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## Importance of the IFS industry in the Mauritian Economy

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### 7.1 Introduction

In 2005 Mauritius' Gross National Product (GNP) was estimated at just over US\$6.25 billion, with per capita income approaching US\$5,300. As table 7.1 shows, its economy is primarily services-based, with government services, distribution, transport, health and education accounting together for the largest proportion. Tourism and financial services exports are significant, but appear to be reaching their potential growth limits requiring Mauritius to move further up the scale of sophisticated value-addition and geographic client (as well as product/service) diversification.

After 38 years of independence, Mauritius has progressively diversified its output and exports away from an overwhelming dependence on sugar. It faced a major economic crisis in 1979-81 when, faced with rapidly rising energy costs and falling sugar prices, its mono-commodity economy came close to collapse. That led to the Government of Mauritius undertaking a major economic adjustment and reform programme aimed at economic and export diversification. However, that period of liberalisation was partial

**Table 7.1** Mauritius Economic Data (Source: *World Bank Development Indicators*, 2006)

	2000	2003	2004
GNI, Atlas method (current US\$)	4.4 bn	5.0 bn	5.7 bn
GNI per capita, Atlas method (current US\$)	3,690.0	4,100.0	4,640.0
GDP (current US\$)	4.4 bn	5.2 bn	6.0 bn
GDP growth (annual %)	4.0	3.1	4.2
Inflation, GDP deflator (annual %)	4.7	6.1	6.0
Agriculture, value added (% of GDP)	5.9	6.1	6.1
Industry, value added (% of GDP)	31.6	30.5	29.7
Services, etc., value added (% of GDP)	62.5	63.4	64.3
Exports of goods and services (% of GDP)	63.3	59.1	55.6
Imports of goods and services (% of GDP)	65.3	57.0	56.2
Gross capital formation (% of GDP)	26.1	22.8	23.9
Revenue, excluding grants (% of GDP)	22.2	21.7	21.8
Cash surplus/deficit (% of GDP)	-1.1	-3.4	-3.2

and asymmetric, focused as it was on freeing restraints and prices influencing the export sector while keeping the domestic economy relatively closed. In the mid-1970s/1980s, Mauritius diversified into garment exports with its export processing zone (EPZ). That was followed by the rapid development of high-value tourism in the 1980s, and financial service exports in the 1990s with the country's offshore financial centre and the development of its IFS industry.

Through successful economic diversification and expansion, Mauritius enjoyed an average growth through the 1990s of around 6 per cent, an unemployment rate of 2–3 per cent and low inflation of 4–6 per cent, with a stable currency. However, since 2000 there has been relentless deterioration in the economy with the growth rate falling to below 4 per cent, the unemployment rate rising to over 10 per cent and inflation climbing to levels of 7–8 per cent, exerting some pressure on the Mauritian rupee. In 2005 Mauritius again faces a situation of stagnation, along with a rapid rise in energy costs reminiscent of the impasse it had arrived at in 1979–81. Falling growth, rising unemployment, rising energy prices, loss of guaranteed price support and EU market protection for sugar and garments, and slowing export income, have all resulted in the fiscal deficit expanding. To avoid political and social dislocations, levels of public consumption and social safety-net support have been maintained only by rapid increases in domestic and external borrowing.

The deteriorating trends affecting the economy are leading to concerns about the future as the country's sugar industry faces phase-out (unless Mauritius invests in ethanol production to become less vulnerable to external energy prices) and its traditional manufacturing industries become uncompetitive due to high labour and transport costs. There is a finite rate at which the Mauritian tourism sector can continue to expand without significantly increasing risks to the island's fragile ecology, although opportunities for attracting long-term 'retirement tourism' are now being explored. Increasingly, Mauritius' future is seen to lie in further exploitation of its marine resources, further expansion and diversification of its IFS industry, as well as exploitation of new service opportunities in the information and communications technology (ICT) space with emphasis on business process outsourcing (BPO) and knowledge process outsourcing (KPO) as well as developing its healthcare and education service exports.

The country now faces a serious strategic challenge. Another round of economic reforms are required urgently to: arrest and reverse the fiscal drain; improve labour and factor productivity; and address the politically sensitive social issues of growing relative poverty and an ageing population, with substantial emigration of qualified professionals. Mauritius needs to overcome continued overt and covert protectionism of its domestic business space, open up its economy symmetrically, attract higher rates of foreign direct investment (FDI), and re-instil a sense of confidence to stop the haemorrhaging of its human capital base to a point of irretrievability. The new government elected in 2005 is attempting to frame an appropriate policy mix for consolidating public finances by trimming back an unaffordable welfare state, creating an enabling environment, opening up the economy, diversifying into other service areas

and enhancing export competitiveness, while creating a wide political consensus among stakeholders on the need for reforms to enhance Mauritius's competitiveness in a global economy without relying on externally guaranteed price supports and protected market access.

## 7.2 The financial services sector

Table 7.2, below, provides summary data gleaned from domestic data sources on value-added.

In the 1990s, financial services (comprising banking, insurance, capital markets, global business and other financial services) grew at an annual average rate of over 8 per cent. In gross value-added, the sector contributed over 13 per cent to GDP in 2000 with the contribution of the IFS industry estimated at about 2 per cent of GDP. However, as with growth in general, growth in financial services has fallen throughout the current decade, with the sector's contribution to total GDP declining to under 10 per cent in 2005.

The demands of enhanced financial regulation and growing business sophistication have necessitated more manpower. The financial services sector has generated more employment while average monthly earnings have increased. Banking and insurance have created the largest number of jobs. However, there was also across the board growth in financial services employment from 2002–05, reflecting an increasing cost base, while the relative value-addition of the sector to the economy has declined and overall employment has increased. The employment trend and regulatory developments may also suggest declining labour productivity in the financial services sector.

**Table 7.2 Value-added in financial services**

<i>Amounts in US\$ million</i>	2002	2003	2004	2005	<i>Total 2002-05</i>
Macro-indicators: GNI at market prices	4,910	5,415	5,723	6,038	
Financial intermediation services: Gross Value-Added	411	469	555	605	2,040
<b>Net Value-Added (NVA)</b>	173	206	255	308	942
<b>IFS industry: Gross Value-Added</b>	45	56	71	85	257
<b>Net Value-Added</b>	28	33	39	43	143
Banking industry: NVA in domestic banks	104	124	163	204	595
NVA in offshore banks	21	25	30	33	109
<b>Other financial services: Net Value-Added</b>	20	24	23	28	95

*Source:* FSC and BoM Annual Reports for 2002-04 and National Accounts (estimates) for 2005.

*Source:* Annual National Economics Data<sup>1</sup>.

**Table 7.3** Financial intermediation: employment and earnings

	2002	2003	2004	2005(E)
Total employment in financial services *	7,347	7,494	8,401	8,856
Average earnings (MRs) *		17,734	20,225	21,478
Category 1 banks (domestic) **	4,353	4,586	4,697	5,371
Category 2 banks (international)**	512	562	588	643
Global business industry ***	510	600	785	950

Sources: \*Central Statistical Office (CSO); \*\* Bank of Mauritius; \*\*\* Estimates based on FSC Sample Surveys.

One indicator of IFS growth is the rate of global business company (GBC) registrations. Other indicators are growth in the assets/liabilities base of international banks and of global business companies. At the end of December 2005, total assets of banks (both domestic and international) rose to US\$14.7 billion, while total deposits were US\$10.1 billion. The number of offshore banks grew from seven in 1996 to 14 in 2002, but diminished sharply to nine in 2005 although their aggregate asset base continued to grow (see table 7.4).

The IFS industry's (GBC licensees and management companies [MCs]) contribution to direct tax is becoming increasingly significant, as shown below. Growth in the IFS industry's contribution to public tax receipts is striking when its contribution to GDP is diminishing. The tax element may also be adding to the diminishing competitiveness of the IFS industry in Mauritius vis-à-vis other international financial centres.

**Table 7.4** Number and assets of international banks

	1996	1998	2002	2005
No. of offshore banks*	7	9	14	9
Aggregate asset base: US\$ million	847	1,022	4,320	7,886

\* including banks conducting international banking under 2004 single licensing regime.

Source: Bank of Mauritius.

**Table 7.5** Contribution to direct tax receipts

	<i>Amount in MRs million</i>	<i>GBCs vs. MCs % contribution</i>	<i>As % of corporate tax</i>
2003	150	75%	7%
2004	500	80%	20%
2005	700	80%	21%

Source: Ministry of Finance, Government of Mauritius.

## Indicators for the IFS Industry (excluding Category 2 banks)

The non-bank part of the IFS industry in Mauritius comprises principally the MCs and their GBC clients. Whereas the number of international banks operating in Mauritius dropped from 2002 to 2005, the number of MCs has increased marginally, although the annual growth of GBC licenses issued decreased noticeably from 2002 to 2004. The average annual growth rate in GBC-1 licensees was a high 59 per cent from 1996 to 2002, but slowed down to 20 per cent between 2002 and 2005. That slowdown was more pronounced with GBC-2 licensees. These grew at an average annual rate of 173 per cent from 1998 to 2002, but at a much reduced 42 per cent between 2002 and 2005.

Likewise, the average annual rate of growth decreased substantially for global investment funds, although their asset base as at 31 December 2005 showed a staggering increase of above 400 per cent owing largely to the revaluation of their portfolios.

Passive investment holding companies predominate in the global business sector. In 2002, they accounted for 57 per cent (increasing to 66 per cent in 2004) of the activities of GBC-1 licensees and 37 per cent of those of GBC-2. Investments through Mauritius are now driven to the Indian stock market because of the favourable tax treaty between the two countries. Investments in Indian stocks through Mauritian GBCs increased from 19 per cent in June 2003 to 54 per cent in December 2004. Apart from India, other countries benefiting from the influx of funds were Indonesia, China, Hong Kong and Singapore.

**Table 7.6** Average growth rate of global business company (GBC) incorporations

	1996	1998	2002	Growth	2005	Growth
Offshore companies: <b>GBC-1</b>	2,652	4,202	6,726	59%	8,068	20%
International companies: <b>GBC-2</b>	1,898	4,307	13,670	173%	19,348	42%

Source: Financial Services Commission Statistics.

**Table 7.7** Global investment funds

	1996	1998	2002	2005
Global funds	92	148	256	359
Aggregate asset base (US\$ billion)	3.20	4.40	6.30	26.75

Source: Financial Services Commission Statistics.

## Notes

1. The data in the national account series are not consistent from year to year when translated from MRs (Mauritian rupees) into US\$. The translation from gross to net value added is unclear. So the figures provided above should be regarded as best estimates.