the part of political leaders to engage in dialogue and a sense of responsibility on the part of captains of industry to participate constructively in the process of policy-making. However, a precondition for such effective dialogue is the existence of a structured private sector. One of the advantages of a small economy is in the area of communications: policies changes can be explained quickly and turnarounds are short.

Importance attached to social stability

An unquantifiable outcome of public-private collaboration has been the social stability that ensued as the fruits of economic growth trickled down to the population. Social stability has been and still is a major factor for attracting FDI and tourism to Mauritius. Although this was arguably achieved at the expense of optimal economic policies, the premium on social peace is high in a multiethnic society. However, care has to be taken to prevent temporary concessions from becoming permanent distortions. For, without economic progress, without perceptible continuous improvement in the standard of living, the social fabric can be easily torn. In the final analysis, moreover, only productive employment creation can guarantee long-term social peace.

Maintenance of political stability

An important factor in the sustained growth of the Mauritian economy has been political stability. Although the political landscape has experienced episodic

turbulence, such stability has manifested in the broadly shared beliefs of the political class and consensual adherence to an economic strategy of outward orientation, market-driven development and the rejection of nationalisation and inward-looking policies. That is, there has been continuity in broad objectives.

Thus, although a Labour government had started implementing policies underlying the structural adjustment loan (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. The fact that the Mauritian Militant Movement (MMM) had been closely associated with the labour movement made it easier for government to influence trade unions and impress upon the latter the urgency to take strict steps to redress the economy. Finally, the MMM, which for years had been clamouring for nationalisation of some sugar estates and for self-reliant development, began to espouse the existing development strategy and reassured political opponents that its objective was no longer social revolution, but economic growth, readjustment and tight financial management of the country's affairs.

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.

Emphasis on macroeconomic stability

An appropriate meso-micro incentive structure, consistent with macroeconomic objectives of stability, prudence and balance, is also crucial. 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 to finance long-term infrastructure development projects). The fiscal and exchange rate reforms undertaken in the context of the SAPs ensured more efficient fiscal governance (the overall budget deficit as a percentage 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.

Emphasis on human resource development

The design and implementation of a given economic strategy requires competent cadres and a productive labour force. Another precondition then is to have a literate

and adaptable work force, as well as an efficient administrative system that is development oriented and not bent on enlarging its bureaucratic precinct.

Since its human resources are Mauritius's only real natural asset, human capital development was considered crucial to sustainable growth, as well as to equitable distribution of income. Although the private sector contributed significantly to education, standards varied across secondary schools. Primary education was free and almost entirely public even before independence. However, free secondary schooling was granted from 1976 only, this as a result of the Labour government'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. Heavy investment in human capital formation provided the semi-literate labour force that was necessary for the initial phase of industrialisation.

Adequate infrastructure

Without investment in physical infrastructure (roads, the harbour, electricity, telecommunications and so on), transformation would not have been possible. Although mistakes were made in the late-1970s with respect to the mobilisation of expensive commercial funds for long-term infrastructure development, there is no doubt that the investments facilitated economic success in the 1980s. Thus, a potential economic disaster was averted, because borrowed funds were used for development projects and were not siphoned off. This is another good point for governance – the objectives were the right ones, even though the economic means were not appropriate. It may also be argued that the government did not have much choice, as official development assistance flows had dried up and investment was needed for future growth. In this respect, 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

Labour markets should function properly, such that conflict 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 may smooth relations between employers and employees and promote a productive work environment. The imperfections in the labour market in Mauritius did not prevent growth from taking place, because there was a consensus on the broad economic strategy and nobody wanted to return to a situation of high unemployment. If that tacit social contract had not been in place, market imperfections could have been a major obstacle.

Collaboration with donors

Compared to many other countries, Mauritius utilised foreign aid assistance from donor countries and multilateral institutions relatively well, thanks to the combination of factors mentioned above. Still, it is important to highlight the importance of technical assistance provided by UN agencies, the Commonwealth Secretariat and the European Union, amongst others. Many of these programmes were implemented successfully because there were consultations with local stakeholders in the conception and design stages. Without such technical assistance (often provided on a grant basis) it is doubtful whether Mauritius, with its limited human resource base, could have progressed so quickly. The flexible attitude of foreign institutions also helped, 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'.[5] Mauritius was perhaps lucky to be faced with interlocutors who believed in local ownership of development programmes and not in universal blueprints!

New challenges

The modern economic history of Mauritius reveals that small states reach turning points very quickly as international conditions change. Success usually translates in higher standards of living, but with accompanying increases in production costs. Thus, by the year 2000, Mauritius found itself again at a crossroads with the challenge of finding the right development path to attain the same objectives as in the 1970s, namely to attract FDI, and to diversify its economic base. However, the context had changed. Internally, the shortage of labour as well as of skills led to an increase in labour costs. Therefore, the major comparative advantage of Mauritius, upon which its early industrialisation had been based, no longer acted as a pull for foreign direct investment. In fact, it was not so much the costs as the unavailability of labour itself that served as a brake.

Mauritius had to re-think its industrial strategy, and the products it wished to sell to the world. Externally, the international scene, with the advent of new low-cost labour-rich garment producers, the World Trade Organization and globalisation, and the dispersion of foreign assistance with the opening up of Eastern Europe, created a situation of heightened uncertainty.

The response of the Mauritian government in the early 1990s was to push for a CMD strategy: 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 was still going through a phase of restructuring, but it consolidated itself through modernisation and increased productivity and quality. These measures were still not sufficient to prevent the closure of many garment enterprises in the period 2000–2005. The industrial structure still

lacked depth, essentially because the approach to industry had been concentrated on building pillars instead of searching for clusters and for linkages between sectors. Within the garments sector, four products dominated the industry, namely pullovers, T-shirts, shirts and pants. Similarly, tourism was Eurocentric, as the bulk of tourists to the island mainly came from France and Britain.

However, Mauritius's attempts at diversification were not totally successful, mainly because of a lack of skills, a mismatch between the output of the education system and the needs of the country, an absence of critical mass, and a reluctance to break with the old paradigm, which had brought relative success to the island in the past.

A 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 preserving past gains. Decisions that face Mauritius in this new phase of transformation relate to the reform of the education and training system, public sector reform, competitiveness and productivity enhancement, an integrated economic system, a flexible labour market, the development of an export-oriented service sector (not only financial services), and a strategy of regional integration (expansion through strategic alliances) as opposed to simple de-localisation.

More specifically, at the beginning of the new millennium it was clear that the priority areas of focus had to be: the role of government; human capital; macroeconomic reform; and regional co-operation.

The role of government

With the new millennium, the Mauritian government's role was evolving more towards that of a regulator, an arbitrator and a facilitator. Given the lack of critical mass, it might still have to be a catalyst in some sectors. Nonetheless, the public sector would have to put in place the proper legal and regulatory framework for the private sector to operate. The emphasis would have to be less on control, more on creating a business-friendly environment, less bureaucracy and more efficient delivery of services. The civil service would have to be streamlined and overhauled to acquire this new mindset as facilitator. It is a politically difficult and sensitive issue, but one that is fundamental to future growth. It is extremely important that the public service attracts and retains the best brains to identify potential bottlenecks fast and take remedial action.

At the same time, there should be a move towards decentralisation. A re-engineering of the parastatal sector is required, such that efficiency criteria prevail over political expediency. In practice, this could amount to a Herculean task in such a small and interconnected country. This is a challenge to the ingenuity of Mauritian politicians and policy-makers, as the social implications of inaction are far reaching.

Human capital

At the time of writing, the reform of the education and training system was under way, following almost a decade's delay. The outcome of this reform will be felt only after another decade or so. In the meantime, there is a need to obtain skilled staff, so a policy for the import of highly skilled human resources will have to be elaborated upon.

Microeconomic reform

While macroeconomic stability is necessary to create the conditions and environment for growth, microeconomic reform has to be addressed once the fundamentals are in place. Production is carried out at the level of the firm, and measures must be taken to increase productivity and efficiency. Structural adjustment helped 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 country's competitiveness. Key points on the agenda should be:

- **Anti-monopoly regulations**. A major handicap to being small is the absence of critical mass and the concentration of wealth. This creates a situation where monopolies and cartels develop rapidly, where invisible barriers to entry are erected by the links that exist among players in manufacturing and finance. A thorough reform of the financial sector is needed. The best prescription to fight monopolistic behaviour is to open up to global service providers; this will also enable faster transfer of technologies and will upgrade local skills.
- **Labour market reforms**. The mechanisms for wage fixing, cost-of-living compensation and salary restructuring must be reviewed to make the labour market more flexible and open, to encourage mobility of labour to efficient sectors. These reforms, which could not be carried out in 1982–83 when there was an unemployment rate verging on 17–20 per cent, should be set in motion.
- **Social services and ability to pay**. Food and housing subsidies used to be justified as circulating capital at a time when the majority of the population lived in poverty. With increases in the standard of living, pockets of poverty can be identified more easily. It makes more sense in terms of both equity and efficiency to provide social services on the basis of 'ability to pay', with subsidies provided on the basis of need. 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 if they are to progress economically. The Lomé Convention is a vivid example. If Mauritius did not have access to a guaranteed market, it would probably not have fared so well,

despite implementing the right policies. Small countries that find themselves in direct competition with labour-rich countries may find it difficult to sustain growth if they cannot depend on secure markets. Such markets may be geographically regional. However, if a country finds itself in a crawling growth region (although this is not the case in the Association of South East Asian Nations [ASEAN]) then the limits to its own growth will be reached rapidly. Regional co-operation by itself will not help small countries, but it is a sure way of expanding markets – provided there is regional integration. In the case of Mauritius, there is need for a planned delocalisation (outward investment).

As at end 2004, when the *Competitiveness Foresight* was completed, Mauritius was signatory of four regional groupings, namely the Common Market for Eastern and Southern Africa (COMESA), the Southern African Development Community (SADC), the Indian Ocean Commission (IOC) and the Indian Ocean Rim Association for Regional Cooperation (IOR-ARC).

The main objective of engaging in these groups is to enhance co-operation among member states on the economic front and on trade relationships. Members also try to make maximum use of the natural resources of other member countries by investing in the opportunities for extraction and downstream processing (value-addition) offered by them.

Under the COMESA, Mauritius enjoys tariff-free trade with eight other African countries and reduced-tariff trade with 11 others. The COMESA comprises 20 member states of Eastern and Southern Africa, with a total population of about 385 million. The member states are: Angola, Burundi, Comoros, Democratic Republic of Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Libya, Madagascar, Malawi, Mauritius, Namibia, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia and Zimbabwe.

Mauritius adheres to seven SADC protocols, including a trade protocol. The latter has been operational since 1 September 2000 and paves the way for a phasing out of a minimum of 85 per cent of tariffs within eight years, and all tariffs by 2012. It is expected that a free-trade area will be created by 2012. SADC was established in August 1995 with a view to enhancing the standard and the quality of life for people and to making the maximum use of natural resources of its member countries. SADC has 14 member states, namely Angola, Botswana, Democratic Republic of Congo, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe.

The Indian Ocean Commission comprises Madagascar, Seychelles, Comoros, Reunion and Mauritius. The objective of the IOC is to enhance co-operation among member states, mainly in the diplomatic, economic, cultural and scientific fields. Among other achievements, customs duties have been removed reciprocally in Madagascar and Mauritius on originating goods.

Mauritius also forms part of the Indian Ocean Rim Association for Regional Cooperation. Established in 1997, this association's objective is to establish a regional

framework for improving trade relationships among member countries. There are 18 members, with a total population of over 1,595 million: Australia, Bangladesh, India, Indonesia, Iran, Kenya, Madagascar, Malaysia, Mauritius, Mozambique, Oman, Singapore, South Africa, Sri Lanka, Tanzania, Thailand, United Arab Emirates and Yemen, with Egypt, Japan, China, the UK and France as dialogue partners and the Indian Ocean Tourism Organization as observer.

A new way forward?

By 2000, the Mauritian economy was showing signs of approaching distress: growth was slowing, unemployment was growing, there was a widening fiscal deficit, increasing internal and external public indebtedness, growing bureaucratic inefficiencies, relatively uncompetitive domestic private enterprises and an increasing welfare cost burden. All these factors pointed to the clear unsustainability of the strategic trajectory that was dependent on the four pillars of sugar, the garment industry, tourism and financial services.

Exacerbating the domestic situation was the fast evolving international context, with new rules and new players coming onto the scene: the end of quotas and preferences, a trading regime increasingly ruled by WTO and intense competition in traditional sectors from other low-cost economies (i.e. large ones like China and India, with their own massive domestic markets to sustain their industries, as well as smaller but competitive ones, like Bangladesh, Sri Lanka and Vietnam). External factors also included the failure of regionalism to provide Mauritius with growth options (although it may provide options for Mauritian firms to invest elsewhere regionally), increasing globalisation of the world economy, especially of world finance and world trade, and the growth of business process outsourcing (BPO) made possible by rapid changes in information and communication technology (ICT) as a new phenomenon in the global reorganisation and redistribution of economic activity.

Given the above, the questions that arose were:

- Has the response of Mauritius to globalisation been inadequate, as it tried to adhere to its strategy of relying on protected markets (sugar and garment production) to grow?
- How does Mauritius cope with the new situation? What options does it have? Does it really have an alternative to complete openness? and
- Is the future in services, rather than in manufacturing or agro-industry?

It was clear that some new directions had to be worked out if national living standards were to continue to be improved.

These were the questions that the Mauritian stakeholders debated at the 'Competitiveness Foresight' exercise organised by the National Productivity and Competitiveness Council in September 2004,[6] the main issues of which are summarised here.

The format consisted of round-table discussions bringing together a small group of key practitioners in their respective fields (industry, agriculture, the public sector, services, the trade unions, civil society and politics) to participate and contribute to disciplined, sharply focused brainstorming and deliberation with the assistance of an independent facilitator with a thorough knowledge of Mauritius (Mr P Mistry). It was felt that this was the best approach to ensure ownership of the ideas and improve the chances of successful implementation. There was only one question:

> **With Mauritius's future as a sugar producer looking bleak, powerful competitive pressures being placed on textiles and garments exports, the OECD placing limits on financial sector competition and finite limits on high-value tourism, what should the island's strategy for growth and development be for the next 10 years and beyond?**

The stark choice facing Mauritius was either to continue with the economic agenda that had been put in place under the structural adjustment programme, or to choose a new economic trajectory that would lead to an average growth rate of 7 to 8 per cent per annum.

To achieve continued increases in income and standards of living commensurate with Mauritius's achievements since 1982, and in order to assure the future political and social sustainability of the island's unique heritage of inter-racial harmony and its model of social justice, the consensus was that Mauritius needs to be a competitive, market-based economy that should aim for at least 7–8 per cent growth per annum. Without such a level of growth, Mauritius will find it increasingly difficult to deliver on its commitment to social justice and equity. Growth without equity is politically and socially unsustainable, if the benefits of growth are captured only by the business elite. Equally, Mauritius cannot have equity and social justice without a high level of growth, for the simple reason that the budgetary costs of delivering equity and social justice become unaffordable. The kind of welfare state that the broad majority of Mauritians want is sustainable only with a real growth of 7–8 per cent or more per annum. Table 2.5 sums up the number of years Mauritians need to wait under different growth scenarios.

If it continues to grow at an average of 4 to 5 per cent per year, the GDP per head would take 16 years to double. The country cannot adopt the approaches of previous decades. These, as described above, consisted broadly of the following. In the years 1968–80, autarchic development based on notions of self-sufficiency within a closed economy was the major orientation. This clearly did not work, because it led to virtual economic collapse and to the intervention of the IMF and World Bank to

Table 2.5: GDP per capita under different scenarios of economic growth

Average annual growth rate (%)	3	4	5	6	7	8
Year where 2003 GDP per capita doubles (given population growth of 1% per annum)	2039	2027	2021	2018	2015	2014

help Mauritius achieve fundamental structural change. Then in 1981–1996, the country was quite successful (more so than Africa and South Asia, but less so than East Asia) with an approach of partial openness practiced on an asymmetric, non-reciprocal, selective basis (i.e. open on the export side for goods and services, but closed on the import side for factors). However, during those years Mauritius remained 'effectively closed' to foreign investment (except on its own terms) and to foreign investors and entrepreneurs, as well as to most foreign transnational corporations. Now, the island's partially open, asymmetric regime is also running out of steam. So what is left? To go back to being closed, to stick to a partial openness paradigm or to go for more complete openness as a strategy to become and remain competitive in a globalising world?

The Competitiveness Foresight exercise decided that Mauritius must change its direction in order to grow. Its 'competitiveness' in textiles/garments and sugar has been bolstered by quotas that provided preferential access to key export markets. Sugar also benefited from a remunerative price, which came under serious pressure, and the sector's scope for further development was viewed as being quite limited. Nonetheless, the Competitiveness Foresight considered that the island had built up capacity and core competencies in sugar and garments that it might profit from if its firms invested in more competitive locations in the region or even further away. Such action may provide the country with dividend and remittance income from overseas investments.

It does not, however, solve the more fundamental problem that Mauritius, now a relatively high-cost producer, confronts in these sectors: that of sustaining a reasonable growth rate in an increasingly competitive environment and, for sugar in particular, limited scope for further expansion. It cannot hope to remain competitive by making marginal improvements in productivity alone.

Given this scenario, are there other areas of manufacturing or agribusiness (e.g. high-value horticulture) where Mauritius might be more competitive? Possibly. But has the island enough domestic firms with core competencies in these areas? To make risks manageable, it will need to open itself to global firms with the necessary technologies and market connections. Yet Mauritius itself provides too small a market for attracting inward investment in manufacturing or agribusiness. For inward investment to come to the country, it must be globally competitive in those areas of investment for at least the length of the life cycle of the large lumpy investments that need to be made in manufacturing and agribusiness to supply the global market.

With its limited human resource base (where sophistication and expectations tend to outstrip income generating capability), the main option for Mauritius (in a globalising economy that brooks no preferential treatment) seemed to the Competitiveness Foresight to be in services where investment capital needs are lower and 'factors' (people, capital, ideas, networks) are more mobile. Indeed, the island already relies on two pillars of services: offshore finance and tourism. It needs to expand those pillars and to develop new ones. However, if Mauritius's economic interests lie

in newer areas that involve providing the wide range of outsourcing services that globalisation has created a need for, then which of these should it focus on? Where do its comparative and competitive advantages lie? What are the implications for human capital requirements that provision of such services necessitates? How should Mauritius address these?

It was agreed during the Competitiveness Foresight exercise that the main options for increasing and diversifying sources of export income lie in areas where ICT/BPO is making rapid inroads, as well as in transport services and in potentially new areas of outsourcing such as the provision of global health, education, global media and entertainment services. Mauritius also needs to develop much larger and more sophisticated domestic construction capability to respond to the needs of its own real estate development as the country transforms to accommodate globalisation and also to compete for construction contracts abroad (especially in Africa).

Activity diversification should be accompanied by market diversification. With its historical and cultural Franco-Anglo connections, Mauritius has been too reliant on preferential access to the EU through quotas, taking a market concentration risk that has now materialised. It needs to retain its presence in established EU and US markets through improved competitiveness and productivity. However, it also needs to make efforts to enter the markets of the present and future, i.e. India, China, East Asia, the Middle East and Central Asia. So strategically Mauritius needs to focus its attention on both activity and market diversification, looking to anticipate and accommodate the future rather than succumb to its vicissitudes.

At the same time, it was generally agreed that there is no single big idea (other than the idea of openness) or new sector that will save Mauritius. The world is changing and it is changing in entirely different ways. ICT/BPO is changing the work scene and creating job location shifts and opportunities that Mauritius can either capture or miss out on. The main constraint is neither resources nor financial capital. It is, rather, attitude, along with human, social and institutional capital. Relieving such constraints requires greater openness to human capital, trade and finance.

Another option that was much discussed during the Competitiveness Foresight exercise was that of transforming Mauritius into a 'city state'. The questions that were asked were:

- Is there a niche for another international city state/entrepôt in the Indian Ocean to play a role similar to that of Hong Kong, Singapore and Dubai? These city states are different in many respects, but similar in strategic outlook and the functional services they provide (freedom of movement of people, capital, knowledge and firms, along with low taxation and light-touch regulation of economic activity) to the international community.
- Can Mauritius play a similar role?
- What does it need to do?

- What are the obstacles and transitional problems it will face?

Table 2.6, below, reproduces some comparative indicators for Hong Kong, Singapore, Dubai and Mauritius to show that each state has been able to forge its own development path. However, the other three states have outperformed Mauritius. Why? Should Mauritius therefore aim to be an international city state?

An international city state is defined as 'a highly urbanised environment with exceptional infrastructure for transport and communications, an entrepôt for trade, finance, ideas, people and networks, acting as a regional node that connects its region to the world credibly. It is a corporate state with minimal barriers to entry of human, financial or physical capital. In a word, an international city state is characterised by openness'.

Mauritius has the potential to become a city state. There are, however, constraints linked to the political system and culture. The prevailing mindset is to control, to

Table 2.6 Some comparative indicators for city/island states

Characteristics	Dubai	Hong Kong	Singapore	Mauritius
Land area (sq. km)	3,900	950	620	2,000
Population (million)	1.01	6.82	4.21	1.22
GNI (2002/03, US$ billion)	32.41	168.03	88.10	4.68
GNI per capita (US$)	32,380	27,690	22,190	3,860
GNI growth rate (1990–2003)	10.5%	2.5%	3.2%	5.4%
Price deflator/inflation (1990–2003 av.)	1.1%	1.0%	0.7%	6.2%
Value-added in: agriculture	0.2%	0.0%	0.0%	8.1%
(as % of GDP) industry	39.2%	13.0%	36.0%	31.2%
(2002–03) services	60.8%	87.0%	64.0%	60.7%
Exports of goods & services as % of GDP	74	151	140	61
Imports of goods & services as % of GDP	72	142	138	57
Trade as % of GDP	146	293	278	128
Gross capital formation (% GDP)	45.3	23.1	24.7	22.1
Government revenues (% GDP)	3.5	5.2	26.4	20.3
Budget balance	+1.1	–1.1	+3.5	–5.1
FDI: inwards (US$ billion)	0.11	13.20	6.11	0.31
outwards (US$ billion)	3.23	4.51	4.14	n/a
External debt (US$ billion)	0.00	0.00	0.00	1.80
Phone connections (F+C) per 1000	1,146	1,507	1,258	559
Personal computers per 1000	153	422	622	117
Registered Internet users per 1000	401	435	504	100
Paved roads as % of total roads	99.2%	100.0%	100.0%	96.4%
Aircraft departures (in thousands p.a.)	42	91	72	14
Planned construction investment	35	5	4	n/a

protect, to be inward looking and to be closed to global human capital. Geography also does not favour Mauritius, as it is a 'micro-dot in the Indian Ocean'.

If Mauritius wants to become a successful international city state, it has to become more open by removing all barriers to trade, finance and people. The whole island must become an EPZ – indeed, there should not be barriers internally between firms or industries. Its foreign policy would then have to be geared towards connecting Mauritius much more closely to its geographic neighbours (i.e. South Africa, India and Australia) and to placing emphasis on new markets for its goods and services (i.e. China, East Asia, the Middle East and Central Asia) rather than remaining focused almost exclusively on maintaining its erstwhile colonial ties. Its health, educational and recreational facilities should be world class for two reasons: first, in order to attract human capital of a calibre capable of adding value to its own indigenous human capital base; and second to be competitive in taking advantage of the global BPO opportunities that are already emerging in these two key service sectors.

Engines of future growth

Changing economic trajectory is not an easy task. Consensus has to be developed at the national level on the new destination before all energies can be mobilised to advance in that direction. Re-engineering the national economy entails some pain before the gains can be enjoyed. What are the main obstacles that can prevent consensus building and the required paradigm shift?

The possible constraints on future growth identified by the participants were: (i) the political model of open democracy that is confrontational and divisive, rather than operating in a way that encourages unity and a rapid consensus for resolving and moving forward on key issues of national interest; (ii) the IT, transport and telecommunications infrastructure, which is inadequate for the demands of a broadband society capable of making its living in a global world; (iii) the budgetary deficit that limits room for manoeuvre and constitutes a constraint that will become even more binding unless growth momentum is revived with a change in strategy and direction; (iv) cultural inhibitions on the part of every segment of Mauritian society, which may obstruct greater openness; and finally (v) the absence of a vehicle for implementation.

Instead of the single new idea, there would be several engines of future growth. It was recognised that these engines would be able to produce output only if precise goals are set and a time frame for action agreed upon. There was a need for a roadmap, for a competitiveness strategy. The most important thing was to create a climate in which successful people, as well as flexible enterprises and competitive industries (that do not require a large commitment of up-front capital) from all over the world are attracted to Mauritius. This attraction should rest on 'natural' elements, i.e. the stability and suitability of macroeconomic policies and the overall business and socio-

political climate Mauritius has to offer, rather than rely on 'artificial' measures such as selective incentives in the form of direct or indirect subsidies.

The only real option therefore is to create an 'open systems architecture'-type environment in Mauritius that permits talent, ideas, capital, capacity and people to flow in and flow out without barriers in accordance with trends, technological changes, innovation and developments in global activities and markets. Resort to the previous methodology of attempting to pre-decide and over- determine what is good or bad may no longer work.

The round-table discussions at the 'Competitiveness Foresight' exercise concluded that Mauritius should focus on creating a platform that is conducive to all ideas being put into action, permitting them to succeed or fail on market terms, as long as the risks were being taken by those who could afford them and knew how to manage them. In the brave new world of information technology enabled services (ITES), Mauritian companies simply do not know enough nor are they sufficiently connected to emerging global business process outsourcing (BPO) networks. This is not an area of core competence as yet, rather it is one that will need to be developed. The easiest way to do so is to import that competence by the expedient of openness and a comparative 'platform' advantage.

For Mauritius to 'piggyback' on capturing a small fraction of the rapidly burgeoning global BPO market, it will have to be totally open and welcoming to firms that want to use Mauritius as a platform, without imposing any barriers to their entry, operation or exit. Yet to create the platform, Mauritius has to reconfigure its own 'systems architecture'. In fact, this is what it should concentrate on, rather than trying to come up with a detailed grand plan that again attempts to define specific industries to be attracted and incentives to be provided. There is no place for a pre-deterministic approach in a future of rising uncertainty. One has only to ensure that all the necessary conditions are put together so that opportunities – including those that are unexpected – can be taken best advantage of whenever they arise.

To make that move forward, the mindset that sees government driving development has to be changed. Instead, the role of government should be seen to be facilitating and supporting business, which should be the main engine of development and investment. Among the things that the government in Mauritius will have to do are the following:

- It must reduce its high overhead costs.
- Parastatals have to become efficient and results oriented, or else they should be privatised and subsidies to them removed so as to enforce market discipline.
- There should no longer be space for discretionary application of unnecessary rules and regulations. Mauritius needs to refrain from seeing every event as a special situation, then creating specific regulations, schemes and licences to manage that situation.

- To create the best operating platform for all kinds of businesses (manufacturing and services), Mauritius has to create the best regulatory capacity in each field and market. An open platform for manufacturing should be phased in.
- Mauritius has also to create the capacity and mindset to cope with occasional market failures, because markets will not always work as anticipated in Mauritius. Markets work best when risks are taken and managed. In Mauritius, there is too high a degree of risk aversion on the part of both domestic business and government. Failures are seen as something that should be avoided at all costs, rather than being seen as part and parcel of the process of 'creative destruction' through which markets enforce discipline and encourage optimal outcomes in terms of rewards for competitiveness and efficiency.
- Mauritius has to eliminate the protective nexus/collusive cartel to protect traditional domestic businesses and let them compete with other local businesses and foreign firms on level terms in all areas. Mauritius has to open up its land market and legislate to capture part of benefits of land development to go into a social fund and to create social housing.

The point was also made during the 'Competitiveness Foresight' exercise that local private-sector institutions will also have to restructure to respond to the new global situation. Furthermore, the concept of 'private sector' should not be restricted to local firms, but should also include foreign enterprises.

Such a shift in orientation would cause some internal hardships and the population would have to bear some transition costs. The discussions ended with a series of questions: What will the transition to openness entail? How will it be financed? How will domestic dislocations be taken care of? How will political support be garnered? How will the Mauritian electorate be taken on board, so that there is as a near universal consensus that this change is necessary and positive (i.e. to be embraced rather than resisted)? What future will Mauritius face if this transition is not made – i.e. what are the costs of inaction? The fundamental question was: **Will there be a government willing to undertake such drastic reforms?**

Bold reforms

A new government was voted into power in Mauritius in June 2005. The Minister of Finance, Hon. R Sithanen, started his second budget speech in 2006 with these words:

> **'We have reached the end of an economic cycle. A cycle based on trade preferences that has allowed our country to make significant progress since independence. We have used these trade preferences and also overseas development assistance well. However, the world has changed and we have not adapted. The preferences are now being swept away, but we have not reacted. We have been naïve in believing that these preferences would endure and that we could continue to obtain concessionary finance to sustain our now outdated socio-economic model.'**

He went on to outline the bold reforms that would be undertaken:

> **'... We simply cannot continue on the same path. It is the surest way to economic disaster and social upheaval. And those who will suffer most are the very people we want to protect: the poor, the vulnerable and the unemployed. We must charter a new course. Government is responding with boldness and imagination to create jobs, promote employment and return to high growth. Implementation of this plan will require discipline from all of us for the next two to three years. It is time for the nation to embrace radical change and build a new, open and competitive service platform that is fully integrated into the global economy, like Hong Kong, Singapore and Dubai. Moving in this direction would benefit all Mauritians. [...]This budget ushers in forty major reforms that sweep away a non-functional system which is very complicated, hard to understand and open to abuse and even corruption through excessive discretion. We want to make things simple, transparent and rule based.'**

Mauritius has thus embarked on a new path towards structural transformation. Success will eventually depend on the extent to which the new vision is internalised by the population as a whole and on the ability of the various drivers of the economy (especially the regulators) to create the right environment to lure foreign direct investment. The project to draw up a roadmap for the export of services from Mauritius, undertaken at the request of the government, was aimed at defining the milestones and the steps as seen by potential investors.

The remaining chapters of this book examine in detail four service sectors that appear to hold some potential for Mauritius and which were explored in depth at a series of symposia held in Mauritius in January and April 2008.[7]

Notes

1. In the 1982 general election the previous government lost all seats in the national assembly to the MMM/PSM Coalition, which split in 1983. The 1982 government was elected on a socialist platform, but ended up signing the second structural adjustment programme with the World Bank. Before 1982, the option of an alternative development path based on self-reliance was still thought to be valid. Since the 1982 elections, all parties have adhered to an export-led development strategy. See Cheeroo and Treebhoohun (1986) 'Development Planning in Retrospect' *Journal of Mauritian Studies*, No. 1.
2. Meade, *The Economic and Social Structure of Mauritius*.
3. IMF (2004).
4. In 1991, the share of foreign investment in the EPZ represented 43 per cent; in 2001, it was only 0.8 per cent.
5. Percy Mistry (1997) Mauritius: Quo Vadis?
6. NPCC (2005) *Competitiveness Foresight: what orientations for Mauritius?*
7. http://www.investmauritius.com/symposium/ [accessed 13 November 2008]