

AID-FOR-TRADE: CASE STORY

WORLD BANK

Loan Program

Mauritius

Four World Bank loans intended to counter a triple trade shock Mauritius faced in 2005 not only helped that country institute trade and other responses, but may offer lessons for euro-zone countries now dealing with similar issues.

In addition, the loan program is notable because it shows how an adept approach to working with the Bank can yield solid results for countries, according to a Bank official.

The loans were spurred when Mauritius was facing the loss of trade preferences in sugar and apparel because of the phasing out of the Multi-Fiber Agreement and sharp reductions in European Union sugar protocol prices - affecting two key export sectors - and rising energy prices. A 2006 Bank report at the time outlined a series of trade competitiveness issues Mauritius needed to face if it wanted to turn its 2 to 3 percent growth rate around - its previous level had been about 6 percent.

In 2005 elections, Mauritians voted in a reformist government, which, according to the Bank, "immediately set to work on an ambitious and comprehensive structural reform program intended to raise the efficiency of the private sector and modernize the public sector for a post-regulatory world."

The L'alliance Social Government, headed by Dr. Navinchandra Ramgoolam, in fact, entitled its 2006 budget speech "Securing the Transition: From Trade Preferences to Global Competition."

Ramakrishna Sithanen, then the vice prime minister and minister of finance and economic development, said Mauritius had to chart a new course, citing the existing system's anti-export bias and difficulties facing outside investors and SMEs as among problems that needed to be eliminated.

His budget included about 40 reforms. Trade measures among them included continuation of tariff liberalization with an eye toward turning the country into a duty-free island. In addition, he proposed accelerating the integration of the export processing zone and non-zone sectors to eliminate a distinction that, according to the Bank, had imposed costs on exporters and effectively barred smaller firms from exporting. He also proposed lowering the cost of international bandwidth to lower Internet costs.

The government approached the Bank and other outside organizations for assistance. The loan program the Bank then put into place, totaling about \$175 million and made from 2007 to 2009, supported a series of reforms that tracked proposals in the speech geared to raising economic growth with equity.

Measures included policy changes aimed at improving trade competitiveness and Mauritius's investment climate. Other steps were aimed at consolidating fiscal performance and improving public sector efficiency, and increasing the circle of opportunity through an Empowerment Program targeted at bringing more lower-income Mauritians into the formal economy. Measures also targeted the empowerment of women who had been disproportionately hit by the external shocks. As reforms progressed, they were widened to emphasize sustainable development via the Maurice Ile Durable program of the prime minister, Dr. Navin Ramgoolam.

The government's program to improve trade competitiveness had two components.

The first involved revamping incentives, including dismantling tariff barriers, and eliminating both the export processing zone distinction and a 25 percent investment tax credit. The tax credit change was designed to

remove a tax system anti-labor bias. In addition, the government eased regulatory burdens.

The second group of actions involved efforts to cut costs and increase competitiveness in both existing and new sectors, including sugar, textiles and apparel, tourism and financial services, information technology, call centers or other outsourced business processes, fisheries, aquaculture, land-based ocean industry and a knowledge hub.

The Bank's support ultimately came in the form of four loans. The first two, in 2007 and 2008, were for \$30 million each, two 2009 loans were for \$100 million and \$50 million.

In a 2010 report, the Bank cited favorable developments following the initiation of the government's reform program,

Foreign direct investment, the Bank said, "rose to unprecedented levels - complementing a major restructuring of the sugar and textile industries and rapid growth in the offshore financial sector," driven by global business companies. FDI rose five-fold from about 2 billion Mauritius rupees in 2004 to more than 11 billion Mauritius rupees by 2007.

These companies, the report said, have been concentrating on investments in India, but "Mauritius has also begun to position itself as a platform for investment from China and India to East Africa."

Mauritian trade and economic growth rose from 2005 levels until the general recession hit.

According to International Monetary Fund figures, GDP growth rose after its 1.5 percent 2005 level to 5.4 per cent in 2007 and 5.0 per cent in 2008 before dropping to 2.5 percent in 2009.

A Bank official attributed the drop to 2.5 percent to the global economic crisis, saying Mauritius had withstood the crisis pretty well. Uri Dadush, the former World Bank director of international trade who worked on the Mauritius program, stressed that Mauritius grew quite rapidly in the run-up to the crisis and did well compared to many other countries during that crisis.

According to IMF projections, the rate is expected to hit 3.6 percent in 2010 and 4.1 percent in 2011. Continued below-par growth shows Mauritius's heavy dependence on the United Kingdom and euro zone - aside from Germany - for about three-quarters of its exports of both goods and services and the slow recovery in these countries.

Mr. Dadush said lessons can be drawn from the Mauritian program for countries like Ireland, Greece or Portugal, which are facing a major challenge in reorienting their economies and improving competitiveness within the euro zone. Although those countries cannot draw on World Bank assistance, some aspects of the program for Mauritius are relevant to their situation.

He noted that the countries had been doing well economically before the current crisis, saying Ireland, for example, had had a reputation for strong governance and had enjoyed very rapid growth based on construction and financial services.

As was the case with the Mauritian model based on trade preferences, though, that Irish model has now collapsed, he said, and the country must find a new development model, as did Mauritius.

The trade aspects of the Mauritius program could be particularly relevant to these countries, he said, noting that there is a "huge trade

dimension" to the euro crisis, given the importance of loss of competitiveness in the problems they are now facing.

Though the stricken countries in the euro zone cannot devalue, unlike Mauritius, they still need to reorient their economies toward manufacturing and export-related services because, like Mauritius, their traditional, non-tradable sources of growth, such as construction, are no longer available.

"So," he said, "there are lessons from the experience of Mauritius on how new incentives can be established so as to achieve the needed transformation."

The loan program also shows how a country can benefit from taking the initiative when dealing with the Bank, according to a Bank official.

Richard S. Newfarmer, the Bank's Geneva-based special representative to the United Nations and World Trade Organization, stressed the Mauritian government's central role in arranging the loans, describing the process as "government-owned and -driven."

According to Mr. Newfarmer, who also worked on the Mauritius loans, Mauritius wanted guidance from the Bank on how to restart growth through trade, the placement of a mission in the field as soon as possible and access to new sources of finance. Mauritius, he said, saw aid for trade as a way to link trade and growth, initiate some domestic reforms that would spur growth - especially in turning the country into a duty-free island - and obtain some transitional financial support.

From the outset, Mr. Newfarmer said, Mauritius knew what it wanted from the Bank and other donors "and set up a process to obtain benefit of the

Bank's knowledge, assimilate it and disseminate it across the government, and convert it into lynchpins of reforms."

"In my view," Mr. Newfarmer said, "four factors explain the success of the program: the government's clear vision that it needed to undertake new policy initiatives to respond to the triple crisis and its request for Bank policy analysis; the quick responsiveness of the Bank team, possible in large measure because of the staff's accumulated knowledge of the trade-related sectors (especially services) in Mauritius; then the follow-through of Ministry of Finance and the economic team in sifting through the policy options to design and launch new and coherent reforms across several sectors; and then the government's sustained effort in implementing reforms over a multi-year period, with the support of the Bank and other development partners."

Ali Mansoor, financial secretary of Mauritius, stressed the importance of coordination arrangements.

"In responding to the crisis," he said, the "government set up a high-level committee co-chaired by the secretary to Cabinet ... and the head of the Joint Economic Committee, the private sector coordinating body."

The subcommittees, he said, were co-chaired by the permanent secretary of the relevant ministry and the relevant industry/sector group from the private sector. This arrangement enabled the government to develop a stimulus package in real time that was relevant to support economic activity. It also created a platform for a social contract involving a commitment by the private sector to avoid layoffs while the government provided support to meet external shocks and accelerated deregulation and other measures to improve competitiveness.

Such collaboration also set the stage for a partnership between government, civil society and the private sector to empower the bottom 10 percent of the population, with an emphasis on dealing with high female unemployment. What makes the Mauritius loan program interesting and contributed to its success, Mr. Newfarmer said, "is that it combined narrow trade policy measures with trade-related reforms to the investment regime, public finance and social safety net."

"The effectiveness of the program should be judged not on short-term outcomes but on its effect on growth in incomes, employment and exports over the medium term," Mr. Newfarmer said.