CHAPTER

9 Medium-Term Challenges and Concluding Remarks

The Factors Behind Sustained Growth

The discussion in the previous chapters leads to some key conclusions. First, the Mauritian growth performance since the 1970s has been exceptional.

Second, Mauritius's approach to openness was very country specific. It did not introduce a conventional trade regime, as its import regime during the 1970s, the 1980s, and much of the 1990s has been rather restrictive. As stressed by Rodrik (1999a) and Subramanian and Roy (2001), Mauritius was heterodox in the manner in which it prevented import taxation from becoming a tax on export and trade. Thus, the anti-export bias was offset by segmenting the export sector from the import-competing sector, and by heavy intervention to promote the former through more liberal labor market policies and through the tax system. The segmentation was achieved through the creation of the EPZ sector. However, the key factor that acted as an offset to the anti-export bias was the preferential access provided to Mauritius by its trading partners, mainly in sugar, but also in textiles and apparel. Thus, while some of the interventionism in Mauritius's trade and development strategy is reminiscent of the policies in some East Asian countries, trade performance was greatly assisted by the preferences granted by trading partners.

It should be noted that while Mauritius was able to offset the anti-export bias, it did not achieve a protrade bias, and did not register exceptional trade performance as in the case of the tigers of East Asia. Thus, Mauritian trade performance cannot by itself explain Mauritius's exceptional growth performance. The efficiency of the service sector, including ports, telecommunications, and financial services, should also not be underestimated as a contributor to growth.

It must be noted that other developing countries tried to exploit similar trade opportunities and pursued similar policies, but did not succeed as Mauritius did. To a great extent, strong domestic institutions have contributed substantially to the Mauritian success. In contrast to many developing countries, Mauritius has since independence been a vibrant democracy and has developed strong participatory institutions, to promote inclusion rather than division among its ethnically diverse population. Indeed, Mauritius has succeeded in reaping the benefits of diversity, including strong ties between the local Indian and Chinese communities with their ethnic counterparts in the world.[38] The need to manage diversity led to the development of efficient political institutions and culture, including free and fair elections, the rule of law, an independent press, and respect of property rights, all factors that have attracted investments to Mauritius.

Thanks to a culture of respect for diversity, Mauritius avoided one of the major pitfalls made in most of resource-rich Africa, namely "destroying the cash cow." Thus while many African countries heavily taxed the agricultural sector, the newly independent government of Mauritius steered away from this dangerous course. Instead, the majority Indian community left the minority Franco-Mauritian community to retain its ownership and stewardship of the sugar sector, in exchange for political control. The divide between the economic elite (a minority) and the political elite (the majority) and the need to achieve balance between the two in a newly independent state was resolved peacefully and in a "win-win" situation for both sides, by ensuring the fortunes of the sugar sector. In return, the prosperity of the business sector allowed for the extraction of some rent to maintain a relatively well-paid civil service, staffed predominantly by the majority Indian community, and to finance a generous system of social protection, particularly in the form of pensions. This can be considered an optimal system of rent sharing between political and economic elites, as noted by Subramanian and Roy (2001).

In conclusion, the Mauritian experiment rested on a successful interventionism that was made possible by the quality of the domestic institutions and political process. The future international trading environment is likely to be less favorable, because the preferential prices and access rights that Mauritius has been enjoying in the past will slowly but inevitably decline as global liberalization proceeds apace. However, the solid foundations of an efficient civil service and good educational and social achievements are likely to provide a strong basis for coping with the challenges ahead.

The Challenges for Policy

Some factors that contributed to the exceptional growth of Mauritius, specifically trade preferences, will be fading over the medium term. Thus the sugar sector and the EPZ, which centers on textiles (an engine of growth in the past that has

[38]The benefits of diversity in the Mauritian case are analyzed in Subramanian and Roy (2001).

generated considerable value added), are facing the need for restructuring. Indeed, it is very likely that the sugar sector will gradually shrink, while the textile sector will need to specialize in niches where it can maintain some competitive advantage. The tourist sector still has prospects for expansion, but these are not without limits, given the constraints on available land resources. The authorities are fully engaged in responding to these difficult challenges, while the textile and sugar sector enterprises are taking important measures to strengthen their viability, by seeking to improve productivity.

Competitiveness in the textile sector particularly hinges on moderating labor costs that have increased significantly in recent years. A more flexible wage-bargaining system, which allows bargaining at the firm level, would be helpful in order to strengthen the link between wage increases and productivity growth. In addition, simplifying regulations on the conditions of employment, including limits on the ability of firms to redeploy workers, could promote the creation of jobs for low-skilled workers.

The continued diversification of the economy is essential in order to secure growth over the medium term. Sectors that are expected to contribute to growth are information and communication technology (ICT), financial services, wholesale and retail trade, and transport, in addition to tourism. The ICT sector had a promising start, with a number of foreign companies having expressed interest in opening facilities in Mauritius, although recently some companies seem to have changed their plans. Efficient port facilities are contributing to attracting high-value-added services in transportation that are oriented to servicing a regional market. There is also the potential to strengthen the private sector's contribution in the electricity sector and to other key infrastructures.

The success of the transformation of the economy hinges critically on maintaining macroeconomic stability and external competitiveness, while preserving social cohesion. A fiscal policy directed at reducing the persistent deficits, so as to allow a stabilization and subsequent fall of the high public debt, is essential in order to preserve stability and reduce the risk from external shocks. A reduction of the budget deficit from the 5.5 percent of GDP projected for 2003/04 to about 3 percent over the next five years would allow the public debt to fall from 73 percent at the end of 2003/04 to about 64 percent of GDP by 2007/08. Persistence of the budget deficit at current levels would lead to a debt of close to 80 percent by 2007/08, making public finances very vulnerable, as possible shocks to real GDP growth and real interest rates could rapidly raise the debt to about 100 percent and critically diminish the authorities' credibility in the management of public finances.

The monetary authorities have been successful in reducing inflation, and in this they have been helped recently by the strong balance of payments, which has contributed to some appreciation of the exchange rate. Looking ahead it will be important that the ample liquidity of the banking system be absorbed, in order to make sure that it does not contribute to inflationary pressures. With the exchange rate mainly market determined, competitiveness can be fostered only through real productivity gains. Maintaining an appropriate competitiveness of the Mauritius economy will remain a key challenge for the future; moderation of labor costs, accompanied by adequate flexibility in the labor market and a continued upgrading of the quality of the labor force through investments in education and training, will remain an essential requirement in order to sustain the transition of the economy toward activities with rising value-added content.