

Facing the Global Financial Crisis - Policy Lessons from Small Mauritius

by

Verena Tandrayen-Ragoobur (Dr, Mrs)
University of Mauritius

and

Vishal Ragoobur (Dr)
Mauritius Employer's Federation (MEF)

Abstract

Most of the attention around the global financial crisis has focused on its causes and effects in the banking and broader finance sector, particularly among developed and leading emerging economies. However, in a globalised world economy, the crisis has serious implications for developing countries, which are highly dependent on trade, foreign investment, and remittances to meet economic growth and social needs. Though without doubt, there are particular countries that will be adversely affected, but there will also be countries that may be less affected, may avoid recession, and may recover sooner than expected. This paper analyses the case of a small island developing state like Mauritius where government has attempted to mitigate the negative consequences of the global economic crisis through an appropriate policy mix. Mauritius has been considered as an outlier in the Sub Saharan African region and is further seen as an example in setting the right strategies in difficult times. Our study firstly examines the various transmission channels via which the crisis operates on the Mauritian economy and we discuss the appropriate policy mix implemented to increase the resilience and optimism of the country to the present crisis.

Keywords: financial crisis, international finance and developing countries

JEL classification: G01, F3, 016, 055

1. Introduction

The financial crisis originated in the US housing market in late 2008 and spread through the financial systems of the US and Western Europe. The initial concern for small state economies was that the crisis would be transmitted from the advanced countries through their financial sectors. However, the strongest transmission channels of the crisis have been through the real sectors of these economies. In most small and vulnerable developing countries, the crisis has since the second quarter of 2009 reversed global GDP growth, resulted in sharp reductions in exports, worker's remittances, access to finance and has triggered declining fiscal revenues. It has also increased demands for social service provision and the maintenance of social safety nets and has substantially increased levels of unemployment. GDP has experienced a huge decline in the developing world and from the World Bank estimates growth will decline to 1.6% in 2009, from an average of 8.1% in 2006-2007. In Sub-Saharan Africa, the worst-affected region, growth is projected to slow to 1.7 % in 2009, from 6.7% in 2006-2007 (World Bank, 2009).

The Mauritian economy has attempted to dampen the effect of the world economic downturn on economic growth and on the performance of its most vulnerable sectors like tourism for instance. Mauritius has so far been resilient to the crisis relative to other African countries or emerging economies but Mauritius not immune. It has been sheltered with appropriate policies and strategies implemented in a timely manner but it is not isolated. Basically the government has tried to be ahead of the curve once it realised as far back as May 2008 that there were some signs that there could be a global recession. The government then created six funds and injected Rs6 billion which would be used for education and training, food security, helping people to get access to housing, investing in the equity of the airport in order to modernise the airport. This has been the fruit of reform in terms of fiscal benefits and has helped the economy in good stead. In addition to these initial policy options, the Mauritian government introduced a Stimulus Package in December 2008. The two main reasons which underline the economy's resilience to such an unprecedented external shock is the effectiveness of the reforms which have been implemented during the past three years. The second is the robustness of the financial system as recognised by the IMF. The reforms have opened the economy and made it more versatile and have also given the country the fiscal space required to deal with such a crisis.

The objective of the paper therefore is to assess the case of a small island developing state like Mauritius where government has attempted to mitigate the negative consequences of the global economic crisis through an appropriate policy mix. So far, Mauritius has been resilient to the world economic downturn and is viewed as an example for other developing and emerging economies. Our paper is structured as follows. In section 2, we analyse the various transmission channels via which the crisis operates on the Mauritian economy. Section 3 discusses the macroeconomic performance of Mauritius in the event of the crisis. Section 4 reviews the appropriate policy mix implemented by government to increase the resilience and optimism of the country to the present crisis. We finally conclude in section 5.

2. Main Transmission Channels

The current financial crisis affects developing countries in various ways. Four major channels will be discussed to analyse the impact of small developing economies.

Firstly, the biggest fear was that of financial contagion where financial institutions in developing countries will be negatively affected. There are both direct and indirect ways in which this can happen. Directly, banks in developing countries may be affected to the extent to which they hold assets contaminated by sub prime mortgages. However, many developing country banks had limited interrelationships with international banks (Naudé, 2009). Foreign owned banks are not significant players in most countries in Africa. There is, however, a more serious indirect threat through declines in stock market prices and housing prices. These reduce the capital of banks and large firms, whereby they do not hold sufficient levels of their capital in cash. Thus, banks are likely to reduce lending in order to shore up their capital. Reductions in bank lending will lead to reduced investment, lower growth, and an increase in unemployment. Lower economic growth implies lower government revenue and less means for government to fight poverty. In a worst-case scenario banks may even face solvency problems and may require their governments to recapitalize them.

Second, in recent years, the economic growth of developing economies has been centred on exports. The crisis is leading to a substantial decline in their export earnings. The declines come essentially through a combination of a fall in commodity prices, in demand for their goods from advanced economies and in tourism. Over the past seven years, prices of many commodities, including copper, nickel, platinum and petroleum, have risen to record highs, and contributed significantly to good growth in Africa. However, since September 2008 commodity prices have been declining. The price of oil fell by more than 70% in the second half of 2008. Other prices followed suit. The dilemma facing many such commodity exporting countries is well illustrated by the case of South Africa, a major exporter of the platinum group of metals. However, it is not just commodity-dependent countries that will be adversely affected as with the recession developed countries will in general reduce the demand for their exports, and these markets are important destinations of developing-country exports. A significant proportion of US and EU imports are from developing countries. Declining global demand has severely curtailed global trade volumes and has brought to a close several years of consistent increases in commodity prices. Global trade levels have declined to their lowest level in eighty years. Declining exports and falling export prices have constituted a devastating double blow to the smaller and poorer economies. The combined impact has been severe, with export revenues sharply contracting, employment in export sectors declining substantially and government's fiscal revenues reducing significantly.

Many of developed countries' imports are also imports of services. Another important source of foreign currency earnings in many developing countries is tourism. Since September 2008, the number of air passengers in the world has dropped sharply. Although a good part of this drop is due to reduced travel for business purposes, it would also include less tourist travel, as households generally reduce consumption on luxury goods, and second mortgages for overseas holidays are becoming more difficult to obtain. Many small island states dependent on tourism, like Mauritius, have already registered a decline in hotel bookings.

Third, declining global output has also impacted the level of workers' remittances from abroad, on which households in many developing countries are reliant. Remittances in recent years have grown to be one of the most important financial flows to developing countries, exceeding US\$240 billion in 2007, more than twice the

volume of aid flows (Ratha et al. 2007). In many countries remittances have sharply deteriorated, reducing household income and contributing further to the reduction in aggregate foreign exchange inflows. In many instances, particularly for unskilled workers, declining remittances have been accompanied by rising unemployment, when workers abroad have been retrenched and have returned to their home countries to seek new employment. Countries with migrants predominantly in the US or EU (for example Mexico and the Caribbean) and small states such as Lesotho, Haiti and Nepal (where remittances contribute in excess of 10% to GNP) have already started to feel the pinch.

Fourth, developing countries require financial inflows from the rest of the world to facilitate and accelerate economic growth, trade and development. These flows include official development assistance (ODA), investment flows (portfolio and foreign direct investment), trade credits and flows of remittances. All of these are set to be affected negatively during the current crisis. Cali, Massa and Te Velde (2008) estimate the decline in financial resources to developing countries to be around US\$300 billion. The reduced access to finance across developing countries results mainly from the fact that the major bilateral contributors are themselves profoundly affected by the global crisis and are facing very substantial domestic fiscal pressure. Further, though, most advanced countries have committed themselves to the 2002 Monterrey Consensus on Financing for Development to provide at least 0.7% of GNP as aid to developing countries, it was clear at the Follow-up International Conference on Financing for Development in Doha in December 2008, that few countries could meet this commitment. Moreover, even if countries were to maintain their share of GNP as aid contributions, with the falling GNP the absolute volume of aid will also fall, although currency depreciations may counter this effect.

Foreign direct investments, in particular, equity capital, and commercial bank lending have declined significantly as foreign investors and banks have sought to reduce their risk exposures. The collective impact of declining commercial bank lending, substantially reduced access to trade credits and uncertain access to concessional financial resources has been a substantial sudden-stop in access to external finance by developing countries. Accompanied by increasing demands for fiscal spending to address the economic and social consequences of the crisis, this has led to the emergence of a large and persistent financing gap. The World Bank estimates that the crisis has created a financing gap for developing countries of between US\$270 and US\$700 billion, representing the additional amount needed for developing countries to address the impact of the crisis and to maintain expenditure at pre-crisis levels (World Bank, 2009).

The implications are very significant and adverse for small and vulnerable countries, and for whom recovery will take far longer in comparison with larger, more resourced economies with greater access to sources of capital and greater and easier access to the global trading system. For the substantial majority of these countries, the crisis is a profound economic and social crisis; and far less a crisis either emanating in or impacting upon the financial sectors of these countries. Yet the impact has not been confined to the smallest and poorest members. Projections for 2010 and 2011, suggest that recovery in the larger and better resourced economies will generally be stronger and quicker than in the case of the poorest and most vulnerable. A further challenge is the unknown duration of the crisis. The crisis has depressed both investor

and consumer confidence, in both advanced industrial and developing countries. Some signs may be emerging in mid-2009, of a recovery in certain variables reflective of improving confidence in the advanced economies most affected by the crisis. But it is not clear whether these signal a sustained recovery in these countries. Moreover, the duration of the crisis is expected to be far more pronounced in developing countries, which have had no fiscal space to stave off the first round effects of the crisis; and in which countries, the crisis has undermined institutional resilience and capacity and significantly increased poverty.

3. The Mauritian Economy in the Global Financial Crisis

There are basically four ways in which the global economic downturn and the recession are affecting a small open economy like Mauritius. Mauritius is highly dependent on international trade, globalisation and foreign direct investment. The first impact has been felt via the trade transition mechanism, textile, clothing, seafood hub and services namely tourism. Second, we rely significantly on foreign direct investment and foreign investors have chosen to reduce their risk exposure. So, the share of our exposure to the global economy and to global trade is probably more than two hundred percent. Third, the capital market, the stock exchange has been affected as many rich corporations move out of emerging markets and go into the safety of the US dollar. The fourth way in which Mauritius has been affected is via the trade finance and export credit. There are commodities in South East Asia and in Africa that have been manufactured. There is a demand for them but there is no trade credit that is no export finance. Many of the rich industrialised countries have bailed out the banking system because of the toxic assets. Commercial banks in Mauritius that used to get line of credit from correspondent banks abroad can no longer do so as this has dried up. In some emerging economies there has been a drying up of funding available to commercial banks and to development financial institutions and this has made trade more difficult. So these are basically the four ways in which the global economic downturn and the recession are affecting Mauritius.

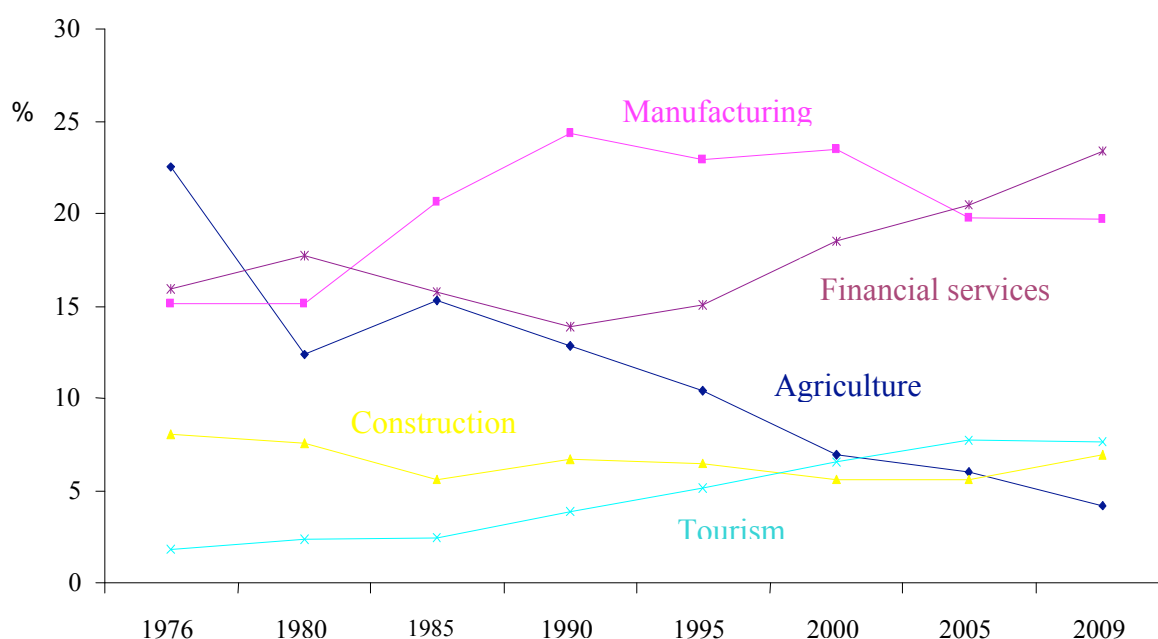
As an open economy, Mauritius has performed well on the international front and is seen as an outlier in the Sub Saharan African region. Globalisation has proved beneficial to the economic growth as the economy has made the most of external trade, FDI and also transfer of skills and know-how from other countries. The economy has been resilient when compared to other developing economies as well as emerging countries like Singapore, Ireland, Hong-Kong, Malaysia that have similar exposure to international trade, tourism and FDI. The reasons for this are two fold, one is reform. The different policies adopted by the government will be discussed in the next section of the paper. If there was no proper reform process, Mauritius would already have been in the recession; and the second is the soundness of the banking and financial system. The system is well regulated, well supervised and the share of loan to deposit is conservative.

3.1 Present Macroeconomic Situation

The Mauritian economy has for long been dependent on three traditional pillars – sugar, textiles, and tourism. Financial services are an emerging sector, with considerable potential with a contribution of 10.5% to GDP in 2007 which is expected

to grow further to 11.6% in 2009 despite the financial crisis. However, the relative significance of these sectors has changed over the years (see Figure 1 below).

Figure 1: Sectoral Contribution to GDP, 1976-2009 (%)



Sugar, once the backbone of the economy, has declined drastically contributing to merely 1.6% of GDP in 2009¹. The clothing industry, which thrived under EPZ incentives and preferential market access, suffered a major setback with the end of apparel quotas under the MFA and the new era of global competition in clothing exports with giants like China, India and others. Tourism has had a robust growth since 2000, contributing to 9.4% of GDP in 2007 but this is expecting to fall to 7.3% in 2009 with the financial crisis. Tourism has contributed significantly to jobs and foreign exchange earnings.

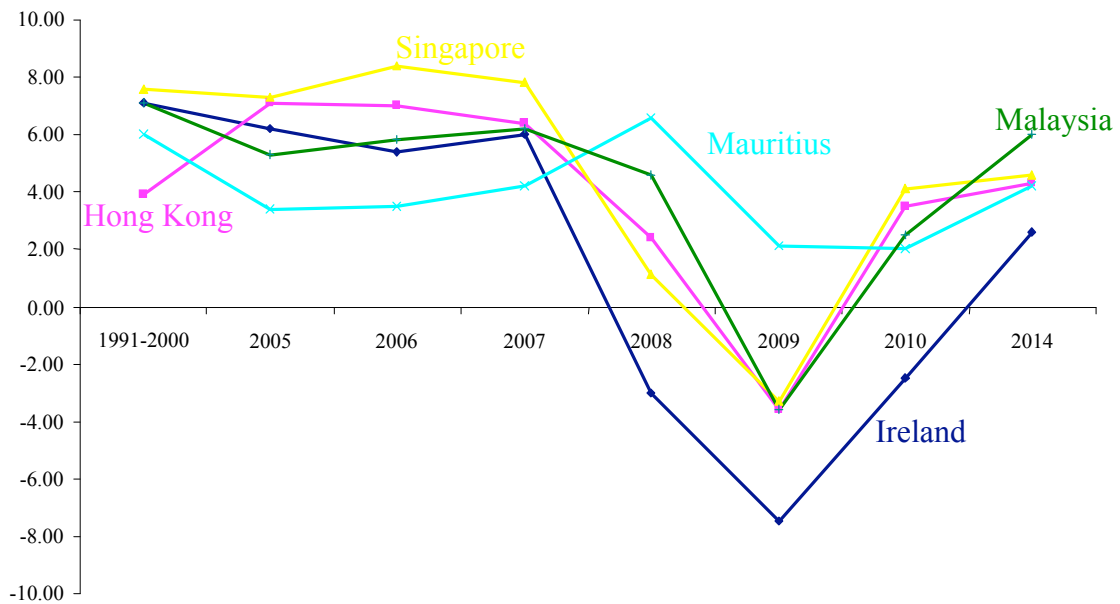
From Figure 1 above, we note that the financial services sector has been growing continuously over the last decade. In fact, domestic banks have long dominated financial intermediation in Mauritius although efforts have recently focused on promoting offshore banking activities by emphasizing the country's reputation as a safe financial haven. Our financial system has not in any way been involved in sub-prime lending or any activity deriving directly or indirectly from that asset class. Our financial system is well regulated, solid and highly profitable. It has ample liquidity to meet the financing needs of the economy. As a result there was no need for government intervention, as in many other countries, to bail out the banks. In fact, for the past 10 months of 2009, commercial bank credit to the private sector has grown by 24%, total assets of banks have maintained a high expansion pace and the fundamentals of the banking institutions have improved significantly. The rest of the financial sector has also performed well. One exception is the stock market where normal corrections from record highs have been exacerbated by fear in major markets across the globe. However, net foreign portfolio outflows have been lower than in most emerging markets.

¹ Forecasted value; Source CSO, National Accounts, September 2009

Mauritius has often been compared to other countries like Singapore, Malaysia, Hong Kong and Ireland which are emerging economies and are as much dependent on international trade and foreign direct investment. From figure 2 below we compare the real GDP growth rate of these nations and we note that Mauritius has performed better relative to these nations in the event of the world economic downturn. All four economies are likely to register negative growth rates in 2009 whilst that of the Mauritian economy turns around 2.5%. Though there has been a fall in growth rate, it has not been as drastic as in the other economies. In fact the reforms set by the government have opened the economy and made it more versatile. The strengthening of the emerging sectors to diversify the economic base has created good capacity to offset the negative effects of external shocks. At the same time, the reforms have created the necessary fiscal space to deal with the crisis. Had it not been for the comprehensive economic reforms undertaken by the government, the economy would have been in recession.

In effect the government strategy has been to reorient the economy's traditional sectors. For instance, the emphasis is shifting away from the sugar industry toward a sugar cane industry, which would produce a variety of by-products – such as ethanol, spirits, and electricity from cane waste – as well as specialty sugars. In the textiles sector, efforts are being directed to building a vertically integrated clothing industry encompassing spinning, weaving and dyeing operations, which call for heavy investments in machinery. In tourism, the objective is to attract 2 million tourists by the year 2015, a more than two-fold increase over the current figure of 800,000. In parallel, several schemes have been launched to attract high net-worth individuals to Mauritius by offering them the possibility of owning luxury villas in a sanctuary-type setting. In the services sector, IT-enabled services are emerging rapidly, fed by the availability of a pool of computer-literate and bilingual labor, and by the country's past investments in telecommunications. Finally, new industries (for example, the seafood hub) are actively being sought out and promoted to diversify the economy's industrial and export structures.

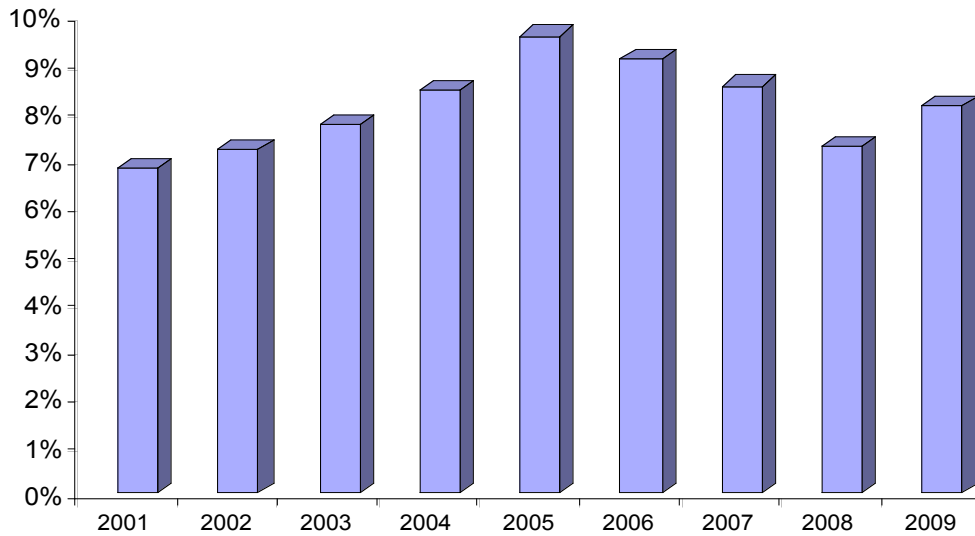
Figure 2: Real GDP Growth Rate (%)



Source: *World Economic Outlook, 2009*

On the domestic front, we analyse the unemployment rate of the Mauritian economy from 2001 to 2009 (Figure 3 below). We observe that the unemployment rate stands at 8.3% (4.8% for males and 14.4% for females) in 2009. The unemployment rate in Mauritius is usually influenced by seasonal factors. It is often higher in the first half of the year because of school leavers joining the labour market, and lower in the second half with more casual jobs being available mainly in the trade sector (street vendors, salespersons in shops, etc.) at the end of the year. When removing the seasonal fluctuations, the seasonally adjusted unemployment rates are 7.4% and 7.9% for the first and second quarter of 2009. Unemployment has not increased drastically in the event of the crisis. In fact, saving jobs has been the priority of the government and in this respect the Budget 2009 has been mobilising Rs4 billion to save employment. For the government, "...no enterprises – no jobs" (Budget, 2009) where it becomes evident that the emphasis is on supporting Mauritian enterprises regardless of size. Much effort is being made to sustain, modernise and ease the access to finance of local enterprises such as to help them survive the crisis and improve their productivity and competitiveness. Small and Medium Enterprises (SMEs) are at the forefront of all the actions taken by Government to support enterprises. SMEs account for more than 40 % of total employment and create more jobs than larger enterprises.

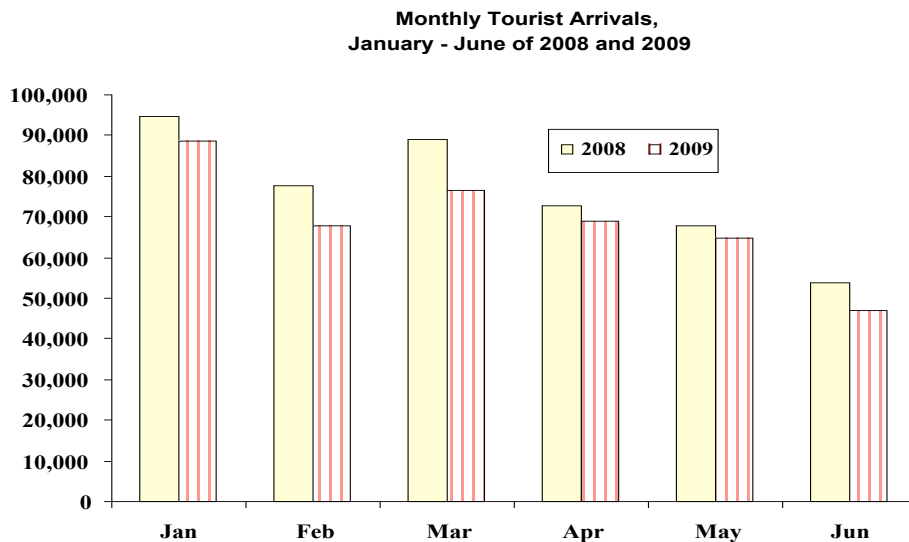
Figure 3: Unemployment Rate (2001-2009)



Source: Central Statistical Office, Mauritius, 2009

From a sectoral perspective, the sector which is most hit by the world economic downturn has been tourism. The tourism sector is much more vulnerable to the global economic downturn as airlines, hotels and tour operators are being affected. There is already evidence of lower growth in tourist arrivals (see Figures 4a and 4b below) which, combined with falling prices constitute a challenging situation. Government's concern is not only about the lower income that will be generated in that sector but most importantly about protecting employment. As explained above, Government is supporting enterprises in the tourism sector that are in difficulty, provided employment is protected.

Figure 4a: Monthly Tourist Arrivals



Source: Central Statistical Office, Mauritius, 2009

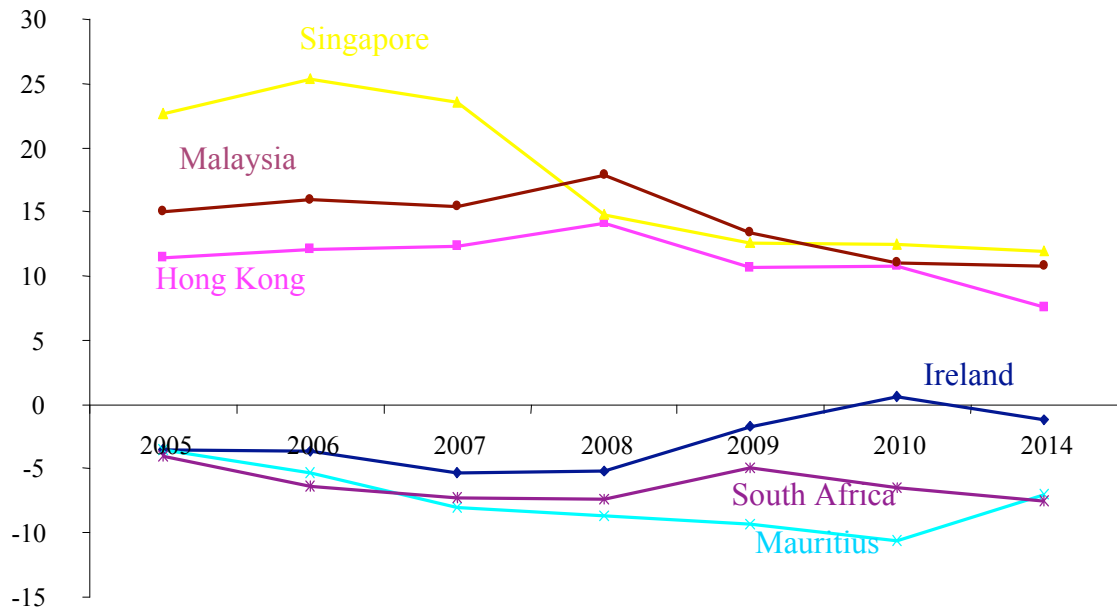
Figure 4b: Tourist Arrivals from Top Ten Markets

**Tourist Arrivals from Top Ten Markets,
January - June of 2008 and 2009**



On the external front, we note that in terms of the current account balance as a share of GDP, Mauritian performance is worst than the emerging economies and also even worst than South Africa (see Figure 5 below). However, over the years, since 2005 Mauritius had always experienced a negative current account balance relative to the other countries and in terms of the increase in the deterioration of the current account balance in 2009, it is much less than the emerging economies of Singapore, Malaysia and Hong Kong. In fact as a resource-scarce, small island economy, Mauritius is heavily dependent on imports for both consumption (food products) and production (raw materials, capital goods and other inputs) purposes. Sustained trade liberalization has resulted in an open import regime. In fact since 2004, imports showed a tendency to rise. The upward trend may be due to the pronounced depreciation of the rupee in recent years.

Figure 5: Current Account Balance as a % of GDP



Source: *World Economic Outlook, 2009*

4. Policy Responses of the Mauritian Government

The world is going through the worst economic downturn since the Great Depression of the 1930s. All of the advanced economies are in recession, the international financial system is in disarray, job losses have hit tens of millions of families across the globe and global trade and capital flows are shrinking. Caught in the midst of a perfect storm, a small open island economy like Mauritius cannot afford to be complacent. There is every reason to fear the worst and the downside risks to growth, unemployment, balance of payments and living standards are real.

The Mauritian economy showed resilience in 2008, growing above 5% despite a difficult international economic environment that saw high volatility of oil and commodity prices and an unprecedented financial crisis. A credit crunch and declining business and consumer confidence ensued in advanced economies, culminating into a global slowdown and recession in our major export markets. The outlook for 2009 is yet more subdued. A slower economic growth rate is anticipated as the economic crisis deepens worldwide. The textile and tourism sectors will inevitably face the brunt of the worsening situation and may hit zero or even negative growth rates.

In order to mitigate the negative consequences of the global economic crisis, some 200 specific and targeted measures have been announced to achieve the short term priorities of protecting employment and maintaining livelihoods while keeping a longer term perspective by improving the capacity of the economy to take advantage of the economic rebound when it comes. In May 2008, recognizing the anxieties that were gripping the world, the government used the greater fiscal space the past reforms

have generated to set up 6 funds totalling some Rs 6 billion. In particular, government applied pro-cyclical policies when the economy was on the upswing. The prevailing convention was to apply counter-cyclical policies which what the rest of the world initially did. Mauritius went against that wave. The global events since then have proved Mauritius right. In October 2008, the G20 and the World Bank called for temporary, targeted, flexible and concerted Keynesian policy actions to stimulate growth. This confirms that Mauritius had anticipated well the global crisis and that the approach adopted needs to be further consolidated. In addition, prices were administered to improve the purchasing power of consumers and interest rates were lowered to increase liquidity in the banking system. Between October 2008 and now, the key repo rate has been reduced by 250 basis points.

Further, government has set out an Additional Stimulus Package (ASP)² to be implemented over the period 2009-2010. Mauritius is one of the few countries that have introduced an ASP in December 2008 and counter cyclical measures when the economy is not in a recession. UK, France, Germany and other countries waited to be officially in a recession in order to mount their stimulus package. The Mauritian government was ahead of the curve. The ASP is a combination of three things: first, easing of monetary policy, second, expansionary fiscal policy, (certain taxes have been suspended over a corridor of two years, in tourism, construction and other sectors) and third a budgetary expansion for investment and infrastructure. In addition to the stimulus package, the government has emphasised on two aspects. The first one is to cushion and to dampen the impact of the recession, on the economy, especially on jobs, and second to prepare for the bounce back, by investing in people and education, investing in infrastructure and capacity building.

The package is primarily directed towards shoring up investment in public infrastructure development, accelerating and facilitating private investment and giving support to vulnerable sectors and enterprises that may be affected by the global economic crisis. The expansionary fiscal measures will be backed by lax monetary policy in a coordinated move between Government and the Central Bank. The aim is to support entrepreneurs, save jobs, protect our markets, industries and economy. Thus, the main features of the additional stimulus package:

- (1) It is targeted, flexible and temporary;
- (2) It will be implemented over the two-year period;
- (3) Significant increase in public sector investment;
- (4) Reduce bottlenecks to boost private investment and where possible accelerate projects of investors;
- (5) Many infrastructure projects;
- (6) Support will be provided to businesses to continue operations so as to protect employment and workers;
- (7) The National Empowerment Foundation will enhance its efforts on re-skilling, retraining and returning retrenched workers to productive employment; and
- (8) Ample protection for the population during the period of the international crisis.

The ASP is a mini-budget and is primarily about investing either in equity or providing loans. The package will essentially involve the implementation over two

² A summary of the measures put forward in the Additional Stimulus Package is given in Appendix 1

years of six funds (namely, the MID Fund, Food Security Fund, Human Resources, Knowledge and Arts Development Fund, Local Infrastructure Fund, Social Housing Development Fund and the Manufacturing Adjustment and SME Development Fund) created in the 2008/09 budget and to which Rs6 billion have been allocated. The government will have recourse to the Rs1.8 billion contingency fund and appropriate additional funds if required. Moreover, reprioritising of certain expenditures is also planned. These funds will realise the Maurice Ile Durable³ vision; build food security; boost education and knowledge to eradicate poverty and widen the circle of opportunities; improve local infrastructure; and sharpen the competitiveness of domestic oriented industries and SMEs. The creation of the Funds and the contingency of Rs 1.8 billion amount to a cushion of Rs 9.3 billion (over 3.4% of GDP) which is significantly higher than the 2% fiscal stimulus that the IMF and G20 have called to boost aggregate demand.

The biggest boost that the Mauritian government will give to the economy over the next two years is in the area of public expenditure on infrastructure. Spending on infrastructure can have powerful stimulating effects in the short term as it will create jobs, generate more income, boost investment and in the medium to long term, it will enhance the attractiveness of Mauritius as an investment destination, improve the doing business environment and expand productive capacity. Two Committees will be set up to address the weaknesses in public project implementation, on all fronts and at their sources, so that it speeds up the process, bring forward and reprioritise public spending on infrastructure. It is good to note that small and medium sized contractors will get a fair share of the projects. In addition to roads, other projects include building up local infrastructure in all regions of Mauritius and Rodrigues. Substantial public investment will be also targeted to upgrade schools, hospitals and sports facilities and protect the environment. Significant investment will further be targeted into the construction industry. Accordingly, an additional Rs 2.6 billion is being provided for public infrastructure, including Rs 1.8 billion for the road network. The process for the acquisition of land required for public infrastructure projects, particularly roads will be improved.

Besides public investment, a slowdown has been experienced in some traditional sectors from private investment including FDI. To this end, the government is adopting the necessary legal and regulatory framework to accelerate the decision-making process. New legislations will also be passed to expand the range of Business Process and Knowledge Process Outsourcing Services offered from Mauritius. This will provide a framework to attract international law firms that will bring the necessary skills to export legal outsourcing services. The Board of Investment has approved some 15 private sector projects in the manufacturing sector where some Rs 1.7 billion will be invested, of which Rs 1 billion are FDIs, creating some 800 jobs. These projects include, amongst others, the building sector, a commodity exchange, a diamond exchange and a paper recycling plant. An Air Cargo Logistics Centre will also be set up to support the setting up of an airport hotel and business commercial centre. This will clear the way for the implementation of 4 major projects in the Air Cargo Logistics Centre for an estimated investment of Rs 1 billion. Legal process outsourcing and business process outsourcing offer potential for new business as firms in industrialised countries are under pressure to further cut costs. Moreover,

³ Mauritius, the Sustainable Island

Mauritius can benefit from investment in clinical trials and develop the education hub including medical training. To attract FDI in these specific areas the Board of Investment is provided with an additional Rs 25 million for marketing and promotion. In the area of business facilitation which is crucial to investment and to attract foreign businesses, permanent residence will be issued to eligible investors, professionals. Government is also giving permanent resident status to purchasers in Real Estate Scheme (RES) developments provided they buy a property worth at least US\$ 500,000. This will maintain the momentum to further improve on the progress made in the World Bank Ease of Doing Business Survey moving up from 32nd in 2006 to 24th in 2008 and 17th in 2009. Mauritius is continuing to streamline regulations to facilitate business.

As an open economy, Mauritius is directly dependent on developments in the rest of the world. Moreover, as a small player in the international market, it has to adapt to changing circumstances. The export oriented sectors, particularly textiles and tourism are the most severely hit by falling demand. Domestic oriented industries are also vulnerable. A weakening export sector adversely impacts on most local enterprises. SMEs may face particular difficulties in responding to the adverse environment due to their size and lack of expertise. For export oriented firms, government is giving assistance to make up for falling demand in Europe. A representation unit is set up to provide marketing back-up and marketing intelligence to support companies in the US market to take full advantage of AGOA including the derogation under AGOA for textile and apparel firms. To give a breathing space to the domestic oriented industries serving consumers, government is freezing its plan to lower import duty to make of Mauritius a duty-free island over the next two years. The Bank of Mauritius is also introducing a foreign currency line of credit for banks to enable them to cope with demand in case the normal sources of supply dry up.

Further, government is accelerating the implementation of the Manufacturing Adjustment and SME Development Fund. Rs 400 million have already been committed out of Rs 500 million towards the widest possible range of support benefiting some 51 projects, mainly SMEs including women entrepreneurs. These include upgrading of standards, quality and packaging for export readiness; productivity and competitiveness improvement; market intelligence and export promotion; equipment modernisation scheme, market development and marketing, market diversification and product development. Rs 100 million will be used to provide direct support to SMEs that require assistance with liquidity or to restructure. Support institutions like Enterprise Mauritius is assisting SMEs to develop a plan that can qualify for financing to meet the challenges arising from the crisis. Government will further help firms on three main fronts namely to reengineer to become more competitive and to ensure their long term survival; to improve access to financing, in particular working capital, at concessionary interest rates; and to restructure their debt. The Manufacturing Adjustment and SME Development Fund will be broadened to include support for the export of services. This will raise the government contribution to Rs 1 billion. Government is also designing a package to assist asset rich but cash poor firms. Banks will provide financing for restructuring the balance sheet of firms, including injection of additional liquidity when required. The additional financing will be provided at a concessionary rate not exceeding the savings rate, currently about 5.5%. For asset-rich but cash-poor enterprises in the manufacturing and tourism sectors, government is creating a Special Purpose Vehicle

to acquire and hold assets in those enterprises. This sale and lease back mechanism will enable them to make use of their assets to raise finance. These enterprises will be given the opportunity to buy back their assets in the future. We are launching the scheme with an injection of Rs 500 million for this purpose

The next area in which resources have been allocated in the medium and long-term is the building of human capacity. In both the public and private sectors, there is a dearth of skills and expertise that hinders project implementation, undermines the country's competitiveness and constrains growth potential. There is now greater access to tertiary education for students, create jobs for graduates and researchers, attract expertise from other countries and make of Mauritius a centre of excellence for the region. This will open the way to an investment potential of Rs 1.2 billion over the next two years. It is mainly government investing responsibly and carefully to save jobs and to buttress economic activities. It will help in protecting the income sources for thousands of families who would otherwise have to face the indignity of being unemployed and suffer the human desolation that high unemployment always entails. The ASP is also about saving the economy and protecting the population from the clutches of one of the worst global economic recessions – an economic scourge that is already causing social despair and unrest in many other countries.

To give maximum protection to workers in the textile sector, export support institution like the Mauritius Export Association (MEXA) and the National Empowerment Foundation (NEF) will establish a programme to reskill textile and apparel workers who could lose their jobs for placement in other sectors. In parallel, the Ministry of Labour will work with the National Empowerment Foundation and the Joint Economic Council (representative of the private sector) to set up a mechanism to generate early warning of possible redundancies so that the NEF can come up with an appropriate response plan. The NEF is working with the Ministry of Labour to kick start a Cité des Métiers⁴ that will improve the capacity to match labour demand to supply. The Cité will offer enhanced counselling to orient first time job seekers and those being reskilled to employment opportunities. NEF will then assist with finding the appropriate job placement and work with training institutions and employers to build up the required skills.

So far ASP has saved jobs in eight ways. First, it has directly saved 2,700 jobs through the Mechanism for Transitional Support, by saving enterprises that are at the breakdown point. Second, indirectly it has saved some 3,000 jobs through the multiplier effect, because for every job saved directly, there are more workers who are not laid off. Third, hundreds of companies that are not benefiting from any kind of support from Government have nonetheless responded to government's call for greater social obligation. They have refrained from laying off workers –until they have exhausted all other ways of restructuring their business. Fourth, the Empowerment Programme has helped in placing many workers in jobs. Fifth, there have been jobs saved through public infrastructure projects. Sixth, hundreds of people have been kept in their employment due to the private investments that have been fast tracked by the various sub-committees set up to oversee the implementation of the ASP. Seventh, government responses and policies have prevented the kind of loss of confidence amongst consumers and businesses that have accelerated the downturn in

⁴ City of Jobs/Career Opportunities

so many other economies. Finally, tax cuts and reductions have also contributed to saving jobs. All these add up to protecting the income, the standard of living, the quality of life and indeed the livelihood of tens of thousands of men, women and children that make up these families. Moreover, the economy wide indicators also bear up the positive impact of government efforts to save jobs.

Tourism is the sector which is most affected by the global economic downturn. The country's concern is not only about the lower income that will be generated in that sector but most importantly about protecting employment. Enterprises in the tourism sector that are in difficulty will be supported provided employment is protected. Specific measures have been taken in that sector such as for the next two years hotels will pay the Environment Protection Fee only if they show a profit at the end of their financial year. Currently, this fee is applied on turnover irrespective of profitability. Second, the Temporary Solidarity Levy will be suspended till 2010. Further, the promotion budget of the Mauritius Tourism Promotion Authority has been increased by Rs 100 million. The additional fund will be used to finance promotion to raise our visibility in existing markets such as South Africa and other short and medium haul destinations. The funding will also be used to attract visitors from the upper market segments of India and to carry out intensive marketing campaigns in markets with great potential, including Russia, China, Nordic countries and the East European nations. The government is also organising special promotion campaigns at the thirty five points now served by Air Mauritius. Lastly, as part of the social contract with the tourism sector, AHRIM and the Empowerment Foundation will work together on a training programme to avoid layoffs in particular, among the 70% of employees of hotels that are below managerial ranks. There will be no layoffs without prior consultations with the Government and a plan for retraining.

The anticipated outcome of the additional stimulus package is an estimated addition of 1-1.5% to economic growth. This will, however, depend on a swift and comprehensive implementation of the measures and importantly, close monitoring and evaluation are essential to ensure the effective and efficient use of the funds allocated. Fiscal policies usually entail a time lag and so the real impact of the stimulus package may not necessarily be visible in the immediate future but rather felt after a period of time. There is a risk that the fiscal and monetary stimulus presently being administered may in the long term keep up the inflationary pressure on the economy although it could be argued that the current increase in government spending is more of the supply side nature and directed toward improving the productive capacity and competitiveness of the country rather than simply boosting demand. But what is more likely is that the budget deficit and public borrowing will rise as a result of the massive injection of funds into the economy by government and given that a shortfall in tax revenue is expected in view of reduced economic activity in the foreseeable future. Finally, government has strong expectations of the private sector and proposes a social contract that asks enterprises to safeguard employment and ensure that restructuring is done in consultation and fairness. Furthermore, it also expects any reduction in costs to be passed onto consumers in the form of lower prices.

Further, in May 2009, the government set out its Budget 2009/2010 which is essentially an eighteen month Action Plan to get by the global crisis – the worst threat

that the economy and society have known in many decades. It is an action plan that builds on the ASP and extends its scope and intensifies its implementation. It is in line with the call by the international community for a concerted response. It focuses on three priorities that Mauritians expect the government to focus on - saving jobs, protecting people and preparing for the recovery. As such, some 200 specific and targeted measures will be implemented to achieve the short term priorities of protecting employment and maintaining livelihoods while keeping a longer term perspective by improving the capacity of the economy to take advantage of the economic rebound when it comes. In times of crisis, saving jobs should be the priority and in this respect the Budget 2009 does not disappoint by mobilising Rs4 billion. The emphasis is on supporting Mauritian enterprises regardless of size. Much effort is being made to sustain, modernise and ease the access to finance of our enterprises such as to help them survive the crisis and improve their productivity and competitiveness. SMEs are more vulnerable and have rightly been put at the forefront of all the actions taken by Government to support enterprises.

The Budget 2009 provides for a massive investment in public infrastructure especially in terms of road network. An efficient road network with less congestion along the main transport corridors is absolutely essential for building a modern and competitive Mauritius. Increased public sector investment in infrastructure will not only give a boost to economic growth and job creation in a context when exports and private investment are declining but will also enhance the productive capacity and competitiveness of the economy in the longer term. It must be pointed out however that in practice Government projects and especially those in infrastructure are faced with important implementation delays. This has indeed been acknowledged in the Budget and remedial actions both in terms of improving human resources and institutional constraints will be put in place to speed up the stringent and bureaucratic procedures. A total of Rs14.2 billion will be injected over the next 18 months to stimulate economic growth and maintain employment. Government has been able to draw on the fiscal space created during the past couple of years to increase spending but with declining revenues and the need to raise expenditure even further, public finances will deteriorate albeit remaining manageable and sustainable. A cost cutting exercise in Government and the tapping of resources from profitable companies should help to contain the fiscal deficit at 4.8 percent of GDP in 2009 and 5% in 2010. One interesting feature about the nature of public spending being undertaken is that it is mostly in the form of investment. This will serve the dual objective of sustaining growth in the short term and improving competitiveness in long term. The call to limit lay offs as a measure of last resort is reiterated in the Budget while new solidarity levies on profitable companies in the telecommunications and banking sectors will apply to make up for additional funds.

The government has so far encouraged the private sector to spend some of their profits on Corporate Social Responsibility (CSR) schemes. However, the response and implementation have been uneven. Thus, in this budget, all profitable firms are required to either spend 2% of their profits on CSR activities approved by Government or to transfer these funds to Government to be used in the fight against poverty. The CSR programme or the direct payment to government could provide some of the resources to underpin the efforts of the Ministry of Social Security to build up a strong NGO community. But there is a major cause for concern in the way the issue of CSR is addressed. There is a lack of awareness in Mauritius about what

CSR as a concept really means. CSR specifically refers to voluntary initiatives that go beyond mere compliance with legislation in a diverse range of social, environmental and economic areas. CSR provides a more meaningful and sustainable way for enterprises to improve the quality of life their workforce and engage in society in general. Furthermore, an enterprise should be free to decide its level and areas of engagement that best suit its business situation and strategy. CSR therefore favours a more flexible and structured approach. It should not be reduced to philanthropic activities in support of NGOs. The mechanism put in place for approving CSR activities or how the transfer of funds will be done are not clear. The trouble is not so much about the contribution enterprises are required to make but more in the way in which they are being asked to do so. There is a risk that attention and resources will be diverted towards philanthropic activities that are peripheral to business in place of positive CSR initiatives that would help Mauritian enterprises turn into sustainable businesses and responsible corporate citizens.

5. Conclusion

The policies set out the government plan to take Mauritius through the global economic crisis. Overall, the ASP and the 200 specific and targeted measures have made the economy even more resistant to the impact of the global crisis. These strategies were to achieve the short term priorities of protecting employment and maintaining livelihoods while keeping a longer term perspective by improving the capacity of the economy. Most macroeconomic indicators are currently better than expected. Employment creation at June 2009 has been a positive 7500 above the level of employment a year ago. The unemployment rate at June 2009 seasonally adjusted was 7.4%, compared to 7.2% for 2008. FDI for the first semester has reached Rs 3.5 billion which is close to its level during the same period in 2008. Foreign exchange reserves are up by 17% in the past year, increasing the import cover by more than one month. However whilst the economy is resisting well, we must recognise that no country is out of the crisis. There are still a lot of uncertainties. The Mauritian economy may be buffeted by still more unexpected shocks. It is therefore crucial that local enterprises - strong or vulnerable - realise that global competitiveness is the surest route to resilience. They must also understand the importance of building the necessary cushion to face the unexpected.

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Appendix 1

Some Key Objectives and Features of the Additional Fiscal Stimulus Package
• Bring forward and increase public expenditure on infrastructure
• Remove bottlenecks, accelerate private investment projects and attract foreign businesses
• Support enterprises by helping them to reengineer and increase quality, productivity and competitiveness; providing access to finance and facilitating debt restructuring
• Increased role of the National Empowerment Foundation (NEF) in terms of training, reskilling and job placement of retrenched workers
• Tax Concessions to Hotels, Construction and Freeport operators: <ul style="list-style-type: none"> - Suspension of solidarity levy imposed on Hotels - Payment of Environmental Protection Fee only applicable if Hotel is profitable - Land transfer tax and registration duty for approved projects suspended - Land transfer tax to be allowed as deduction for income tax purposes - Reduction of import duty on iron bars in coils from 15 to 7.5 percent - Tax exemption for Freeport operators extended by further two years
• Government expectations: enterprises to protect employment and where possible lower consumer prices
• Implementation of stimulus package: a steering committee and ten sub-committees set up

Appendix 2

Summary of Main Government Actions

Government actions to mitigate the impact of the crisis on the Mauritian economy have been as follows.

Expansionary Budget (May 2008)

- Creation of 6 funds to the tune of Rs6 billion
- Setting up of a contingency fund of Rs1.8 billion
- Payment in full of the PRB recommendations costing Rs5.2 billion

Additional Stimulus Package of Rs10.4 billion (December 2008)

- Bringing forward and increasing public expenditure on infrastructure
- Supporting enterprises by helping them to reengineer, providing access to finance and facilitating debt restructuring
- Tax concessions to Hotels, Construction and Freeport operators
- Removing bottlenecks to accelerate private investment projects and attract foreign investment
- Increasing training and reskilling of retrenched workers

Budget 2009 (May 2009)

- Planned injection of Rs14.2 billion over next 18 months
- Creation of a Saving Jobs and Recovery fund to support and modernise SMEs and large enterprises
- Massive investment in infrastructure and boosting up of project realisation capacity
- Social measures targeting the poor and vulnerable
- Cost cutting exercise in Government

Flexible Monetary Policy

- Coordination with the Bank of Mauritius to lower interest rate and increase liquidity

