Summary of Mauritius Investment Climate Assessment

Mauritius has experienced impressive economic growth by both regional and international standards over the last few decades. This stellar growth rate has been dubbed “The Mauritian Miracle,” with GDP growing from $1.8 billion in 1984 to $5.3 billion in 2004. However, due to past protectionist policies, Mauritius’s economy has become reliant on the export processing zones (EPZs) established in the late 1970s, the relatively and preferential regulation of these EPZs had an extremely large impact on diversification by deterring development in other sectors.

Growth rates began to falter slow in the late 1990s with changes in key export markets, new trade patterns and competition from lower costs manufacturers in Asia and Africa. Currently, the Mauritian government is seeking to reform and evolve the economy by transition to a high-tech and services oriented economy. In order to determine effective and productive policies, the entire investment climate of Mauritius must be considered and analyzed.

This note summarizes the Investment Climate Assessment (ICA) undertaken in Mauritius in 2006. The objective of the ICA is to examine the nature of the investment climate in Mauritius and provide policy options to promote further growth of the private sector. It is based on a survey of 285 firms from the manufacturing and service sectors in Mauritius.

Background

Following its Independence in 1968, Mauritius’s economy was based primarily on sugar. In the late 1970s, the government established export processing zones (EPZs) in an attempt to diversify the economy. By 1984, sugar’s once nearly 100% share had fallen to 15% of GDP. The government set up regulations and policies that were particularly nurturing to the EPZs, such as duty-free access for all imported inputs, tax incentives, and a separate labor market with different market conditions until the late 1980’s. By 2002, EPZs made up 60% of Mauritius total exports.

Today, Mauritius faces several macroeconomic challenges. It stands to lose trade preferences in both textiles and sugar and, at the same time it faces rising global oil prices. In response the government is committed to actively pursue diversification by transitioning from low-skilled agricultural and manufacturing sectors to the higher-skilled sectors. The greatest challenge that the Mauritian government will face is managing the unemployment level while undergoing this transition. These goals must be achieved by using prudent policies that take into account the specific economic environment of Mauritius.

Productivity

Labor productivity in Mauritius is far higher than in any other Sub-Saharan African country, except for South Africa. Compared to similar middle-income counties, Mauritius’s labor productivity is average. In fact, Mauritius has much higher labor productivity than China, which has experienced explosive growth in the past two decades. However, although higher than China’s overall average, it is still far less than China’s most productive coastal provinces, like Hangzhou. One reason that Mauritian enter-

Figure 1. Labor Productivity

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<tr>
<th>Country</th>
<th>Value-Added per Worker (in US $1000)</th>
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<td>Malaysia</td>
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<td>Poland</td>
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<td>Brazil</td>
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<td>Lithuania</td>
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<td>Hangzhou (China)</td>
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<td>Shenzhen (China)</td>
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<td>China (Average)</td>
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<td>Senegal</td>
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<td>Kenya</td>
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<td>South Africa</td>
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prises might be less productive than those of South Africa is because they are concentrated in industries that are more labor intensive. That is, the differences in productivity may be caused by differences in capital intensity. This also accounts for the lower labor productivity in EPZs than in non-EPZs, because EPZs are less capital intensive sectors than non-EPZs.

Although labor productivity is high in Mauritius, associated labor costs are also high when compared to similar countries. The I.C survey found that the Per worker labor costs in Mauritius were nearly double that of workers in China’s Hangzhou region, whose productivity far outpaced Mauritius’s. This high wage of laborers in Mauritius ultimately lowers its competitiveness in the market and divert FDI.

Once controlling for differences in productivity due to differences in the use of labor and capital, sector of operations, characteristics of the investment climate and the firm, enterprises in Mauritius appear to be more productive than similar enterprises in India and China, but less productive than enterprises in South Africa, Brazil, or Malaysia.

**Investment Climate Constraints**

Firms in Mauritius perceive four major areas to be constraints to operations and growth within the investment climate of Mauritius: (1) finance (access and cost), (2) bureaucratic red tape, (3) skills and education of available workers, (4) corruption and informal practices. More than 30% of firms in the sample rated each of these four constraints to be “major” or “very severe” obstacles to growth.

**Finance**

Both cost to finance and access to finance are major obstacles to firms in Mauritius. 49% of firms perceive cost to finance as a serious obstacle, and 33% of firms perceive access to finance as a serious obstacle. This constraint is far more problematic in Mauritius than in nearly all its other comparator countries. It is also important to note that the perception of finance as a constraint differed depending on the size, ownership, and sector of the firm. Smaller firms view finance as a greater constraint than larger firms, and domestic firms view finance as a greater constraint than do foreign owned firms.

One factor that explains these differences is that domestic firms tend to seek short-term financing, which has higher interest rates than long-term financing, on which foreign firms tend to rely more. Another explanation for this perception of finance as a serious constraint is that more than 80% of firms in Mauritius were required to provide collateral. This is a much higher percentage than firms in South Africa, China, and Brazil.

**“Red Tape”**

One of the major business constraints according to firm managers is “Red Tape”—licensing and permits to run or start a business. 47% of Mauritian firms surveyed viewed business licensing and operating permits as a serious constraint. 46% reported the procedures of starting a business as a serious obstacle.

These perceptions do not seem to agree with certain Doing Business indicators that indicate a lower level of red tape would reinforce Mauritius’s low levels of red tape. For example, among its comparator countries, Mauritius has the least number of procedures and the second lowest cost to start a new business. Again, this disparity in perception and indicators can be explained by the different characteristics of the firms. Foreign firms have significantly less challenges in starting a business because the government offers them incentives to do so.

Overall, the percentage of Mauritian firms perceiving red tape as a major constraint is extremely high, given that similar counties have fewer than 25% of firms reporting
constricting red tape. This disparity has major implications for policymakers, as this image perception could certainly deter investors to enter the market.

**Skills and Education of the Workforce**

The level of skills and education of the workforce was the fourth highest ranked constraint. 43% of Mauritian firms believe that the skill level of their workforce pose a serious obstacle to their operations and growth. In fact, Mauritius has the highest percentage of firms with this perception of all its comparator countries. This problem will only become more severe as Mauritius makes its transition toward the service sector, which requires a greater education level than manufacturing. On average, only 10% of workers attend university and/or graduate school and 25% had no more than primary education. Nearly all of the rest finished only secondary school.

Since the majority of workers receive little education, on-the-job training is critical. 61% of Mauritian firms provide training to their workers. This is similar to most comparator countries except for China, where 90% of the firms provide training to their workers. However, despite their fairly high percentage of firms providing training, Mauritius ranks low in depth of training (see Figure 3).

Training has large effects on worker productivity and, therefore, wages; a worker who has received training will receive a 21% higher wage than a similar worker who has not received training. Within the last decade unemployment levels have increased from 4% to 10%. This increase can certainly be attributed to the skills mismatch between the kind of labor firms want and the kind of labor that is available.

**Corruption and Informal Practices**

Once again, there seems to be a disparity between constraint perception and the indicators of the constraint. 37% of firms report corruption as a serious problem, and 38% of firms report anti-competitive or informal practices as a major constraint. However, Transparency International ranks Mauritius among the top performing developing countries with respect to perception of corruption. In addition, the percentage of Mauritius’s firms reporting that an informal payment was expected by selective agencies or for specific services was lower than all of its comparator countries. It is important to note that at the time of the survey, there were several high profile scandals in Mauritius that could have easily influenced the perception of enterprises and corruption, explaining the disparity between the data. It is also possible that Mauritius had relatively less constraints compared to the other countries, so that while corruption in Mauritius might be less of a problem than in other countries in absolute terms, it is a bigger constraint in relative terms.

**Tourism**

Tourism plays on an increasingly prominent role in the Mauritian economy, especially as a source of foreign exchange and employment. However, after a decade as the fastest growing sector of the economy, tourism’s momentum is slowing down. There are several areas contributing to this slowdown, which, if not improved upon, will completely undermine this potentially high growth sector.

The poor degrading state of the environment, on which tourism is founded, is the first major obstacle to the continued expansion of the industry. A second concern is the limited international air access to the island. Third, the private sector needs to innovate to access the markets of foreign travelers and diversify its products.

**Conclusion and Policy Options**

Despite impressive growth over the last few decades, Mauritius’s economy continue to still face several major challenges. As the government prepares for a large transition toward a more diversified and service oriented economy, it is critical that the current investment climate weaknesses are addressed. The following reforms of the businesses department are necessary to enable a more competitive and productive private sector prosperous business environment:

**Finance**

- Update Financial Sector Action plan.
- Promote the establishment of a Credit Rating Agency and an efficient credit information system.
- Promote further development of equity financing, venture capital, and introduction to innovative financial products.

**Red Tape**

- Shorten the duration of administrative processes
- Reduce number of agency visits required to obtain permits and licensing.

**Skills/Education**

- Simplify existing scheme/regulations on residency and work permits for foreign skilled workers to attract much-needed skilled labor.
Establish new institutional and regulatory framework for private education and training to better meet the needs of the enterprises.

**Corruption**
- Strengthen the capacity of the Independent Commission against Corruption by establishing and monitoring performance indicators and empowering the commission to tackle private sector corruption.

**Tourism**
- Establish better environment regulations.
- Allow entry of other airlines to improve air access.

Hotels (Private Sector) will need to reposition themselves to reflect the needs of market, such as considering business centers, gym facilities, etc.

This note is part of a series of summaries of analytical work of the Africa Private Sector Development Unit. It is based on the report *Mauritius Investment Climate Assessment* (March 2006). For more information, visit the website [www.worldbank.org/afr/aftps](http://www.worldbank.org/afr/aftps).