THE MAURITIUS CHAMBER OF COMMERCE AND INDUSTRY

MCCI
ECONOMIC OUTLOOK

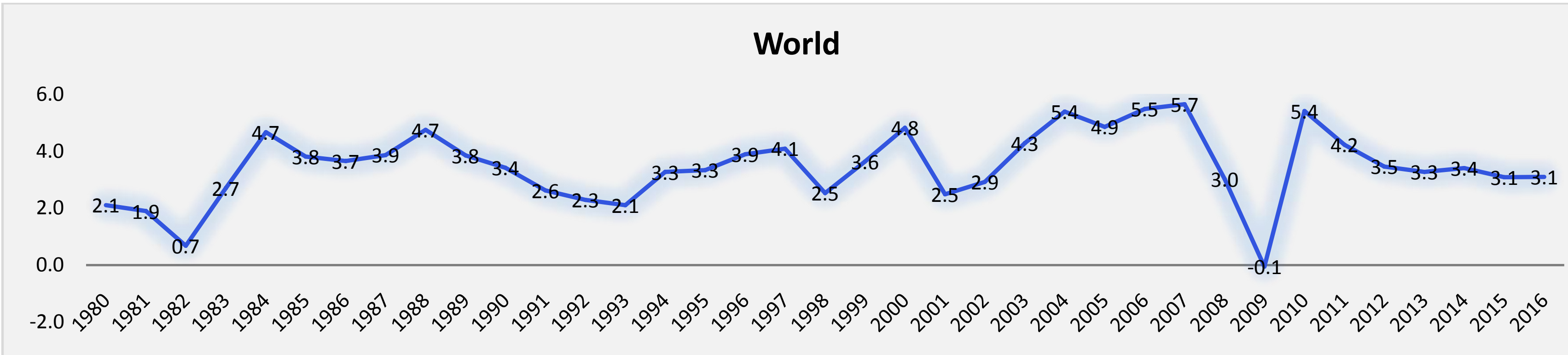
2016-2017

September 2016

10th Edition

I. THE INTERNATIONAL CONTEXT

Figure 1 : Real growth rate of global GDP, 1980-2016



Source : IMF

The Global Economy has weakened

After an interlude of exceptional world growth in the period 2000 to 2011, with an average of 4.1 percent, driven primarily by the fast emergence of a new heavyweight of the global economy, China, we have returned since 2012, to a more classic outline of the evolution of the global economy.

Indeed, since 2012, the growth rate is close to 3 percent. As a reminder, the average world growth rate over the period 2012 to 2015 was 3.3 percent similar to the period 1980 to 1999 where it was 3.1 percent.

For 2016, we expect this trend to continue. Growth is going to continue progressing at a modest pace in spite of extremely accommodative and exceptional monetary policies.

The most favoured macro-economic scenario of the IMF is that global growth should at best be at the same rate as last year - **3.1 percent**.

This figure is significantly lower than the rate of growth achieved before the crisis, and lower than the rate predicted by the IMF a year ago.

The economic slowdown of emerging and developing economies since the second half of 2014 is expected to continue in 2016.

Large emerging economies such as Brazil and the Russian Federation should experience a contraction in 2016, similar to 2015, while slowdown is expected to continue in China and some other emerging and developing economies.

The group of emerging and developing economies nonetheless continues to show levels of growth higher than the world average, with forecasts of 4.1 percent for 2016.

As a reminder, these economies experienced growth rates of 4.6 percent in 2014 and 5 percent in 2013.

In this phase of the business cycle, growth in advanced countries should remain modest at 1.8 percent after a rate of 1.9 percent in 2015.

Even if the very accommodative monetary policy and the fall in oil prices should support activity for this group of countries, the persistent lack of demand, new currency appreciations, especially in the United States, and the lasting effects of the last financial crisis will have an impact on the recovery.

In the euro area, expectations of a fall in prices is of concern as it would impact on the level of demand in a context where public debt is very high and the leeway for an expansionary fiscal policy to boost demand is very low.

Factors behind the slump in global growth

According to the IMF, the main reason of this weak economic climate is the persistence of too low demand.

Economic growth has been too low for too long, and this has dampened the confidence of all economic agents. Nonetheless, as Kenneth Arrow pointed out, confidence is the most essential factor of economic activity.

Lack of confidence prompts consumers not to consume and companies to postpone or cancel their investment. This behaviour, in return, slows down demand, which ultimately slows down economic activity.

Other factors have also impacted on global economic activity.

Firstly, uncertainty linked to Brexit

The results of the UK referendum have taken all economic agents by surprise.

Brexit has strongly increased economic, political and institutional uncertainties, and should have negative economic impacts at the global level.

However, as stressed by the IMF, the situation is still evolving and it is very difficult to quantify the potential impacts.

The reference scenario of the IMF is based on a positive assumption of a gradual dissipation in uncertainty. In this scenario, the European Union and the United Kingdom come to an agreement in order to avoid a large increase in economic barriers. This would bring serenity to the different actors and allow a normalisation of short and medium-term economic prospects.

However, this favourable scenario may not be achieved, and thus we cannot exclude a more negative outcome.

In the negative scenario, the financial conditions tighten and the confidence of businesses and households continue to worsen, both in the United Kingdom and in the rest of the world. This decline in confidence should have a negative impact on consumption and investment and, consequently, there would be a more distinct slowdown in global growth as from 2017 itself.

Secondly, slower growth in the working-age population

The rapidly ageing population in advanced economies, slowdown in the growth of the working-age population in the emerging and developing economies and a widespread downward trend in activity levels of the workforce are all factors that impede to the growth in labour supply and, consequently, on the potential for growth in employment and expansion in production.

Thirdly, unequal redistribution of growth proceeds

After a temporary break with the crisis, incomes of the richest 1 percent of the world population have gone on the rise again, at a pace much faster than for the rest of the population.

According to estimates of the International Labour Organisation, the wealthiest 1 percent, will own, in 2016, more than 50 percent of global wealth, against 44 percent in 2009.

Moreover, we note a secular decline in the share of labour, which contributes to the worsening of income inequalities, particularly in developed countries.

Together, these elements are at the source of the fall in consumption and lack of demand, resulting in a lower demand for investment and, ultimately, a weaker economic growth.

Other risks remain.

The Brexit shock occurs at a time when European banks, particularly in Portugal and Italy, are unable to counter the after-effects of the successive crises.

The continued dependence on credit as a source of growth worsens the risk of a disruptive adjustment in a number of countries.

Risks arising from non-economic issues also remain important.

The political tensions in advanced countries can impede efforts aimed at correcting long-term structural problems, whilst geopolitical tensions and global terrorism keeps impacting heavily on the outlook of several countries, particularly in the Middle East, and shows transnational spill over.

Global Trade Slowdown

The fall in demand thus slows down world trade.

After reaching an annual growth rate of 6 percent between 1990 and 2011, trade growth fell to only 2.7 percent over the period 2012 to 2014.

The World Trade Organisation argues that growth in the volume of world trade should remain weak in 2016, at 2.8 percent, similar to 2015.

The slowing down and rebalancing of the Chinese economy explains to a large extent these trends, given the importance of China, at more than 10 percent of total world trade. In fact, growth in Chinese imports fell by around 4 percent between 2014 and 2015 and this trend should continue in 2016.

The fall in imports in some commodity exporting countries have also contributed to this. This particularly concerns Brazil, Russia and commodity exporting countries experiencing macro-economic difficulties who, in total accounted for around 5 percent of world trade in 2014.

Increase in Unemployment

The level of economic growth is too slow to trigger a real dynamic in the labour market and thus significantly decrease the unemployment rate worldwide.

In 2015, according to the World Labour Organisation, unemployment concerned around 197.1 million people, i.e. an unemployment rate of 5 percent, more than 1 million more than the previous year, and around 27 million more than before the crisis (169.8 million unemployed in 2007)

According to latest estimates from this institution, the number of people unemployed in the world should increase by nearly 2.3 million in 2016 and 1.1 million additionally in 2017.

The world unemployment rate should be of 5.8 percent in 2016 and 2017, similar to 2015.

Inflation at its lowest level.

One of the main paradox of this current period is that central banks have never used so much expansionary and exceptional monetary policy. Nevertheless, inflation remains dramatically low, and in certain cases close to deflation.

According to the IMF, inflation rate in 2016 should be the same as in 2015, that is 2.8 percent.

It is the second lowest rate since 1980, after an inflation rate of 2.7 percent in 2009 during the recession.

This rate clearly indicates that demand is insufficient. As a reminder, according to the IMF, actual GDP Growth is lower than potential growth by around two percent.

Long term outlook

Latest macro-economic forecasts suggest that growth in global Gross Domestic Product (GDP) will remain moderate in the coming years, confirming the trend of medium-term growth forecasts being continuously revised downwards since 2011 .

Our baseline scenario is stabilization of global growth at around 3 percent annually by 2020.

II. EVOLUTION OF DETERMINANT FACTORS

Since the beginning of the year, we are faced with contradictory factors influencing the evolution of the Mauritian economy.

Our level of exports

Since 2012 , the world economy has entered a downturn with relatively low growth rates. As adverse effects pile up, the probability of a strong recovery in the short and medium term global economic conditions is close to zero.

External demand has weakened significantly and we experience it with the global slowdown

Moreover, we are faced with "Brexit".

43 years after joining the European Union, the UK prepares itself to leave Brussels.

According to a number of experts, the resulting uncertainties are so significant that we cannot ignore the downward risks to the global economy.

The IMF, in its July update, has already lowered its forecast for global growth and there is a high probability that it will further lower its forecasts in October.

However, the UK of tomorrow will not necessarily be the loser of the situation.

With its newly-found monetary and fiscal independence, it will be able to put an end to a policy of imported deflation.

The UK has been outstanding in managing the short-term post- referendum period. They have adopted an expansionary, demand-driven policy to stimulate the economy .

Firstly, the Bank of England reduced the key Repo Rate by 100 percent from 0.50 to 0.25 percent in its efforts to stimulate the economy.

Secondly, it maintains a competitive exchange rate. The fall in the pound sterling by around 10 percent acts as a boost to their local production and immediately improves their competitiveness. Manufacturing activity has, in August 2016, recorded its highest rise in over 25 years.

Thirdly, the new Prime Minister has expressed an interest in adopting a proactive policy of supporting local production.

Thirty years after Margaret Thatcher buried the industrial policy, the head of the British government wants to renew the British economy by setting up a new economic strategy based on industrial revival .

We are already experiencing its effects with the latest forecast of the National Institute of Statistics of England (Office for National Statistics). The latter forecasts a UK economy which is expected to grow at 1.6 percent in 2016, a much higher rate than in 2015 when it was merely 0.5 percent.

Nonetheless, in the longer run, the evolution of the United Kingdom economy will largely depend on the type of deal it negotiates with the European Union.

At the local level, this exit from the EU should have an impact on our export of goods and services.

In the short-term, Mauritius is faced with the depreciation of the pound sterling by around 8 percent.

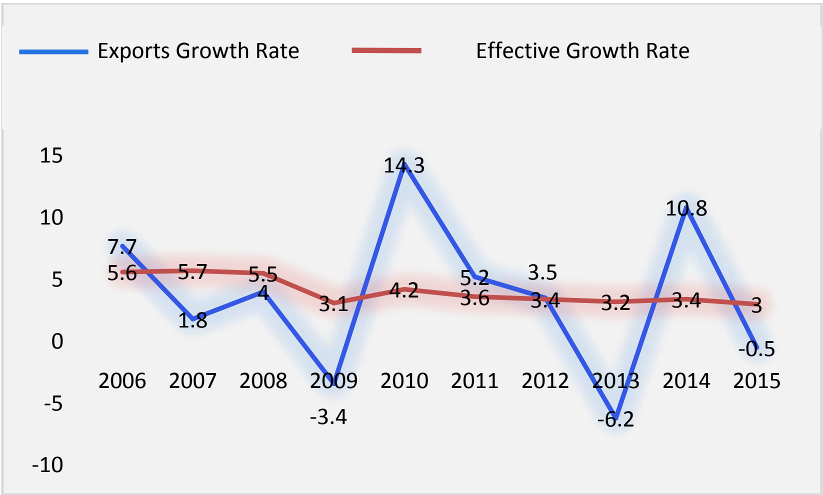
In the long-run, there are uncertainties concerning our access to the UK market, and our margin of preference on specific products, given the new industrial policy.

The United Kingdom represents around 10 percent of our exports and around 6 percent of our exports are in Pound Sterling.

The level of our exports of goods and services has experienced high fluctuations during the recent period. There have been significant increases (14.3 percent in 2010 and 10.8 percent in 2014) and decreases (- 3.4 percent in 2009 and 6.2 percent in 2013).

Yet, based on official figures from Statistics Mauritius, we observe that these large fluctuations did not have any disproportionate impact on the economic growth rate, as shown in Figure 2 below.

Figure 2 : Export Growth Rate and Economic Growth Rate, 2006 to 2015



Moreover, our econometric model shows that the weight of export in our economic growth is quite low.

Indeed, the regression coefficient for this variable in our growth equation is 0.037. It implies that an increase in the rate of growth of export of 1 percentage point would increase the economic growth rate by 0.037 percentage points, ceteris paribus.

Thus, in the worst case scenario, the impact on economic growth of the devaluation of the pound sterling would be a decrease of 0.002 percentage points, ceteris paribus.

For 2016 and 2017, given the increasing uncertainties linked to Brexit and the weak external demand, we expect growth in the export of goods and services to be 0 percent.

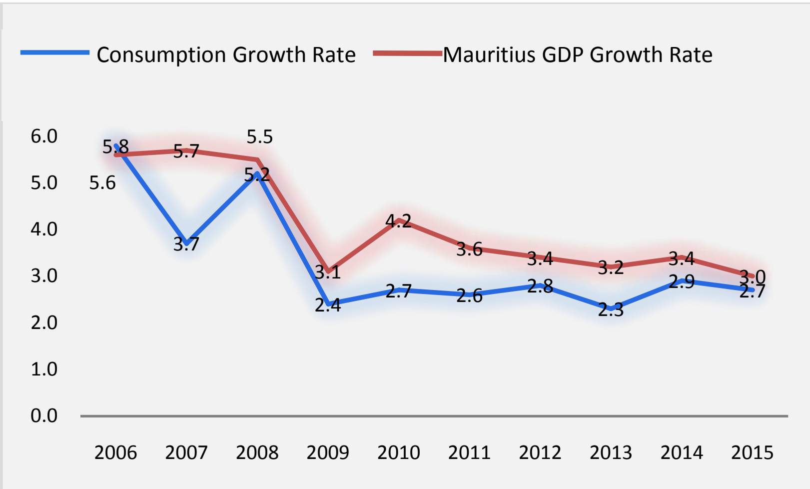
Consumption, engine of economic growth.

Consumption is the essential foundation for economic growth in Mauritius. According to our econometric modelling , the regression coefficient on consumption growth in real terms is 0.56 in our economic growth equation.

This implies that a 1 percentage point increase in consumption would increase the economic growth rate by 0.56 percentage points, ceteris paribus.

Yet, in Mauritius, since 2009, we observe a sharp slowdown in consumption growth.

Figure 3 : Consumption growth rate and economic growth rate 2006 to 2015



Indeed, consumption growth fell from an average of 6 percent over the period before the crisis to an average of 2.6 percent in the post crisis and over the recent period as shown in the figure above.

We must take into account a fundamental aspect that influences the level of overall consumption; the psychological element.

There are a number of empirical studies showing that in times of crisis, consumers limit purchases by adopting a prudential behaviour.

Consumers, constrained by a difficult economic situation, become selective and postpone their purchases to the maximum. They forsake, for the most part, any impulsive purchase.

Moreover, such lasting crises favour a change in consumer behaviour and push them to minimize expenses.

This year, the public authorities, through fiscal measures, particularly the increase in income support to those at the lower end of the ladder and a number of measures to support employment , should boost domestic demand.

However, the impact of these measures will depend largely on the implementation capacity of public authorities, and the speed at which the measures are implemented.

Given the tumultuous phase in which we operate, negative expectations remain. This is reflected in the Consumer Confidence Indicator in Mauritius, which is at a very low level.

These negative expectations will affect the evolution of the consumption growth rate.

Economic growth has been too low for too long, and we need strong and out-of-norm consumption stimulus measures to break this negative spiral and trigger a virtuous circle.

A consumption stimulus policy would allow us to move from a sub-optimal equilibrium, weak demand, unemployment and under-utilization of capital, falling confidence and investment levels leading to negative expectations to a more optimal equilibrium, higher demand, and rising investment levels, positive expectations and falling unemployment rates.

Marco Buti and Olivier Blanchard, respectively the former chief economist of the European Commission and Economic Advisor of the IMF, explain that budgetary stimulus is essential in a slack period of the economic cycle, as the fiscal multiplier is high and greater than 1, to achieve nearly 1.7.

Based on the above, we forecast, at the MCCI, a 2.7 percent growth rate in consumption in 2016 and 2017.

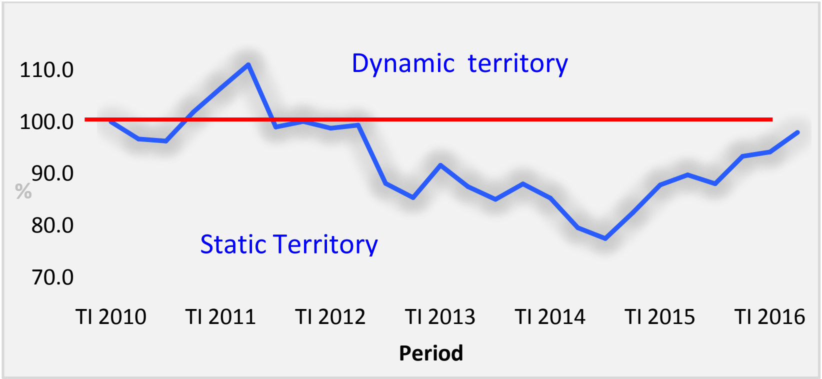
The business confidence indicator in static territory

Despite successive increases in the business confidence indicator since the third quarter of 2015, we observe that the index remains in the static territory.

In fact, since 2011, after a sharp decline in its index, the BCI has been in the static territory - below its long-term average of 100 basis points, indicative of remaining uncertainties and negative expectations in the economy.

This lack of confidence in the economy may adversely impact on the depth of the recovery.

Figure 4 : MCCI Business Confidence Indicator



However, the BCI remains in static territory below its long-term average of 100 basis points, indicative of remaining uncertainties and negative expectations in the economy.

This absence of confidence in the economic context may have an impact on the depth of the recovery.

Investment Rate remains weak

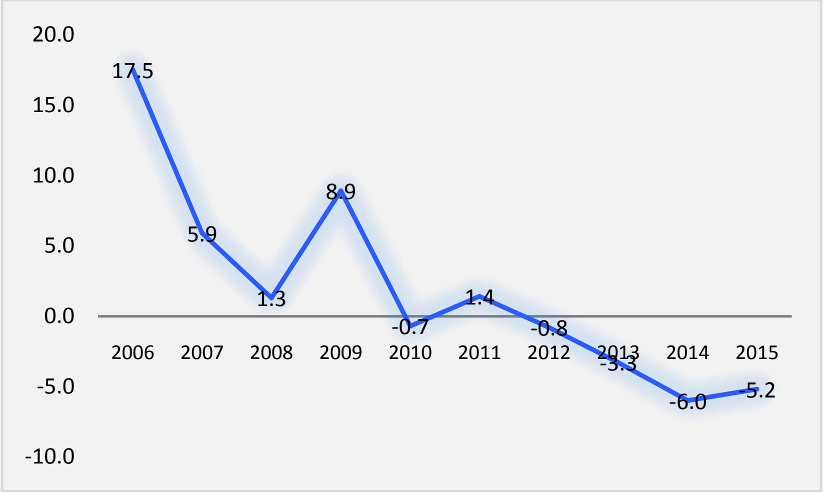
Investment is crucial for sustainable growth. It is an essential element to improve productive capacity, transform the economic structure and create jobs.

For Mauritius, an economy in transition aspiring to reach the next level of development, the minimum required, according to economic literature is an investment rate of 25 percent.

However, since 2008, the level of investment has steadily decreased from around 26 percent in 2009 to 17.5 percent of GDP in 2015.

We find that investment has been contracting since 2012.

Figure 5 : Investment Growth Rate



This trend has intensified over the last two years with negative growth rates of -6 percent in 2014 and -5.2 percent in 2015.

Hence the need for public investment in this period of low economic activity.

For there to be a continued recovery in economic activity when in a slack period, the Keynesian concept advocates that a boost to consumption be accompanied by an increase in public investment.

These investment will trigger higher demand for capital goods, which therefore will encourage suppliers of those goods to improve their supply and thus in turn, increase investments to meet this additional demand.

By snowball effect, it will boost economic activity, boost employment, dividends and consumption, hence resulting in a further increase in investment.

In other words, a virtuous circle.

This has triggered the public authorities in Mauritius to increase public sector investment by more than 100 percent for the 2016-2017 fiscal year.

This decision is justified and will have a positive impact on total investment.

However, the lack of strong demand since the beginning of the crisis has significantly affected the investment capacity of the private sector.

Entrepreneurs have resorted to significant decrease in their prices in order to withstand declining consumption, causing a disinflationary phase.

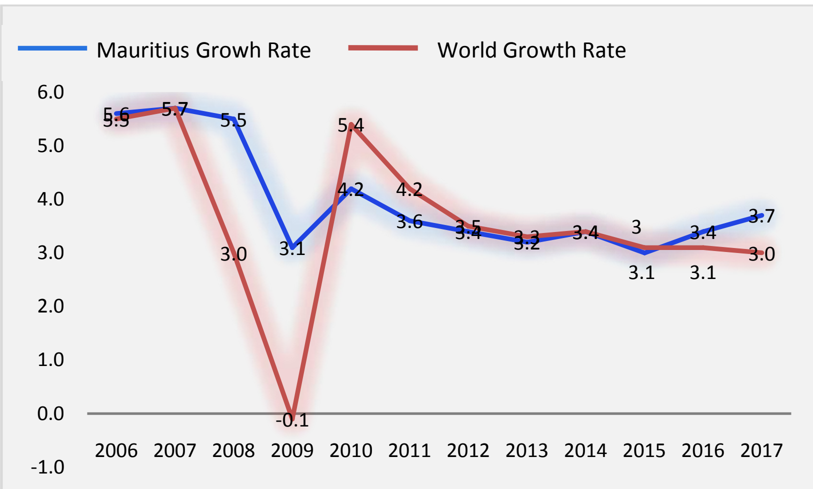
The cumulative decline in private investment between 2012 and 2015 is over 13 percent and the private investment recovery in the short and medium term will depend on the level of the increase in consumption.

Thus, after significant decrease in investment in 2014 and 2015 with negative growth rate of -6 percent and -5.2 percent respectively, we expect, at the MCCI, an investment growth rate of -4 percent in 2016 and -2 percent in 2017.

III. FORECASTS OF MAIN ECONOMIC INDICATORS

An economic growth rate of 3.4 percent in 2016 and 3.7 percent in 2017.

Figure 5 : Mauritius and World Economic Growth, 2006 to 2017



Taking into consideration the evolution of the different variables mentioned above in Section 2, we believe that the low point in activity was reached in 2015, ceteris paribus.

On an annual average, the econometric model of the MCCI forecasts that the Mauritian economy should grow, after adjusting for the price effect, by 3.4 percent, higher than that observed in 2015, by 3.0 percent.

In 2017, without a strong recovery in activity, the economic situation in Mauritius should remain stable.

In fact, the GDP of Mauritius is expected to grow by 3.7 percent in 2017, ceteris paribus.

The forecast of 2017 have been made with anticipation of a number of challenges in implementing all measures announced in the last budget.

However, if the public authorities manage to implement the measures in a short timeframe, our will be adjusted accordingly.

A potential growth rate of 3.7 percent

To analyse this recovery, it is wise to conduct a cyclical diagnosis. We need to evaluate the potential of our economy, i.e. our economy's ability to recover.

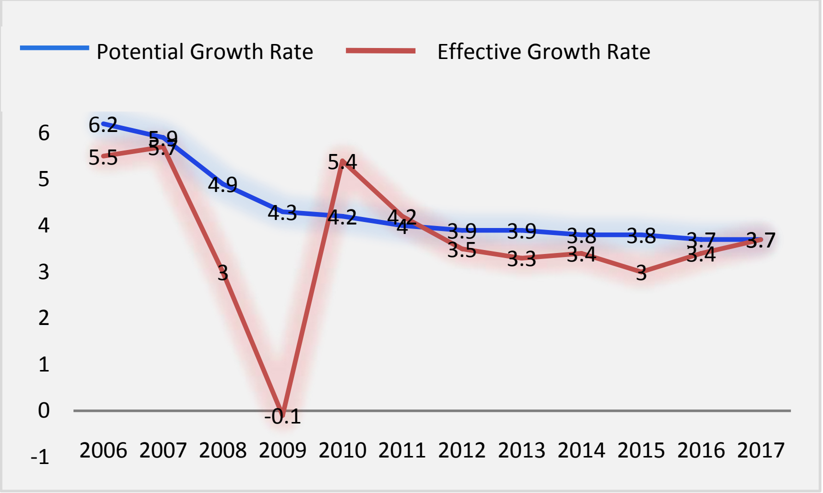
Potential GDP means gross domestic product that can be sustainably achieved, i.e. without generating imbalances on the markets for goods and labour, rather than the maximum possible level of production at a time given.

The economic recovery is generally identified by sustained increases in the index of the business confidence climate leading to a positive gap between actual growth and potential growth rates.

In other words, the end of a downturn results in a higher effective than potential growth. Thus, growth in demand goes up, adjusting upwards the level of prices in the short-term, and thus profitability and self-financing capacity.

In the medium term, the increase in demand and improvement in the financial situation will encourage entrepreneurs to enhance their supply, resulting in increased investment and employment. This will in turn, re-boost demand, and consequently generate a virtuous circle.

Figure 6 : Potential and effective growth rate, 2006-2017



We forecast a potential growth rate of 3.7 percent for 2016 and 2017.

Too weak inflation

The output gap is a useful theoretical indicator of short-term risks of fluctuations in inflation.

Indeed, any deviation of GDP from its potential is by definition a sign of disequilibrium in the labour or capital market, resulting in disinflationary pressures if it is negative or inflationary pressures if positive. This link is empirically conclusive.

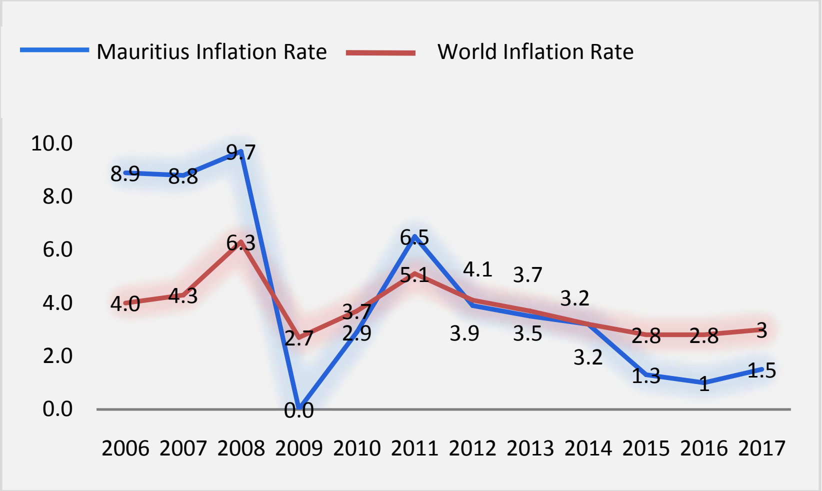
The output gap is negative since 2012 and since then, Mauritius has entered a deflationary phase.

Until 2014, Inflation has evolved in a reasonable range between 3.2 and 3.9 percent. It experienced a turning point in 2015 with a very low inflation rate, well below its equilibrium level.

Although supply-side factors are at play with falling commodity prices, the lack of dynamism in inflation is mainly a symptom of low demand.

Far from being a force to boost the economy to its equilibrium level, it is, on the contrary, likely to maintain economic activity durably below potential.

Figure 7 : Economic Growth and Inflation Rate, 2006-2017



For 2016 and 2017, we estimate inflation to be of 1.0 and 1.5 percent respectively.

Low inflation can be good or bad, depending on whether it is wanted or incurred.

Most often, this distinction amounts to answering whether the phenomenon is linked to a positive supply shock or falling demand.

Thus, an increase in productivity can allow us to produce more at an unchanged or reduced cost, leading to a deflationary pressure on prices.

The purchasing power of households and the competitiveness of enterprises will rise.

Similarly, the opening up of markets to competition generally benefits consumers and reduce production costs. The fall in inflation is here a desired outcome, favourable to economic activity.

Conversely, the fall in inflation linked to a lack of demand is mainly a symptom of an economy in crisis. Faced with low income, and high unemployment, the restraint in price levels brings only a meagre support to consumption.

In addition, when this trend continues, the beneficial effects are themselves temporary. Gradually, nominal wage growth adjusts itself to the falling inflation, until the increase in purchasing power disappears.

Companies operating only on the local market struggle to maintain profit margins, or even survive if there is a sustained weakness in activity.

In this case, a low inflation has mainly negative effects on the economic outlook.
Deflation is not simply a fall in prices, it is the combined and self-sustaining drop in prices and activity; a process in which expectations play a key role.

Mauritius is not in a deflationary period. However, inflation is too low, inducing adverse effects. It is synonymous to a modest growth in income, which will discourage investment and limit the repayment capacity of economic agents and ultimately have a negative impact on our country's production capacity.

Inflation is the thermometer of economic activity. When it is too high, it indicates an overheated economy, where actual growth is above potential growth. We must then engage in contractionary policies accompanied by supply side measures.

Conversely, where it is too low, this indicates a clear disequilibrium, where actual growth is lower than its potential. We then need to engage in an expansionary policy with measures to support consumption.

Fall in unemployment

The downturn which started in 2009 has resulted in a continuous rise in unemployment in Mauritius, of almost 1 percentage point from the low point reached in 2008 (7.2 percent) and the figure for 2012 (8.0 percent).

This increase is partly the result of fluctuations in the cyclical unemployment rate related to a lack of economic growth and partly a rise in structural unemployment.

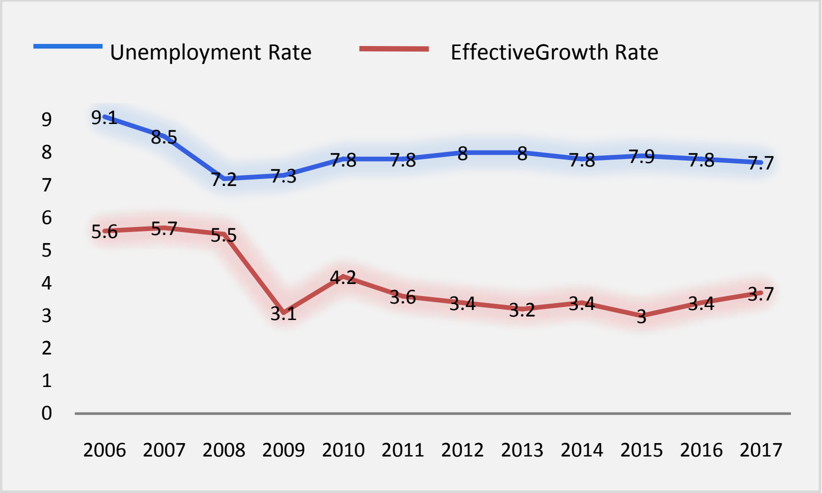
Indeed, DeLong and Summers empirically show that the structural unemployment rate is likely to increase during a downturn. The unemployed see their skills deteriorate, thus reducing their productivity levels and also their employability.

The last budget contains a number of important and critical measures to support training and employment and is expected to have an impact on the unemployment rate in the short-run itself.

However, delays in implementation and excessive bureaucracy could limit the positive impact of these measures.

Considering our implementation capacity, we forecast that the unemployment rate in Mauritius will fall to reach 7.8 percent in 2016 and 7.7 percent in 2017.

Figure 8 : Effective Growth Rate and unemployment rate, 2006 - 2017



IV. TREND ANALYSIS

Latest statistics show that growth in the global economy remains modest. The world economy remains on a fragile base and is faced by a number of uncertain elements.

Economic growth is expected to be of around 3 percent in 2016 and 2017.

For Mauritius, our forecasts point to a rate of 3.4 and 3.7 percent for 2016 and 2017 respectively.

Compared to the low point reached in 2015, we notice a real recovery in economic activity. However, the intensity of this recovery is weak.

Analysis of macroeconomic data in the recent period show that economic growth remains static because it is unbalanced.

The Mauritian economy has been, for some years now, in a phase where supply is greater than demand, resulting in disinflation and the non-reversal of the unemployment curve.

Companies respond to falling demand and lower profits by deliberately reducing their capital expenditure.

It is recognized that anticipation of future demand is the main factor affecting private investment . However, in a low growth phase or recession, there is a slowdown which will in turn negatively impact on the investment rate by encouraging companies to adopt a prudential investment strategy.

Taking into account the multiplier effect, a mere slowdown in demand may be enough to cause a sharp fall in investment.

Therefore, through this vicious circle, a fall in demand will cause a larger fall in investment which in turn will reduce investment.

To break this vicious circle in an economy faced with a lack of opportunities, a public policy stimulus to create additional demand is an effective instrument of economic recovery in the short term.

Harrod and Domar, in their theory on the imbalance of economic growth, show that public authorities have a major role to play in long term growth by ensuring that it is balanced.

By loosening and tightening its economic policies, the Government should adjust demand to match supply.

Major economic institutions worldwide, from the OECD and IMF to the G20 and European Central Bank are today in consensus to recommend demand-side measures to boost economic growth.

The IMF argues that in the current economic context, with lower outlook and weakened potential, it is urgent to adopt measures which improve short-term growth while also enhancing potential output.

The institution advocates for a three-sided policy: continued expansionary monetary policy, demand-side budgetary measures and structural reforms.

This approach aims, firstly, to boost demand in order to raise short-term growth, and secondly, to improve supply to strengthen the production potential.
On the demand-side, it remains essential to conduct expansionary monetary policy when output gaps are negative and inflation is too low.

Moreover, to give a boost to short-term growth, monetary policy should be accompanied with stronger short-term budgetary support when there is fiscal space available.

On the supply-side, the institution proposes the implementation of a credible program of structural reforms tailored to the needs of the country while taking into account both short-term and medium term impacts. These reforms are for instance those that lead to fiscal stimulus and reduce barriers to business.

In Mauritius, we find ourselves in a situation where economic growth and its potential are both weak .We thus need to adopt this three-sided policy.

V. OUR PROPOSALS

Demand-Side Measures

In the short term, economic growth depends essentially on demand factors which are the international environment for external demand and budgetary policy through income reallocation and salary increases for internal demand.

As external demand is expected to remain weak in the coming years , we must focus on our domestic demand. To boost the economy through an increase in demand, we need to work on two aspects.

There is a need to raise the purchasing power of those with the highest marginal propensity to consume i.e. those at the lower end , coupled with a broadening of the consumption base of the country through an increase in the number of consumers in the country.

Firstly, with inflation rate estimated at a historic low, and the persistence of output gaps, we should engage in an expansionary monetary policy. Throughout the world, according to available figures, around 40 percent of countries show a Repo rate of 2 percent or less. **With inflation rate less than 1 percent, we are of the view that there should be an additional cut in our Repo rate by 100 points.**

Secondly, to support those at the lower end, we propose the introduction of a negative tax on income.

This concept, invented by Milton Friedman, Nobel laureate in Economics in 1968, advocates for a direct income support from the Government in a reducing scale on personal income less than a specific threshold.

For Milton Friedman, it implies that, on the one hand, below a certain threshold, the Government gives you an income support. On the other hand, if you have incomes higher than a certain threshold, it imposes an income tax.

This support is at its maximum for an individual with no income, and is reduced till it is nil when the threshold is reached.

Based on the income gap in Mauritius, we propose a maximum monthly income support of Rs 2,000 to households with at least one dependent and an income of less than Rs 25,000.

According to our estimates, this measure could add up to 0.3 percentage points to our GDP Growth.

Thirdly, we propose to review the income tax exemptions thresholds in order for each dependent to be treated equally on a scientific basis and also to address the issue of low fertility rate in the country.

There are a number of inconsistencies on how our income tax exemption thresholds have been defined, as it doesn't take into consideration the equivalence scale.

Indeed, to compare the standard of living of households of different composition, the statistician uses an equivalence scale, to obtain the income per equivalent adult. The equivalence scale shows the link between a household's consumption and the number of adults and children for a specific living standard. It captures economies of scale realized by a multi-person household, mainly through use of shared goods.

Economic experts advocate for the use of an equivalence scale where the first adult accounts for one unit of consumption, each additional adult for 0.5 and each child for 0.3 units of consumption.

However, the income tax exemption thresholds in Mauritius is as follows- the first dependent weights 0.39 in consumption, the second dependent 0.21, the third dependent 0.14 units, and any additional dependent have a weight of 0.

This definition has had an adverse impact on our continuously declining fertility rate as it does not encourage households to have children. The fertility rate has fallen from 1.44 in 2013 to 1.36 in 2015.

Yet, the renewal rate, that is the average number of children per woman needed to maintain the population level of each generation is a minimum of 2.1 children per woman.

We propose to redefine the exemption threshold to allow for an additional exemption of 0.5 and 0.3 units for each additional adult and child respectively.

This will have a significant impact on consumption and could increase by up to 0.5 percentage points our GDP, ceteris paribus.

Fourthly, we propose to enlarge the country's consumption base by attracting 200,000 retired foreigners by 2020

Economic history shows us that at times of low economic activity, a number of opportunities arise. Mauritius has two major assets; on the one side it figures on the Top Ten of the most peaceful countries in the world and on the other hand, it is a country that makes foreigners, particular Europeans, dream.

In addition to the weak economy, the world is currently faced by geopolitical tensions and terrorism. There are many retired individuals in Western countries who are willing to settle elsewhere. In Europe alone, there are over 1 million British retirees who are in an uncertainty situation due to Brexit.

In addition to the budgetary measures to attract pensioners in nursing homes in Mauritius, we could amend the "Resident Scheme for Retired Individuals" to allow retired foreigners with a minimum monthly pension of $1,500 ($2000 for a couple) to live in Mauritius for a minimum of six months.

If we can attract 200,000 such individuals, this would bring an additional Rs. 65 billion yearly in terms of consumption into our economy.

To kick start, we should aim at attracting 20,000 such individuals to Mauritius for 2017. This has the potential to increase our consumption by Rs 6.5 billion, to increase our GDP growth by an estimated 1 percentage points, ceteris paribus.

This measure will have a spillover effect on all sectors of the economy. The increase in consumption will boost supply, increase investment in the economy and have an effect on all sectors of activity.

Fifthly, the extension of the VAT Refund Scheme for departing Mauritians

In a number of countries, the Government allows the refund of VAT and other taxes to its residents travelling abroad in order to encourage domestic demand.

We should adopt such a measure in Mauritius. In 2015, there were more than 250,000 Mauritian passengers leaving Mauritius for other destinations. Based upon the maximum of Rs 15,000 that the authorities allow for duty-free shopping abroad, **this measure could bring an additional 0.7 percent of our GDP**.

Supply-Side Measures

Given the weakness of our production potential, we should also adjust our supply with the setting up of structural reforms which are credible and adapted to our country's needs.

In fact, an economy in transition like ours, should have a potential growth rate of 5 percent and more, for it to reach the next phase of development.

Short and medium term increase to potential output is conditioned on improvement in the cost of doing business and the establishment of policies to promote research and innovation.

Firstly, lowering of the costs relative to starting a new business

The World Bank Indicator records all official procedures required to create and run a business. As from these procedures, there is a compilation of data on the costs and time involved.

These include obtaining all administrative documents, especially licenses, and performing all formalities for the company and its employees with the relevant authorities.

The cost is expressed as a percentage of GDP per capita.

In Mauritius, this cost fell from 8.8 percent of GDP per capita in 2005 to only 2 percent in 2016, which is in itself a huge progress.

However, Mauritius is ranked at only the 37th place, even if we have made efforts, 36 countries have done more.

New Zealand is the country which ranks first on this indicator. In that country, it takes only half a day to create a business and the costs relative to it is at 0.3 percent of GDP per capita.

We believe that there is a significant margin in Mauritius to further reduce the costs relative to the creation of a new business to a maximum of 1 percent of GDP per capita. Our estimates show that this measure would result in an increase of 0.4 percentage points in our GDP Growth, ceteris paribus.

Secondly, reducing the freight related costs

According to the "Ease of Doing Business 2016" report, Mauritius is ranked 66th on this subject, implying that freight related charges i.e. the administrative charges linked to custom clearance and inspection, custom brokerage, port charges, and inland transport are too high and that there is a large leeway for improvement.

Our estimates show that if we decrease these costs by 10 percent, it will bring 0.3 percentage points to our GDP Growth.

In addition to these measures to reduce the cost of doing business, we should promote research and innovation with an incentivisation policy. Mauritius ranks at a mere 76th according to Global Competitiveness Report of the World Economic Forum, with respect to the use of innovation in production processes. Our Research & Development (R&D) expenditure represents less than 0.5 percent of our GDP. This implies that there is a margin and that a marked improvement in the total factor productivity is possible and within our reach.

Thirdly, we thus propose the setting up of an "Innovation Box" regime in Mauritius

To promote investment (local and foreign), and productivity, we should consider the setting up of measures to favour productive investment and innovation.

Some countries such as Cyprus, Ireland or even the United Kingdom have set-up an "Innovation Box" regime to attract innovating enterprises and improve their economic performance.

This measure is a preferential tax regime used by these countries to support research and innovation through a lower rate of corporate tax or an exemption for income derived from IP assets such as patents and franchises.

Fourthly, a tax credit of 200 percent for investment in Research and Development (R&D)

Economic literature shows that the long-run elasticity of R & D in companies is 0.13. This elasticity, which is the private return on R & D tends to increase with time, a sign of the growing importance of innovation in business strategies.

However, expenditure on R&D in Mauritius represents a meagre 0.18% of GDP today. This is in stark contrast to EU countries in particular who have R&D expenditure to GDP of 2 percent and further aim to spend at least 3 percent of their GDP on R &D as per the Europe 2020 Strategy.

In the medium-run, we should aim to achieve 2 percent of GDP on R&D.

We can cite Schumpeter, who rightly argued that R & D is the driving force of economic growth in the long-term.

For Mauritius, we propose a zero percent tax rate on worldwide income derived from the totality of IP assets.

Macro-economic effect

The above measures correspond to a stimulus package of around 1 percent of the GDP.

A stimulus package of around 1 percent of GDP, can increase economic growth by up to 1.7 percentage points.

Indeed, the former chief economists of the IMF and the European Commission, Olivier Blanchard and Marco Buti, point out that public stimulus is essential in a slack phase of the economic cycle, as the value of the multiplier is high and greater than 1, going up to 1.7.

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