



# **Memorandum**

**For the**

# **2012 National Budget**

## **INTRODUCTION**

In the past, with a set of international rules which were clear and which gave us a guarantee of markets through quotas and preferential tariffs, it looked easier for us to define our development strategy and our budgetary policy. To-day, with changing rules and severe competition from the larger developing countries with higher competitiveness, even the near future appears difficult to predict.

Given our limited means, the strategy that we must follow is not anymore obvious and we need to be careful with our fiscal and budgetary instruments.

The new decade has to bring forward our ambitions tinged with realism. We'll have to ask ourselves how to achieve a fairly high growth rate that will help double the GDP in the next ten years.

The 2012 budget will be crucial as it will provide the basic elements to achieve this goal.

Beyond its specific mandate for Industry and Commerce, the MCCI takes part in the national economic policy formulation which shapes the economic future of our country through its research and by developing new economic analysis tools.

In this context, The Mauritius Chamber of Commerce and Industry is submitting its proposals for the 2012 Budget through this Memorandum and it is organised in the following order:

- SECTION I: ECONOMIC CONTEXT;
- SECTION II: RESTORING A COHERENT POLICY STANCE;
- SECTION III: THE MACRO-ECONOMIC POLICY ORIENTATIONS;
- SECTION IV: SECTORAL ISSUES.

## **I. THE ECONOMIC CONTEXT**

### **(i) The International Context**

Since the worsening of the financial situation, the world is in crisis again. According to the latest statistics from the Federal Reserve<sup>1</sup>, last August, the economic outlook for the United States, Europe and the World has changed. The organisation recognises that it is now clearly on the downside. In addition, the President of the European Central Bank, Jean-Claude Trichet, now speaks of "the worst crisis since the World War II."

The deterioration of the American note by Standard and Poor's, one of the three major rating agencies, on August 4, has worsened the situation. As in September 2008 with the bankruptcy of Lehman Brothers, this hasty action could be the trigger of another global crisis. The risk of a double-dip recession, as feared in 2009, is now real.

Except that the situation today is different from 2008. At that time, doubt came from the poor health of financial institutions and the response was massive public intervention through exceptional monetary policies, direct support to the private sector and fiscal stimuli. Governments took courageous action to prevent a disastrous collapse of demand. They counteract the private contraction with the use of fiscal expansion. We got through an economic crisis which could have been systemic, paralysing the global economy.

But the developments during the last quarter have indicated that we are in a dangerous new phase. The current crisis could be more acute than that of 2008 as this time the tools available to stimulate the economic activity is much more limited.

Today, it is the public sector balance sheet itself that is in the firing line. There are doubts about the sovereign debt. Adding to this, global growth is also being held back by slow demand in advanced economies. Rigor looks all over Europe and even in the United States as the U.S. Congress has approved budget cuts of 2.5 trillion dollars over 10 years.

The scope for public responses is much narrower today than in 2008. The monetary policy is more constrained as the precedent crisis has left behind a legacy of public debt.

The problem is that if growth continues to lose momentum and if the advanced countries succumb to recession, the emerging markets will not escape. Hence we risk seeing the fragile recovery of the global economy derailed.

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<sup>1</sup> Federal Reserve Statistical Releases, Aug 2011

According to the IMF<sup>2</sup>, World Gross Product is forecast to expand by 4.2 per cent in 2012, well below the 5.1 per cent reached in 2007. The recovery may, however, suffer setbacks and slow to below 2 per cent<sup>3</sup>, while some developed economies may slip back into recession if several of the downside risks take shape.

(ii) **The Domestic Context**

For Mauritius, with an open economy like ours, it is logical that the fortunes of our economic activities be influenced by developments on the global scene and, particularly, the performance of our main trading partners.

The outlook for 2012 is positive. However, taking into account the expected downturn in the world economy, real GDP growth is projected between 3.5 to 4.0 percent in 2012, according to the main international organisations, all things being equal.

Taking a longer view of the performance of the Mauritian economy, it appears that we have not yet found the comprehensive policy response to migrate from a strategy built on preferences to one fuelled by global competitiveness. We have not found the answers to the changing global economic landscape.

During the three decades after independence, the economic strategy enabled Mauritius to register an annual growth rate of about 5.5%, more than double the rate of Africa, significantly higher than that of developed countries and only lower to that of countries of East Asia. Between 2001 and 2010 the average growth rate has been about 4 %, with 6 out of 10 below 5%, lower than Africa in recent years and significantly lower than the emerging countries of East and South Asia.

The new economic strategy initiated as from 2006 has provided some answers. We should build upon these “acquis” to do more to reinforce that strategy both at macro and sector levels

The long-term growth prospects for Mauritius lie around 4 percent, but could increase with deliberate effort. To achieve the target of 6 percent, which would allow the reduction of unemployment, we need to implement now a new economic agenda, which we can call the 2020 Agenda, in reference to the 2010 Agenda in Germany.

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<sup>2</sup> IMF World Economic Outlook, Apr. 2011

<sup>3</sup> UN World Economic Situation and Prospects 2011

## **II. RESTORING A COHERENT POLICY STANCE**

It is to be recalled that Mauritius has been pursuing since 2006 a new economic strategy which seeks to build a more dynamic and competitive economy. The main thrusts of this strategy have been:

- The Uniform Tax Regime
- Open Trading System
- A Business Friendly environment
- Globally Competitive Sectors

There is no doubt that implementation of this strategy since 2006 has delivered a number of positive results, mainly in terms of economic growth and unemployment reduction. However, since the Great Crisis in 2008/2009, the growth momentum is clearly on the downside despite the different public stimuli.

Given the risks of a new economic downturn we should build upon the “acquis” of the 2006 economic strategy and go further beyond to achieve higher growth rate in the short/medium term.

### **(1) The Uniform Tax Regime**

Behind the introduction of the Uniform Corporate Tax and Personal Income Tax rate of 15% was the idea to replace the Progressive taxation, an immensely complicated and highly distorted system of taxation, by the fairest, most efficient, and simplest tax system, the Flat Tax.

The established evaluation criteria for effective taxation are efficiency, fairness, and simplicity.

Efficiency requires that economic distortions be minimized when taxes are imposed. A flat tax removes nearly all tax-based programs, thus minimising the amount of economic distortions caused by special-interest driven initiatives.

Fairness, or equity, requires that individuals or households with similar incomes face similar tax burdens and pay more tax as its income increase. This means that different types of income must be treated equally. One of the main strengths of a flat tax is that it treats all sources of income equally. Specifically, a flat tax fully integrates personal and business income to ensure that all sources of income are taxed once and at a uniform rate.

The final criterion, simplicity, refers to the levels of citizens’ comprehension of the tax system, and their ease of complying with it. Simplifying the system is a central part of flat tax reform.

In addition to the reasons listed above, there are also competitive and economic reasons for adopting tax reform based on a flat tax. This system would establish a relative advantage on our competitors and

would include greater rates of economic and income growth, higher levels of capital formation and investment, and greater social welfare.

Under a flat tax system, income is taxed once at a flat rate, encouraging people to save (or consume) and invest more of their income, since their investments will not be taxed at every turn. An increase in consumption, savings and investment will have positive spillover effects on the economy as a whole.

Thus, a flat tax would increase tax revenues, by simplifying the tax code, removing the loopholes currently exploited to pay less tax and more income due to higher levels of economic growth from the introduction of the flat tax as predicted by the Laffer Curve.

This reform has been a success for the country in terms of economic growth and has represented a major step forward in creating an attractive level playing field for all activities and a major a major source of competitiveness for Mauritius. This is why it should be maintained and intensified.

It has been a major factor in raising FDI to unprecedented record levels.

Some countries (example in Eastern Europe) have gone lower than 15%. From a strategic standpoint we should in the medium term **lower further the uniform tax rate**. This would act as a catalyser on the business and consumer confidence and hence promote private investment and consumption, triggering a positive dynamics of our economy and an increase of our growth prospects. This would generate more tax revenues, offsetting the loss due to lower tax rates.

Furthermore there has been a carving out for companies operating in the global financial sector. And the crisis has motivated a postponement of the date of extending the uniform rate to Freeport Operators. The MCCI believes that Freeport Operators should be subjected to the same regime as in the global financial sector as competitiveness issues are similar in the two sectors.

The principle of uniformity should continue to be the rule but very few temporary exceptions, if fully justified, can enhance the effectiveness of the tax system. Lower than the uniform rates should be applied in an exceptional manner on sectors faced with special difficulties. It should also act as an incentive to promote investment in new sectors / products / markets and **R&D**. For the latter we should base ourselves on the Singapore model.

To support innovation and productivity growth, the Singapore government has established, through the 2010 Budget, the "**Productivity and Innovation Credit Act**", effective from 2011 to 2015. This allow all companies that invest in research and development, tax deductions up to 250 percent of expenses they have incurred in each of 6 qualifying activities:

- Research & Development (R&D) (e.g. Salaries for R&D personnel);

- Registration of Intellectual Property (e.g. Fees to Intellectual Property Office of Singapore and patent lawyer to register patent);
- Acquisition of Intellectual Property (e.g. Payments to buy a patented technology for use in a manufacturing process);
- Design activities (e.g. Fees to an outsourced designer);
- Automation through technology or software (e.g. Payments to buy a point of sales system to be installed in a restaurant); and
- Training of employees (e.g. Course fees for front-line staff).

For business without adequate taxable income, they can use their excess tax deductions for future years.

## **(2) An Open Trading System**

Mauritius is ranked as the world 12<sup>th</sup> freest economies<sup>4</sup> in the world in front of United Arab Emirates (47<sup>th</sup>), South Africa (74<sup>th</sup>), Brazil (113<sup>th</sup>), India (124<sup>th</sup>) and China (135<sup>th</sup>). On this basis, we can say that we are ready to implement the 'shopping paradise' concept, which could be a new source of growth for the Mauritian economy.

However, at the same time, we should be very careful and pragmatic to choose the best option to set it up, for our own interests, by continuing to ensure the good development of the Domestic Oriented Enterprises (DOEs) which is a major contributor to growth, employment and social stability.

It was on the basis of our comments that a Committee, chaired by the Ministry of Finance and comprising representatives from the JEC, MCCI and AMM, was set up to reconcile the objective of an open trading system with the continued development of the DOE. The subsequent elimination / reductions of duty were carried out on the basis of the 'hyper sensitive' and 'sensitive' lists of products determined by that Committee.

This approach was discontinued with the new economic strategy which had as objective a 100% duty free regime. There were deep cuts of duty, including on products on the 'hypersensitive list' in the 2007/2008 and 2008/2009 Budgets.

Taking into consideration that:

- (i) 94% of tariff lines are already duty free;
- (ii) The maximum tariff rate has been slashed from 85% to 30%;
- (iii) The tariffs in many products in the 55% - 85% range have been reduced to 15% or even zero;
- (iv) The attempts to put the DOE on a level playing field with equivalent imported products (pre-condition to moving to a duty free regime) have not been fully conclusive because of unequal

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<sup>4</sup> 2011 Index of Economic Freedom

- conditions of production and the existence of Non Tariff Barriers to trade in the originating countries;
- (v) The slow setting up of regulatory measures (standards, labelling, consumer packs size, ....) on imported products to stop the unequal playing field and level competition between local and imported goods;
  - (vi) The inappropriate monetary policy in the actual economic context, concerning the interest rate and particularly the exchange rates, which acts as a subsidy on importation;
  - (vii) A 100% duty free regime will put at risk our preferential market access to the region (IOC, SADC, COMESA) which should be a major target for market diversification, discussed later.

And that in spite of these barriers, the DOE sector continue to grow and to be competitive:

- (i) The contribution of the DOEs to GDP represents more than 11% in 2010 and ranked 4<sup>th</sup> among the top leading contributors to GDP;
- (ii) The employment trend of the sector is on the increasing side, from 37,100 in 2007 to nearly 57,000 in 2010. We should take into account that employment in DOEs cannot be delocalised;
- (iii) The sector accounted in 2010 for Rs 85.8 billion of Gross Output, Rs 60.1 billion of intermediate products, Rs 25.7 billion of Value Added, Rs 10 billion as compensation of employees and Rs 24.3 billion of Gross Operating Surplus.
- (iv) The DOE are exporting significantly more than 6 years ago and they need the domestic market to reinforce their export potential;
- (v) The existence of a vibrant agro-industry in Mauritius has significantly mitigated the adverse impact of the 2008 food crisis on the Mauritian consumer and a Food Security Fund has been put into place to reinforce the sector.

The MCCI is convinced that we should maintain a residual duty of 15% on a list of strategic products (food and other products) in which there is significant value addition and which contribute to maintaining the competitive strength of our industrial sector.

It is undoubtedly the best alternative to reconcile our various objectives ('Shopping Paradise Island', the 'level playing field' principle, our market access in the region, food security) with that of a competitive DOE sector.

This residual duty which, according to our estimates, will apply to around 3% of product lines, will in no way frustrate the objective of making of Mauritius a 'shopping paradise' (neither Singapore nor Dubai has a 100% duty free regime).

Further, a proper strategy has to be put into place. This strategy should include:

- (i) The elimination of duty on remaining non industry-sensitive products';
- (ii) The alignment of our labelling and standards requirements on international best practice;



- (iii) The enforcement of Intellectual Property Rights Legislation, (including some licensing of shops) to comfort foreign buyers on branded products;
- (iv) The development of access to shopping malls to tourists;
- (v) An appropriate policy by the national airline to favour shopping tourism from the region and beyond; and
- (vi) The extension of the VAT Refund System.

We would, therefore, recommend that:

- (i) The Committee established in 2004 to reconcile the objective of an open trading system with the continued development of the DOE, be reinstated to re-visit the issue and make recommendations on the way forward. The study commissioned by MCCI/AMM on this issue and which will be available at the beginning of October 2011 should help;
- (ii) A Task Force be set up to strategise and making of Mauritius a genuine shopping paradise.

### **(3) A Business Friendly Environment**

The business facilitation exercise initiated since 2006 has indeed gone a long way in creating a much more business friendly environment. The ranking of Mauritius at the 20<sup>th</sup> place out of 183 countries in the '2011 Doing Business' report of the World Bank is a clear testimony of the progress achieved. We should note that Singapore is the top ranked in the Ease of Doing Business.

However, if overall the progress has been remarkable, especially in the pace at which legal and regulatory provisions have been reviewed to facilitate business; there are still some areas which need further attention. The performance of the country on a number of indicators should be upgraded to improve the business climate. Our aim should be to enter the top 10 of the "World Bank Doing Business" ranking. It would help to enhance the country's relative and comparative advantage by improving our competitiveness, attracting FDI inflows and hence increasing our potential growth.

#### a) Measures to improve the ranking of Mauritius

##### (i) Dealing with Construction Permit

This indicator measure the 'Number of Procedures to legally build a Warehouse', the 'Time' and the 'Cost' required to complete each Procedure'. Mauritius is ranked 39 out of 183 countries on the benchmarking of this indicator.

There are **18 procedures and it takes 107 days with a cost of 32.3% of income per capita** to complete these procedures. Comparing with good practices (6 procedures in Denmark, 25 days

in Singapore and a cost of 0.8% of income per capita in Qatar), we find that the leeway is important and that we can only do better.

We can point out some criteria which could and should be improved. The plan approvals from the CEB, CWA and WWA authorities take 15 days, the sewage connection from the WWA takes 60 days, power connection from the CEB and water connection from the CWA takes 14 days, phone connection from Mauritius telecom takes 10 days, building and land use permit takes 14 days, occupancy permit 10 days and plan approval from the Fire Department 14 days. Furthermore there are different costs attached to these procedures and you need to go to each of these institutions to obtain the approvals.

There is a need to harmonise all these procedures and set up a one-stop shop for construction permits. We should perhaps have a close look on the following two reforms:

- In Botswana, a one-stop shop for construction permits, 'Centre de Facilitation des Actes de Construire', was opened in May 2008. The new regulation merged 32 procedures into 15, reduced the time required from 226 days to 122 and cut the cost by 40%. From May 2009 to May 2010, the number of building permits increased by more than 400%.
- Toronto reformed its construction permitting process in 2005 and introduced time limits for different stages of the process. Between 2005 and 2008, the number of commercial building permits increased by 17%.

## (ii) Registering Property

This indicator measure the 'Number of Procedures to legally transfer title on Immovable Property', the 'Time' and the 'Cost' required to complete each Procedure'. Mauritius is ranked 69 overall for Registering Property.

There are **4 procedures** and it **takes 26 days** with a **cost of 10.6% of property value** to complete these procedures.

Good effort has been achieved by the country as in 2009 the time required to complete the procedures was 210 days.

However, comparing with good practices (1 procedure in Norway, 2 days in New Zealand and a cost of 0.0% of income per capita in Saudi Arabia), we can do better. The costs attached to these procedures could and should be reduced. We could perhaps lower the transfer tax (5% of property value) and the registration fee (5% of property value) by half.

Moreover we could increase the number of authorised users. In Georgia, for example, Property Transfers can be completed through 500 authorised users, mainly banks. This saves time and reduces cost for entrepreneurs.

## (iii) Getting Credit Regulations

This indicator assesses the legal rights of borrowers and lenders with respect to secured transactions and the sharing of information through 2 variables: the Strengths of Legal Rights Index (marked 0 to 10) and the Depth of Credit Information index (marked 0 to 6). Mauritius is poorly ranked at the 89<sup>th</sup> place for this indicator (Kenya was ranked 6<sup>th</sup> on the 2011 report). We have got respectively a score of 5 and 3 during the last three years. We should note that Singapore got 10 on 10 for the first variable and United Kingdom had a score of 6 on 6 for the second variable.

We think it is time to change completely our approach on these two variables and introduce a time limit agenda to improve our performance.

(iv) Enforcing Contract

This indicator measure the 'Number of Procedures to Enforce a Contract', the 'Time' and the 'Cost' required to complete each Procedure'. Mauritius is ranked 61 overall for enforcing contract.

There are **36 procedures** and it **takes 645 days (25 days for filing, 440 days for trial and judgement and 180 days for the application of the judgement)** with a **cost of 17.4% of claim** to complete these procedures. Comparing with good practices (20 procedures in Ireland, 150 days in Singapore and a cost of 0.1% of claim in Bhutan), we find that the number of procedures, the time and the cost are too heavy and we need to act on the three variables. In Rwanda, for example, the implementation of more specialised commercial courts in May 2008 contributed to reduce the time to resolve a commercial dispute by nearly 3 months.

(v) Closing Business

This indicator concerns the Bankruptcy System of a country. It measure the 'Time required to Recover Debt (in years)', the Cost required to Recover Debt (% of debtors' estate value)' and the 'Recovery Rate for Creditors (cents on the dollar). Mauritius is ranked 71 overall for its bankruptcy system.

It takes **1.7 years** with a **cost of 15% of debtors' estate value** to Recover Debt and the recovery rate is 35.1%. Comparing with good practices (0.4 years in Ireland, cost of 1% estate value in Singapore and a recovery rate of 92.7% of in Japan), we find that there is a lot we can do to improve this criteria. Following the Bankruptcy Reform in Brazil in 2005 to improve creditor protections in insolvency proceedings, there has been an average reduction of 22% in the cost of credit for Brazilian companies, a 39% increase in overall credit and a 79% increase in long-term credit in the economy.

b) Implementation of New Laws and Regulations.

Another area which calls for further work is the actual implementation of new laws and regulations at operational level. There are still complaints about insufficient sensitisation on the many changes being made and the delivery of services by those who are supposed to implement the new rules of the game. A review process of the quality of the implementation can help to improve the implementation of new measures.

c) Regulatory Impact Assessment

More importantly, the concerted efforts being deployed to improve the business environment are being undermined by regulations being implemented overnight in response to specific occurrences or to new initiatives in some quarters. These initiatives (for example the regulations on food or road transport) have brought major hardships to various segments of the business community, which could have been avoided if a consultative process was put into place prior to implementation.

d) Enforcement of Regulations in The Health Sector

Although we do agree that public health is an area which requires strict enforcement of regulations, there should be a due process whenever any contravention to existing laws and regulations are identified. This should include a right of appeal to an Independent Authority, and possibility of counter expertise for the contravening party. Given also that the reputation of businesses is at stake, any action of relevant authorities should be exercised with discretion and caution.

e) The logistics Performance Index

Although Mauritius has been doing well in most performance indices published by international organisations, its ranking in the Logistics Performance Index of the World Bank in 2010 was very poor.

In 2010 the country underperformed on three aspects: infrastructure, logistics competence, and tracking and tracing. There are serious infrastructure bottlenecks and poor logistics performance both of which are not at par with its middle income status. In particular this is a deterrent if we want to attract globally competitive industries.

A committee should be set up under the aegis of the Ministry of Finance, which regroups stakeholders from the public and private sectors, to improve the quality of our logistics and its rating by the World Bank.

f) Infrastructure Development

The ERCP rightly puts emphasis on the development of infrastructure, without which there cannot be a business friendly environment.

Time taken to review alternatives regarding the provision of major infrastructure and public utilities facilities has had a negative impact on the level of service in the country. Identified projects should be implemented with a real sense of urgency.

The airport and roads were the two major areas of concern.

The new terminal at the SSR International Airport is finally underway. As we have mentioned in the past, in spite of some major projects in the road sector, there cannot be any long-term solution without the implementation of a mass transit system along the Curepipe – Terre Rouge corridor.

In the port sector a number of projects have been initiated in the recent past (petroleum jetty, cruise jetty, additional gantry cranes, dredging, etc.) to improve the port infrastructure. And the decision to extend the MCT quay represents another step forward. However, the ‘soft’ part of the equation, the management of handling operations, has still not been finalized. This can only come with the finalization of the deal for a strategic partner. As suggested by ASP Steering Committee, it is imperative to remove the social costs associated to the partnership, to make the deal go through quickly and in the best conditions.

The absence of an independent regulator in the energy and the delay in determining the objectives of the MID project, are major missing links to implement a long term energy development plan in the country. If these issues are not resolved quickly, we not only run the risks of implementing the wrong projects but the country also runs the risk of power shortages in the medium term.

Finally, there is water. Again this year, the country is faced with restricted water supplies. As opposed to energy, this sector has not received a lot of attention. But there is growing consensus worldwide that water will be the great challenge of the future and according to international classifications, Mauritius is already a ‘water stress’ country. In spite of an attempt to devise a long term development of the sector, actual projects to collect, store and process water are nowhere near to the challenge. The recourse to expertise from Singapore in this area is a positive initiative as there is indeed a need to take a more strategic approach to the development of this sector.

#### **(4) Globally Competitive Sectors**

The strategy to move from preferences to global competitiveness has delivered very little on its promise. If the sugar sector is weathering the storm of the drastic reduction in price, by reorganising itself and diversifying its activities, and the textile and clothing sector has survived the phasing out of Multi Fibre Arrangement, the future of both sectors still hang on a number of factors beyond the control

of operators. The global financial sector still relies heavily on the existing provisions of Double Taxation Avoidance Agreement with India.

In spite of various schemes to encourage product and market diversification by existing export enterprises and to bring the Domestic Oriented Enterprises to export their products, the results both in term of new products and new markets have been very limited, the only notable exception for new products being tuna loin, and for new markets, South Africa (thanks to the SADC Trade Protocol).

The continued appreciation of the Mauritian rupee has had and continues to have a devastating impact on the profitability rates of the productive sectors, stifling private investment, creation of new employment and revenue generation, and hence jeopardizing future growth.

In addition, the successive crises continue to weaken these companies.

The lesson we can draw is that the inherent disadvantages of Mauritius (distance from sources of supply and markets, lack of natural resources, limited trained working force, R&D, etc), coupled with the costs of innovation and marketing represent major challenges, which enterprises and industries on their own cannot overcome to achieve global competitiveness.

There is a strong case for an 'offensive agenda' in the support measures to industry. This agenda implies a significantly higher level of support, in line with what our main competitors are doing, in the four key areas of competitiveness at firm level (internal financial strengths, investment in technology, R&D and Marketing) and a diversification of markets.

#### **(a) Enhancing the Internal Financial Strengths of Enterprises**

The high leveraging of our enterprises can be a source of weakness. We share the policy initiated recently for a deleveraging of enterprises, a vital condition for internal strength to develop competitiveness. This policy has to be maintained.

#### **(b) Investment in Innovative Equipment**

Growth is highly reliant on investment and in the case of industry; investment in innovative equipment is a major element to achieve competitiveness. And, in addition, during periods of economic crisis operators are reluctant to invest in new machinery because of uncertain prospects. Therefore, incentives to acquire new equipment should become a permanent feature of support to industry, as was the case in the past. The following instruments could meet the objective:

##### **(i) LEMS**

It is not surprising that among the instruments put into place under the ASP, the Leasing Equipment Modernisation Scheme (LEMS) has been the most widely used by economic

operators. The resources earmarked under this sector should be increased and consideration should be given to making it a permanent feature.

(ii) **Double VAT Deduction**

In order to support investment in new technology, modernisation and upgrade of businesses, a double deduction of VAT paid on productive equipment is practiced in various countries.

This measure is simple to implement, cost effective and on a 'one-off' basis. It can be assimilated to a tax break of 15% without any cash injection from Government, as it used to exist prior to the abolition of all tax incentives.

This measure will put our operators at par with their competitors in these countries and compensate some of the inherent disadvantages linked to a small market and remote location like Mauritius.

(c) **Innovation and R & D**

As we move from an economy based on preferences and protection to one based on global competitiveness, innovation backed by R & D will become the determinant factor in competitiveness. There has been in the past, on the one hand assistance directed mainly to business process re-engineering (through NPCC or EM and foreign institutions like the CDE) or some limited research work carried out by the MRC or the University of Mauritius.

But, except from the MSIRI for the sugar industry, there is not in place any instrument to support industry-based R & D. In spite of this situation, a number of individuals / enterprises have over the years developed innovative products, equipment and processes. Their challenge has been to exploit commercially these innovations and to protect their inventions both in Mauritius and abroad. On this last aspect, it is to be noted that the costs of patenting inventions overseas are very high.

To develop the competitiveness of industries and for future growth, R & D is vital. It is imperative to set up an R & D dynamic policy to encourage private enterprises to invest in R & D.

We could put in place the **Singapore model** with the "**Productivity and Innovation Credit Act**", to support Research & Innovation and hence enhance productivity and growth. The mechanism is explained above.

(d) **Diversification of Products and Markets**

Our colonial history and trade preferences obtained have led to a concentration of both markets and products. As preferences disappear, while efforts to keep market shares in existing markets and products should be maintained, long term sustainability and competitiveness will come from a diversification of products and markets. Two new factors militate in favour of this strategy. First, recent economic performance and prospects for future growth are much lower in established markets than

other regions. Second, the recent wider fluctuations in exchange rates have further exposed enterprises / sectors with over dependence on specific markets.

As far as diversification of and improvement in the quality of products, EM with the support of sector organisations is already involved in a series of activities in various sectors (textile & clothing, jewellery, agro-industry...). These have to be maintained and more resources dedicated to this exercise.

The diversification of markets is a much bigger challenge. It requires a more coordinated approach and sustained efforts both from operators as well as public and private sector organisations. 'One-off' trade missions and participation in trade fairs are clearly inadequate to make inroads in new markets. We recommend the following:

- (i) Targeted and sustained promotional campaigns in identified markets (as EM has started to do in South Africa);
- (ii) Re-introduction of the grants for marketing trips with a higher level of grants for developing new markets;
- (iii) Extend the Export Credit Insurance Scheme to the new markets (some countries, especially in Africa, are not covered by the COFACE scheme);
- (iv) Review existing and put up new facilities for certification of products according to standards required in targeted markets; and
- (v) Put more emphasis on bilateral economic diplomacy to eliminate NTBs and enhance market access conditions.

### **III. THE MACROECONOMIC POLICY ORIENTATIONS**

The long-term macroeconomic performance of Mauritius have been influenced by a combination of exogenous factors, mainly preferential accesses by trading partners which can be compared to an implicit export subsidy and sound economic policies, including efficient trade development strategies and favourable dynamics of our currency which have helped to maintain the external competitiveness and support economic growth.

With the dismantling of these preferential accesses, our country was in a delicate position and the main objective of the new economic strategy of 2006 was to promote globally competitive industries to sustain our economic growth.

However, further to the succession of crises and misalignment of our economic policies, there is a need of better coherence of our macro-economic policy orientations to reach the main objective of an average growth rate of 6 percent for this decade. Our recommendations are as follows.

#### **(1) Investment**



One of the main concerns for the Mauritian economy is the investment rate and the situation is quite alarming in regards of private investment. There was no growth in 2010, in real terms, after a drop of 1.3 percent in 2009. For 2011, we forecast a minor growth of 0.6 percent. Furthermore, there is a steady decline in the share of private investment in the GDP. For 2011 it is estimated at about 18 percent.

	2008	2009	2010	2011
<b>Private Investment as a % of GDP</b>	20.5	19.8	18.8	18.2

Our country, no longer has a comparative advantage with the rest of the world. The privileged accesses to markets have disappeared. And there have been new taxes such as CSR tax, the tax on dividends and that on capital gains, which is changing the fundamentals of our tax policy. Furthermore, some investment projects are blocked at the government level and we are having a restrictive monetary policy.

All these elements give a confused and uncertain image of our economic policy, which casts doubts on investors. The tax model and the monetary policy have evolved in the wrong direction and at the wrong time. This results in the loss of faith in the Mauritian model.

This can and should be corrected as soon as possible. We need a strong signal from the authorities to restore investors' confidence. The factors that can influence the level of investment are: real interest rates, the rate of growth of demand, corporate taxes, technological change, degree of market competition and especially business confidence, which is a prerequisite for investment.

If there is a significant decrease in the repo rate, which is maintained for some time (like recently in the US), we can have an improvement in the business confidence (as observed, after the 100 points decrease in the repo rates, during the business climate survey conducted by the MCCI in December 2010).

Furthermore, as explained earlier, we should **lower further the uniform tax rate** and implement it in the 2012 Budget.

These actions would act as a catalyser on the business confidence and hence could trigger a positive dynamics of the private investment.

## **(2) Exchange Rate Policy**

The active policy of gradual depreciation of the Rupee, pursued for three decades, has helped to maintain a comparative advantage and served the country well; however, since 2010, according to the IMF report on Mauritius<sup>5</sup>, our currency appears to have appreciated with respect to its estimated

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<sup>5</sup> IMF : Public Information Notice No 11/49, May 2011

equilibrium rate. In other words the rupee is overvalued, the more so when the economic situation is difficult.

The appreciation of the rupee is hampering our growth potential by undermining the competitiveness and the profitability rates of our industries, particularly businesses facing global competition. This unfavourable rupee dynamics has cropped up just after the successive economic crises which has very seriously affected these companies.

This policy has pushed us into a vicious circle of: a strong rupee, lower profitability rates, lower business confidence, lower investment rate, rising of unemployment, lower salary compensation, lower household confidence, a decrease in consumption, fall in tax buoyancy and a lower growth expectation for years to come.

The long-term objective of the exchange rate policy should be to have stability in the average exchange rate of the Rupee (preferably on a trade-weighted basis). But in the short medium term, we need to come back to the 2009 values. This single measure will undoubtedly contribute the most to restoring the competitiveness of our industries, lessen apprehensions in many sectors and enhance our growth potential for 2012.

	2006	2007	2008	2009	2010	2011*
US\$ to Rs	31.15	31.37	28.36	31.94	30.89	28.88
€ to Rs	39.51	42.92	41.61	44.52	40.95	41.29

\* Jul 2010-Jul 2011 Period Average

As said by Christine Lagarde, the central bank should be ready to dive once more into unconventional waters when the needs arise. For Mauritius, we have lost so much time with incoherent decision. It's now time to act on this issue and to have a progressive monetary policy by decreasing significantly the repo rate.

### **(3) Inflation and Monetary Policy issues**

Everyone knows inflation by its most apparent signs that are prices increases and a decrease in the real value of money, however, it is more difficult to analyse the origins as they are numerous and often overlap with each other.

We can distinguish two main sources: demand inflation and cost inflation. The first one, demand inflation, occurs when demand exceeds production capacity, resulting in higher prices. It implies in theory, a situation of full employment as production is at its highest level. The second one, cost inflation, occurs when there is an increase of at least one variables of production (salaries, raw materials, taxes, distribution costs), not compensated by productivity gains. The cost-push inflation can grow in parallel with unemployment. This corresponds to the local context.

There is also the case of the excess of money on the market, whether to deal with increasing demand of credit or due to increasing public expenditures.

There are several forms of inflation depending on the nature of the phenomenon. We can talk about rampant inflation, open inflation or hyperinflation. We also distinguish inflation that occurs in period of sustained economic activity and stagflation which occurs during downturn.

It is true that intuitively we tend to give bad credit to inflation. Inflation has negative consequences as it increases social inequality by penalizing those whose purchasing power depreciate and can lead to imbalances in economic relations with other countries. However, inflation has some positive aspects. Moderate inflation can stimulate economic activity and growth. We speak in this regard of growth inflation. Indeed, economic growth relies heavily on investment, which can be an inflation factor as there are raises in income distribution, while the goods and services associated with the increase in investment are not yet on the market. In addition, it reduces borrowing costs, which are repaid in depreciated currency.

By the way, contained within acceptable limits, it serves the economic development of a country by stimulating demand in view of further price increases.

The question then is: what is the acceptable limit level of inflation?

According to Rogoff<sup>6</sup>, moderate inflation can help in crisis period because it can effectively absorb all non-indexed debt in the economy. This author believes that a moderate rate of inflation, in times of crisis, is **6 percent**.

In Mauritius, since the end of 2010, there are increasing inflationary pressures marked by rising prices of raw materials and foodstuffs. According to the IMF, most of the recent increase in the inflation rate appears to be due to one-time exogenous factors as 53 percent of the CPI basket, in Mauritius, consists of imported goods, which have experienced a level increase. In addition, there were one-time increases in administered prices. These developments need not result in sustained inflationary pressures, with the appropriate wage policy.

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<sup>6</sup> Rogoff. K, (2008) Is the 2007 US Sub-Prime Financial Crisis So Different?, An International Historical Comparison, *American Economics Review* 98 (May 2008):339-344

Rogoff. K, (2011) The Forgotten History of Domestic Debt, *Economic Journal* Vol. 121

At the MCCI, in March 2011, we estimated an inflation rate of 6 percent for this year. We note that despite the tightening of the monetary policies, marked by two consecutive increases in the repo rate, the inflation should be of more or less 6 percent for 2011. The main reason behind this is that the increase in the inflation rate is directly related to the increase of imported goods prices'. It is not on the demand side.

We can conclude that the successive increases in the repo rates are only operating as a barrier to our economic development and hence reaping an unfavourable dynamics. We believe it is time to change our monetary policy and to carry out a significant drop in the repo rates.

#### **(4) Wages Policy**

2012 will be a very difficult year for all sectors. At this juncture, a coherent wage policy can contribute to protect jobs and avoid a social crisis developing in the country, with an increase of unemployment. The level of wages and the quantum of increases as a principle should be conditional on productivity increases and capacity to pay. Government should consider the general situation in the private sector, to determine a quantum of salary compensation that would not only be fair but would also be in favour of employment protection and the economy as a whole.

There is also another issue that should be tackled. It is the next PRB.

The wage share of the public sector continues to rise since the previous PRB and this even though the share of the public workforce to the total is lowering.

Percentage distribution of Compensation of employees			
	2009	2010	2011
<b>Public Sector</b>	<b>22.6</b>	<b>24.5</b>	<b>24.6</b>
<b>Private Sector</b>	<b>77.4</b>	<b>75.5</b>	<b>75.4</b>

In our view there are two key constraints. On the one hand, the decline in tax revenues for 2012, due to a predicted fall in economic growth, and, on the other hand, the fact that the level of public debt has reached the acceptable limit.

We must remain vigilant in relation to what is happening worldwide and not to give international institutions and credit rating agencies, arguments for degrading our credit rating. This will have an irremediable consequence on our economy. In addition good governance forces us to be careful. If, in

the future, there is an increase in tax revenues, either by higher growth or with revenues generated from privatisation, we must use the additional gains to reduce the level of public debt.

The civil servants, in addition to the annual increment, have an important revaluation of their wages with the PRB, with insufficient productivity gains. This policy is unfair, creates distortion on the labour market and, ultimately, could weaken the public accounts, thus affecting the economic viability of our country.

That's why we think it is time to have only one wage policy, based on productivity gains, for both private and public sectors.

## **(5) Labour Market Issues**

The concept of 'mismatch' has often been used to describe the situation in the labour market, where scarcity in some areas prevailed while unemployment figures remain sizeable. But beyond this mismatch, there are two characteristics of this labour market which are contributing to erode the competitiveness of enterprises.

First, this a 'shallow' market in term of the pool specialized skills. As soon as there are significant developments in existing sectors or emergence of new activities, the market dries up quickly, pushing employers in a 'poaching mode', which drives remunerations up artificially and, in the process, significantly erodes the competitive edge of enterprises.

Second, there is resistance from Mauritian workers to join certain sectors (ex. the textile and building industries), which compels employers to have resort to imported labour, which increases their costs and, again, erodes their competitive edge.

There is no quick fix to address labour market issues. In the short term, assessment of skills requirements at sector level, and incentives for specialised training, coupled with more flexibility in the recourse to imported labour, are the appropriate responses.

The quality and efficiency of our labour market information system should be improved. Our Employment Information Centres (EIC) needs to be improved. For example, the EICs should be strengthened and operated as a one-stop shop, decentralised at the district level, where all the necessary employment, training and career-related information, guidance and advice could be available under one roof.

They should be modernized both in terms of their IT system and physical environment. The human resources also require appropriate capacity building in order to offer high quality services to customers (unemployed, employees, employers, etc.). Furthermore, targeted assistance could be given to the

most vulnerable groups that have difficulty in finding jobs in order to manage and prevent long term unemployment.

However, the unemployed should report on a monthly basis to an EIC adviser, with the risk of being removed from the list if one does not comply for three consecutive months. This will lead to more pertinent information on the unemployment rate and on the characteristics of the unemployed. Thus, we can develop better policies to fight against unemployment.

In a longer term perspective, there is a need to assess the projected skills profile of the labour force so as to bring appropriate changes in the education / training system to match the future demands of the economy. In parallel, given the narrow skills base of the country and the ambitions of a 'knowledge economy', a more systematic and open recourse of foreign specialised labour should replace the 'ad-hoc' approvals of work permits.

#### **IV. SECTORAL ISSUES**

We understand that various sectors are making their own proposals to the Ministry of Finance. We have some specific proposals for a few sectors.

##### **(1) Industry**

In addition to the earlier points for the sustainable development of the DOE and the measures in favour of competitiveness, we suggest the following additional measures in favour of the industrial sector.

###### **(i) Setting up of 'Pôles de Compétitivité'**

In a context becoming more and more difficult, competitiveness is the ultimate tool for success. We need to find the best industrial policy which would allow us to meet this challenge.

The '*Pôles de compétitivité*' exist in many countries and is defined as the consolidation of enterprises, higher education institutions and research institutions which intend to work together to implement innovative economic development projects. The poles are mainly focused on industry, but it must be understood in the broad sense, i.e. all sectors with an industrial nature.

They are designed to make the economy more competitive, while creating jobs and bringing together private and public initiatives, and eventually taking an international dimension.

For the proper implementation of the 'Poles', economic issues, the strategic research and development program, quality of partnership, the degree of collaboration between businesses and research facilities as well as training must be planned. It requires full involvement of SMEs, a sufficient international openness and complete clarity of strategy.

In general, financial benefits granted to programs associated with the '**Pôles de compétitivité**' are:

- Tax exemptions. In France, for example, a company involved in research and development in an area defined for this purpose does not pay corporate tax in the first three years.
- Credits intervention to support research and development.

The MCCI proposes to set up a committee of the key stakeholders (Public and Private) in the industrial sector to study its implementation.

(ii) Promotion of Mauritian Products on the Local Market

Government devotes large budgets to the promotion of our products abroad while very little has been done to promote our products on the local market. To-day, because of globalisation, we can no longer differentiate between local and external markets.

Local producers are competing on the local market with world producers/exporters. It is only fair that some resources are earmarked to promote Mauritian products on the local market.

There is a joint project of the MCCI and AMM covering the creation and administration of a **National Brand**. We think it should be the perfect tool to promote Mauritian Product on the local market and the start of a new policy against all-import.

This project needs the full political and financial support of the Government for its successful implementation.

(iii) Unfair Practices

a) VAT Zero-Rated

Locally manufactured goods which are exempted from VAT are discriminated against imported goods because local manufacturers cannot claim back the VAT paid on part of the raw materials used (eg. sausages, tea, honey, poultry products, potatoes, onions)

In order to ensure a level playing field, it is recommended that locally manufactured VAT exempt goods be rather classified as zero-rated.

This change would enable a price reduction varying between 2% to 7%.

b) Same Quality Standard between local and imported products

Some imported products do not meet the quality standards appropriate to similar products that are locally manufactured.

The government should make sure that there is strict control on imported products for a level playing field.

(iv) Setting up of an ‘Observatoire de l’Industrie’

In a changing world, it is important to support the continuous improvement of performance at all levels of an organisation: management, production, logistics, human resources, quality, safety and environment.

We recommend the establishment of an ‘Observatoire de l’Industrie’ to evaluate the industrial performance of a company with the centralisation of high level experts for short-term audits and grouped for all areas of intervention (strategy, international development, information systems, safety, quality, production, inventory management, environment, legal system and financial, human resources).

The observatory should also function to better know the needs of businesses to allow public policy to adapt.

(v) The Industrial Upgrading and Modernisation Project (IUMP)

UNIDO has implemented in a number of countries the IUMP project which through leveraging upon various programmes put into place to support regional blocs, gives a 10% to 20% grant on industrial equipment. UNIDO has initiated a similar project under COMESA and the Ministry of Industry has agreed to work with UNIDO on this project. This project needs to be revisited because it can bring tangible benefits to the modernization of our industrial sector.

## **(2) Commerce**

In addition to the proposals made earlier regarding the development of a ‘Shopping Paradise’ in Mauritius, the following additional measures are proposed:

(i) Trade Facilitation

In spite of several exercises conducted previously to reduce permits and streamline procedures, the actual reduction at the end of exercise has been minimal. The main explanation is that a larger number of permits are justified by the authorities who impose them on the grounds of public health or other scientific reason. There is no independent counter expertise involved in the review process which could have recommended further reductions in the number of permits or simpler alternatives.

Following a recent study of the World Bank on this subject, a Committee (previously chaired by the Ministry of Business) has been set up to review all the permits and licences with the objective of rationalising the application process and reducing the number of permits required. For the MCCI, the Ministry of Commerce should play a leading role in facilitating this process.

The MCCI has also been involved in several other trade facilitation initiatives such as the setting up of TradeNet and the Mauritius Cargo Community Service (MaCCS). As part of this objective, a study was



conducted in 2010 to examine the requirements for setting up a 'Single Window' in Mauritius. The objective of a Single Window would be to set up a single web-based portal for the electronic submission of all trade documents (customs declaration, import permits, trade licenses, etc....) to facilitate trade. Given the critical importance of this exercise in improving the trading environment, the MCCI is of the view that the Ministry of Commerce should drive this initiative and would therefore request that a Task Force chaired jointly by the Ministry of Industry and Commerce and the MCCI be set up to look at the requirements for the implementation of a 'Single Window' in Mauritius.

(ii) Price Control

In the same vein, price control runs counter to all the efforts to create a genuine business friendly environment.

Following several years now, the MCCI has been pressing for a review of the legislation on price control which is unnecessarily extensive and acting as a serious impediment to trade. Over the last couple of years, there have been major developments in the local trading environment to ensure that markets are operating efficiently:

- (i) The Competition Commission is now fully operational and can investigate any possible anticompetitive behaviour by businesses.
- (ii) The setting up of the Price Observatory helps monitor the evolution of retail prices, provides information on prices to consumers and encourages competition in the retail sector.
- (iii) Other committees such as the 'Price Advisory Committee' have also been set up to monitor evolution of prices of essential goods.

In the light of the above developments, the MCCI strongly feels that the price control is no more warranted on a number of products and would therefore like to make a following proposal for the elimination of the list of goods subject to maximum mark-up.

**(3) ICT Sector**

The Information and Communications Technology (ICT) activities have become a key driver of economic growth and an increasingly important engine of job and wealth creation in Mauritius. The ICT industry today employs over 15,000 people working in the ICT industry and contributes to around 6.4% of its GDP. The sector has positioned itself as the third pillar of our economy.

Given that the MCCI works very closely with OTAM and assists in the formulation of its proposals, we support the main submissions of the ICT Sector.

- (i) The need to have more than one landing points in order to eliminate the risks of Mauritius being disconnected from the outside world in case of problems on one cable link.
- (ii) A decrease in the price of IPLC (international Private Leased Circuit) (there is room to decrease the price by at least 50%)

- (iii) Tariffs of ADSL being a key component in the democratization of high speed Internet access still need to be reviewed further down.
- (iv) Government should create the appropriate environment to encourage partnership between the training institutions and the private sector for skill development and to make people more employable.
- (v) IT entrepreneurship should be encouraged among the young graduates and entrepreneurs in the technology sector to develop technology products for the global market.
- (vi) Appropriate measures such as Sensitisation campaigns should be undertaken to strengthen and accelerate the 24 / 7 Economic Model.
- (vii) An entity should be earmarked to promote the services proposed by the Mauritian ICT Sector in foreign markets.