AFRICAN DEVELOPMENT BANK GROUP
GROUPE DE LA BANQUE AFRICAINE DE DÉVELOPPEMENT

COUNTRY FOCUS REPORT 2024

MAURITIUS

Driving Mauritius' Transformation

The Reform of the Global Financial Architecture

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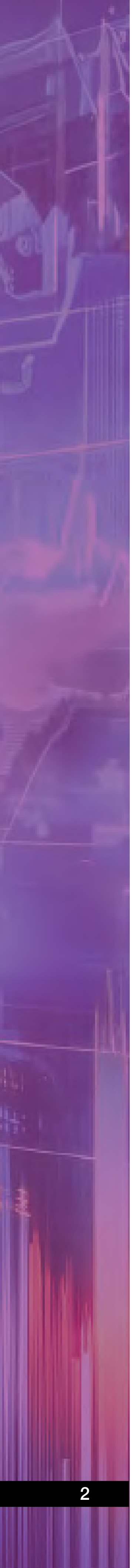

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ACKNOWLEDGEMENT

The 2024 Country Focus Report for Mauritius was prepared in the Chief Economist and Vice-Presidency for Economic Governance and Knowledge Management Complex (ECVP), under the direction and supervision of Prof. Kevin C. Urama, Chief Economist and Vice-President, with support from Amadou Boly (Chief Assistant to the Chief Economist), and Amah Marie-Aude Ezanin Koffi (Executive Assistant).

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The team thanks (i) the Mauritius Country Team led by Leila Mokaddem, Director General, RDGS; Kennedy Mbekeani, Deputy Director General and Mauritius Country Manager, RDGS; (ii) the Macroeconomics Policy, Forecasting and Research led by Abdoulaye Coulibaly, Director, Officer-in-Charge; (iii) the Transition States Department (RDTS) led by Yero Baldeh, Director, (iv) the African Natural Resource Center (ECNR) led by Désiré Vencatachellum, Director, Officer-in-Charge; and (v) the Macroeconomics Policy and Debt Sustainability Division led by Anthony Simpasa, Division Manager, for their contributions.

The data in the report was compiled by the Department of Statistics led by Babatunde Samson Omotosho, Director, with significant contributions from Louis Kouakou (Manager of Socio-Economic Statistics Division, Department of Statistics), Ben Paul Mungyereza (Head of the Statistical Capacity Building Division, Statistics Department), Anouar Chaouch (Senior Statistician, Division 1 of the Statistics Department) and Momar Kouta (Senior Statistical Information Systems Officer, Division 1 of the Statistics Department).

Peer review comments were received from Flavio Soares da Gama, (Principal Country Economist, ECCE); Omolola Amoussou, (Principal Research Economist, ECMR); and Maglo Marcel, (Principal Institutional Capacity Development Officer, RDTS). Dr Joseph Atta-Mensah, Senior Fellow from Africa Centre for Economic Transformation, acted an external reviewer.

The cover of the report is based on a general design by Laetitia Yattien- Amiguet and Justin Kabasele of the Bank's External Relations and Communications. Copy-editing was done by the Bank's Language Services Department (TCLS) and layout was done by Lagence Creativ.

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ABBREVIATIONS

GFC	Global Financial Centre
GFCF	Gross Fixed Capital Formation
GHG	Greenhouse Gases
GII	Global Innovation Index
GoM	Government of Mauritius
HDI	Human Development Index
HIC	High Income Country
ICT	Information and Communication Technology
IMF	International Monetary Fund
IRS	Integrated Resort Scheme
MPF	Monetary Policy Framework
MDBs	Multilateral Development Banks
NDC	Nationally Determined Contribution
NDP	National Development Plan
NMW	National Minimum Wage
NPF	National Pension Fund
ODA	Official Development Assistance
R&D	Research and Development
SDGs	Sustainable Development Goals
SIDS	Small Island Developing State
SME	Small and Medium Enterprise
WIPO	World Intellectual Property Organization

EXECUTIVE SUMMARY

Macroeconomic Performance and Outlook

Real GDP growth in Mauritius slowed to 7% in 2023, from 8.9% in 2022. Growth was driven by tourism, construction, and financial services on the supply side, and consumption and investment on the demand side.

Headline inflation decreased to 7% in 2023 from 10.8% in 2022 and remains subject to downside risks from the conflict in the Middle East.

Government expenditure increased by 29% from 2020 to 2023, and fiscal policy is expected to remain expansionary in the election year of 2024. Public debt has increased significantly but remains sustainable.

Addressing skills mismatches, labour market rigidities, and regulatory barriers is crucial for sustained economic transformation. Integrating climate considerations into policy and planning is essential for building resilience against extreme weather events.

Taking stock of Mauritius' structural transformation

Mauritius has transitioned from a sugar-based to a diversified, services-oriented economy, achieving an advanced degree of structural transformation. However, low relative productivity in many service sectors needs to be addressed.

Mauritius faces small but important financing gaps to achieve a desired level of structural transformation by 2030 (1.25% of GDP per year) and to address climate change (1.6% of GDP per year until 2030).

For continued structural transformation in the future, the government should mobilize higher revenues through tax reforms; invest in digital infrastructure; and tailor industrial policy to modern services and high-value manufacturing.

The private sector must step up investment in training, technology, and innovation; and leverage trade agreements like AfCFTA to diversify and increase exports.

Regional institutions and DFIs must provide financial and technical support for sustainable infrastructure and climate finance access.

Financing structural transformation in Mauritius: The need for reforms of the international financial architecture

The international financing system must offer more sustainable and equitable financing for developing countries, fairer debt pricing and debt relief, and special and differential treatment for Small Island Development States like Mauritius.

Mauritius can attract FDI into dynamic sectors like renewable energy, pharmaceuticals, and sustainable agriculture by reviewing the incentive structure. There is also some scope to use debt (both domestic and foreign) as an instrument to finance structural transformation.

Direct access to multilateral climate funds and innovative instruments such as sustainable bonds can help close the climate financing gap.

GENERAL INTRODUCTION

Mauritius is a small island developing state (SIDS) located in the Eastern Africa region of the Indian Ocean. Mauritius is not endowed with any natural resources. However, the country has leveraged its natural beaches and human resources, along with its strong democratic tradition, good governance, and political stability, to build a dynamic upper-middle-income economy. Mauritius has achieved a high degree of structural transformation, transitioning from a sugar-based to a diversified economy dominated by services.

While Mauritius has now fully recovered from COVID-19, the pandemic highlighted the economy's vulnerability despite its status as a structurally developed country in Africa, suggesting that continued structural transformation is necessary. The financing needed for this is small by African standards, but Mauritius also faces a financing gap for addressing climate change and achieving the Sustainable Development Goals (SDGs). Mauritius enjoys an investment-grade credit rating and has been able to attract significant FDI flows. In recent years, it has mobilized loans from friendly countries like India, China, and Saudi Arabia for large-scale infrastructure projects. The country has also secured financing from international financial institutions, including the AfDB, to foster structural change and sustainable development. Mauritius can nevertheless benefit from reforms to the international financial architecture that ease access to external financing, including climate funds.

The rest of the report is structured as follows. Chapter 1 reviews the current macroeconomic performance, outlook, and risks. Chapter 2 presents an overview of economic transformation in Mauritius, discussing its drivers and challenges, and opportunities. It identifies the financing gap needed for achieving fast-paced structural transformation and discusses the contribution of domestic resource mobilization to plugging this gap. Chapter 3 discusses how reforms of the international financial system can help Mauritius mobilize scaled-up external resources to fill both the financing gaps for achieving a desired level of structural transformation and for effectively dealing with climate change.

1

MACROECONOMIC PERFORMANCE AND OUTLOOK

KEY MESSAGES

Mauritius' real GDP growth was 7% in 2023, down from 8.9% in 2022. The strong macroeconomic performance was driven by sustained recovery in the tourism sector, with tourist arrivals reaching 1.3 million, close to pre-pandemic levels, and continued growth in construction and financial services.

Real GDP growth is projected to be 6.5% in 2024 and 3.7% in 2025 averaging 5% in the medium term. The projected robust performance in 2024 is attributed to the continued recovery in tourism sector, higher investment in construction and strong performance by the financial sector. However, the macroeconomic outlook for 2024 and 2025 is subject to risks including global conflicts, climate change, and domestic economic pressures.

Headline inflation dropped to 7% in 2023 from 10.8% in 2022 but remains influenced by domestic factors (such as currency depreciation) and external events (such as the escalation of conflict in the Middle East). The Bank of Mauritius adopted a new Monetary Policy Framework in 2023, targeting an inflation range of 2%-5%.

Fiscal policy has been expansionary, with government expenditure increasing by 29% between 2020 and 2023. With 2024 being an election year, public spending will remain on an upward trajectory, as confirmed by the government Budget presented in early June 2024. Public debt has increased significantly, crossing the Rs 500 billion mark in 2023, but remains within the medium-term sustainability limit of 80% of GDP.

The current account deficit shrank from 11.7% of GDP in 2022 to 5.1% in 2023 thanks to the increase in tourist arrivals. However, imports were about three times higher than exports, indicating a lack of export competitiveness or a lack of export diversification, or both.

The depreciation of rupee deepened as the pandemic shut off a critical source of foreign exchange – the tourism sector – and as the government ploughed into the central bank's reserves to support its spending during 2020 and occasionally thereafter. Between February 2018 and March 2024, the rupee depreciated by 31% against the US dollar.

Addressing skills mismatches, labour market rigidities, and regulatory barriers is essential for continued economic transformation.

Integrating climate considerations into development policy and planning is critical for enhancing resilience to extreme weather events.

The main downside risks to the outlook include the following:

- The escalation of conflict in the Middle East and consequent supply chain disruptions
- Financial stress arising from high level of debt although debt has fallen below the 80% statutory limit
- Persistent inflation despite the recent decline to a single digit
- Geopolitical and trade-related tensions
- Climate change vulnerability as a small island developing nation and significant climate financing gap
- Tightening labour market conditions, characterized by a sharp increase in the minimum wage and growing labour shortages amid rapidly aging population

Potential upside risks include:

- Acceleration of investment on social programmes which could spur growth
- Completion of the pipeline projects
- The end of monetary policy tightening since 2023 and the readoption of inflation targeting monetary could support economic growth

A mix of short-medium-and long-term policies are needed to deepen Mauritius structural transformation and enable the country to achieve high income status:

In the short term:
To manage inflation, Bank of Mauritius should remain vigilant about persistent imported inflation and domestic wage-price spirals. Beyond the new Monetary Policy Framework, the central bank should continue to employ a mix of monetary instruments, including interest rate adjustments, open-market operations, and effective exchange rate management to control liquidity and maintain price stability while limiting currency misalignment.
Fiscal policy should strike a balance between supporting economic recovery and maintaining fiscal sustainability. Strengthening efforts to contain the fiscal deficit and manage public debt through expenditure rationalization, tax reforms, and innovative financing is necessary without compromising social spending and infrastructure investment.

In the medium to long term:
To boost economic diversification and long-term growth, the government should support emerging sectors such as pharmaceuticals and the blue economy while addressing the perennial food security issue.

The widening trade deficit underscores the urgency of diversifying exports, enhancing export competitiveness, and reducing import dependency. Supporting import-competing industries and investing in high-growth sectors like renewable energy and agribusiness can help. Revisiting incentives for foreign investors, currently biased towards real estate, is also recommended.

Addressing skills mismatches, labour market rigidities, and regulatory barriers is crucial to unlocking Mauritius' growth potential and deepen structural transformation. Investing in education and training, promoting innovation and entrepreneurship, streamlining regulations and continuously improving the business environment can help attract larger FDI inflows, enhance productivity, and facilitate economic transformation.

Proactive climate risk mitigation and resilience measures are imperative to tackle climate change. Integrating climate considerations into planning, sustainable land use practices, and investing in adaptation measures can protect infrastructure and promote sustainability. Reforms of the global financial architecture, including easier access to climate funds, can further support Mauritius' efforts to address climate change.

Introduction

This chapter presents an updated analysis of Mauritius' economic performance in 2023, and medium-term growth projections over the period 2024-2025. It assesses trends in key macroeconomic indicators, fiscal and monetary policies, changes in domestic and international financial flows, investment, and public debt. The chapter discusses key risks to the outlook and provides policy options for fostering high and resilient growth; supporting macroeconomic stability and economic transformation; and dealing with shocks that have continued to hit the Mauritian economy.

1.1 Growth performance

GDP Growth and GDP per capita

Real GDP growth settled at 7% in 2023, down from 8.9% in 2022. The country has experienced steady and remarkable economic progress over the past three decades on the back of a long tradition of democracy, rule of law, and a business environment conducive to economic transformation. Mauritius graduated to the High-Income Country (HIC) category in 2020 before dropping back to its Upper-Middle-Income status in 2021 due to the dramatic impact of COVID-19 on the economy. The rapidly aging population could shrink the labour force and harm long-term economic prospects, given zero net migration as of 2023.

The strong macroeconomic performance was driven by sustained recovery in the tourism sector, with tourist arrivals reaching 1.3 million, close to pre-pandemic levels, and continued growth in construction and financial services. Other service sectors such as transportation (0.5 percentage points (pp)), wholesale and retail trade (0.4 pp) and information and communication (0.3 pp) also made positive contributions to economic growth in 2023. Remarkably, agricultural output growth added a respectable 0.6 pp to GDP growth, higher than manufacturing (0.3 pp), which was adversely impacted by a contraction in the textile industry.

On the demand side, as in the recent past, consumption remains the locomotive of growth in Mauritius. However, gross fixed capital formation (investment) increased by 30.9% in 2023, driven mainly by the public sector investment, which expanded by 73.5%. On the other hand, after rebounding by 36.9% in 2022, export growth slowed to a mere 1.1% in 2023.

The Mauritian economy continues to register robust growth rates since 2020 and GDP per capita has been rising constantly. However, the economic contraction in 2020 (-14.5%) was so severe that GDP per capita at the end of 2023 was just 3% higher than its pre-pandemic level in 2019. In other words, GDP growth in the past three years has only made up for the loss of real income sustained in 2020.

1.2 Other recent macroeconomic and social developments

Monetary Policy, Inflation, and Exchange Rates

At the end of 2023, Mauritius' headline inflation rate was 7%, down from 10.8% in 2022, the highest since 1990. While external factors such as commodity market disruptions and freight increases have eased, persistent high inflation in Mauritius is largely due to local conditions, particularly the steady depreciation of the rupee since early 2018. This depreciation deepened as the pandemic shut off a critical source of foreign exchange – the tourism sector – and as the government ploughed into the central bank's reserves to support its spending during 2020 and occasionally thereafter.[1] Between February 2018 and March 2024, the rupee depreciated by 31% against the US dollar, 24.3% against the British pound, and 21.7% against the euro.[2]

Mauritius recorded robust economic growth in recent years. The strong macroeconomic performance was driven by sustained recovery in the tourism sector, with tourist arrivals reaching 1.3 million, close to pre-pandemic levels, and continued growth in construction and financial services.

Mauritius imports over 85% of its consumption needs, so currency depreciation has intensified inflationary pressures, with the inflation rate averaging 6.1% between 2020 and 2023, compared to 2.1% in the four years before the pandemic. Increases in the basic retirement pension (BRP) and the national minimum wage (NMW), and annual salary compensations, combined with stagnating productivity and merchandise exports, have raised liquidity in the economy, leading to a wage-price spiral. Additionally, cyclones and floods in early 2024 have caused food prices to spike. However, inflation was 3.2% at the end of Q1 2024, indicating a downward trend.

In 2022, the Bank of Mauritius (BoM) maintained a tight monetary policy stance, raising the key rate from 1.85% to 4.50% by the end of the year. The key rate remained unchanged at 4.5% in 2023, reflecting expectations of lower inflation as global supply disturbances eased. The BoM also conducted regular open-market operations to mop up excess liquidity, absorbing more than Rs 150 billion through BoM Bills by June 2023. In January 2023, the BoM unveiled a new Monetary Policy Framework (MPF), aiming to better control inflation. The MPF replaced the key repo rate with the 'key rate', reintroduced an inflation target range of 2%-5%, and adopted the 7-day bill as the main monetary policy instrument. Although it is early to judge its effectiveness, falling inflation suggests progress towards the target range.

Fiscal Policy and Public Debt

Mauritius has maintained an expansionary fiscal policy since 2020, with general government expenditure increasing by 29% between 2020 and 2023. This increase is mainly due to social benefits and public investment. With progressive hikes in the BRP and related benefits, welfare payments have increased by 30% between FY 2019/2020 and 2022/2023, accounting for about one-third of total government spending in 2022/2023. Public sector investment surged by 118% from 2020 to 2023 as the government invested massively in infrastructure projects, notably a tramway linking the south of the island to the capital, and its extensions to major suburbs. It represented 26.3% of Gross Fixed Capital Formation (GFCF) in 2023.

The fiscal deficit narrowed to 3.9% of GDP in 2023/2024 from 5.3% in 2022/2023 due mainly to rapid economic growth. The primary deficit also on a downward trend since 2020/21, reached 2.7% of GDP in 2022/2023, with the interest charge on government debt amounting to 2.6% of total government spending in 2022/2023. Debt servicing, however, rose to 9.2% of total government spending in 2022/2023. Recent budget deficits have been financed by domestic borrowing, causing government debt to rise above the half-a-trillion-rupee mark in 2023. Public debt as a share of GDP declined from 94.7% in 2020 to 78.6% at the end of 2023, staying within the IMF's 80% limit, indicating sustainability. Although public debt is projected to decline further, based on the IMF's Sovereign Risk and Debt Sustainability Framework, Mauritius' overall risk of sovereign stress is assessed as high (IMF, 2024b).

External Position

In 2023, Mauritius had a trade deficit of Rs 180.3 billion, slightly lower than the previous year. Merchandise exports have increased

[1]Moreover, in June 2020, the BoM took Rs 80 billion from its reserves to set up the Mauritius Investment Corporation (MIC), with the mandate to support financially distressed and high-growth-potential companies with equity injections. The MIC continues to operate as a subsidiary of the BoM despite repeated calls by the IMF on the central bank to give up its control of the company (IMF, 2024).

[2]This contrasts with the situation in Seychelles, where the currency depreciated sharply between April 2020 and April 2021, but returned to pre-pandemic levels later in 2021, suggesting effective exchange rate management in the country.

modestly since the pandemic year of 2020, while imports have surged. Imports were over three times higher than exports in 2023, highlighting the decline in manufactured exports and lack of industrial diversification. The current account deficit narrowed significantly from 11.7% of GDP in 2022 to 5.1% in 2023 due to a recovery in the tourism sector. However, the overall balance of payments shifted from a historic surplus of Rs 55.2 billion in 2021 to a deficit of Rs 31.3 billion in 2023, financed mainly by international borrowing. Gross international reserves shrunk to US$ 7.25 billion in 2023, covering 10.6 months of imports.

Table 1.1: Mauritius: Macroeconomic and Social Indicators

Table 1 - Macroeconomic Indicators	2019	2020	2021	2022	2023(e)	2024(p)	2025(p)
Real GDP growth	2.9	-14.5	3.4	8.9	7.0	6.5	3.7
Real GDP Growth per Capita	2.8	-14.6	3.3	8.9	6.9	4.8	3.6
Inflation	0.5	2.5	4.0	10.8	7.0	5.8	5.0
Overall Fiscal Balance, Including Grants (% GDP)*	-2.2	-7.7	-13.2	-6.1	-5.3	-3.9	-3.4
Primary balance (% GDP)	-0.3	-5.5	-11.0	-4.0	-2.7	-2.0	-1.7
Current Account (% GDP)	-5.4	-12.1	-12.8	-11.7	-5.1	-4.2	-4.5
Total Population (Millions)	1.3	1.3	1.3	1.3	1.3		
Life Expectancy at Birth (Years)	75.1	73.3	73.6	74.0	75.7		

Source: AfDB Statistics Department, April 2024 *Note: *Data in fiscal year 1 July (n-1)/30 June (n)*

Social Developments

By the World Bank's standard of US$3.65 a day, poverty is virtually non-existent in Mauritius. At US$6.85 per day upper middle income poverty rate, 13.5% of the population was estimated to be living in poverty in 2017. The poverty headcount ratio at the national poverty line stood at 10.3% in the same year. Although recent poverty figures are unavailable, poverty may have declined due to the increase in the NMW from Rs 9,000 in 2018 to Rs 18,500 in 2024, and the continuously falling unemployment rate (6.1% at the end of 2023) since 2020. However, youth unemployment was at 18.2% in 2023. However, persistent inflation has likely impoverished some segments of the population, particularly senior citizens, and low-paid workers.

Mauritius maintained its high human development status ranking72nd globally in 2022. It is among the 7 African countries in this category ahead of Libya, Algeria, Tunisia, Egypt, South Africa and Botswana in that order. Between 2021 and 2022 the country registered a 0.8 percent increase in HDI (UNDP, 2024).

1.3 Macroeconomic Outlook and Risks

Outlook GDP growth and GDP per capita

The outlook for GDP growth remains positive, with growth forecasts of 6.5% and 3.7% in 2024 and 2025, respectively, averaging 5% in the medium term. Growth in 2024 will be driven by sustained government investment in social housing, public transportation, and road infrastructure while the recovery in the tourism sector will continue. GDP per capita will therefore keep rising and, on this

Box 1.1: Impact of tighter international financial conditions (transmission channels)

International financial conditions in 2023 were tight as central banks raised interest rates to fight off inflationary pressures. Nevertheless, economic activity proved resilient, with global growth estimated at 3.2% in 2023. With inflation now on a downward path, central banks are switching to policy easing in many economies (IMF, 2024a). Global financial conditions account for a significant portion of the variation in domestic financial conditions, despite countries maintaining some control through their own monetary policies (Arregui et al., 2018).

A critical transmission channel is the effect on cross-border bank lending. Albriozio et al. (2019) demonstrate that tighter monetary policies in major economies, like the US, lead to higher funding costs and a decline in cross-border bank lending. For Mauritius, this means reduced access to foreign capital, which can strain domestic liquidity and credit availability, thereby impacting investment and economic growth.

Other channels include short-term policy rates, long-term interest rates, exchange rates, and market risk-taking. In Mauritius, tighter US monetary policy resulted in the key rate being held at 4.5% throughout 2023. This, along with frequent US dollar sales by the Bank of Mauritius, was necessary to attenuate the constant pressure on the Mauritian rupee to depreciate.

Despite these challenges, the Mauritian banking sector has shown resilience, supported by robust solvency and liquidity buffers (BoM, 2023). However, continued tight international financial conditions could still pose risks. Enhanced stress testing and macroprudential measures are essential to mitigate these risks and maintain financial stability.

trend, Mauritius will soon be back in the league of HICs.

Inflation

Globally, commodity prices are falling but remain above pre-pandemic levels. This trend is also visible in the headline inflation rate for Mauritius, which is projected to decline to 5.8% by the end of 2024 and 5% in 2025. This forecast, however, ignores several risks to inflation. Globally, the ongoing war in the middle east could disrupt shipping and cause increase in freight rates, and hence import prices, to rise. Domestically, the doubling of the NMW and the award of salary compensations in January 2024 could further add a degree of cost-push inflation, and major pension hikes could raise the level of liquidity and stoke demand-pull pressures. Moreover, the rise of the NMW has called for a holistic re-alignment of salaries in view of maintaining equity and balance in pay scales, and salaries in the public sector may rise further with the anticipated publication of the Pay Research Bureau (PRB) report later in the year. These developments, along with the panoply of social measures announced in the 2024-25 Budget, several of which involve cash handouts to various segments of the population, will result in a significant increase in the money supply, potentially raising the inflation rate above the forecasted 5.8% in 2024.

Fiscal position

The overall fiscal deficit is projected to fall to 3.4% in 2024/2025 from 3.9% in 2023/2024 due to the projected increase in recurrent revenue by 19.3%, driven by an estimated 18.9% rise in tax receipts. On the other hand, recurrent expenditure is estimated to increase by 13.9% in 2024/2025, significantly lower than the projected increase in recurrent revenue, mainly due to increases in social benefits, employee compensation and grants. The recent hikes in salaries (including in the public sector) and in pensions and other allowances to be paid out of the Contribution Sociale Généralisée (CSG) are the main contributors to increases in recurrent expenditure. Expenditure on social benefits, estimated to increase by 22.2%, will alone account for 37% of the government's budget in 2024/2025. Recourse to debt financing will increase the public sector debt by 8.2% to reach Rs 567 billion at the end of June 2025. However, debt as percentage of GDP will maintain its downward path, falling from 74.5% to 71.1% over the same period. Conversely, the debt service ratio, estimated at 2.8% in 2023/2024 will rise slightly to 3.1% in 2024/25 and settle at around 3% in the medium term.

External position

The current account deficit as a percentage of GDP is expected to narrow to 4.2% in 2024 due to the likely impact of a weakening currency, but to deteriorate slightly to 4.5% in 2025 as imports maintain their robust upward trend. The Mauritian rupee is expected to depreciate further in the near term since it is deemed to be currently overvalued. This could prove beneficial for the trade and current account balances. In the long run, however, the widening gap between the exports and imports of goods need to be addressed through deeper structural reforms.

Risks

External risk factors: The macroeconomic outlook for 2024-2025 is subject to significant external downside risks to the global economy, including the escalation of conflict in the Middle East and consequent supply chain disruptions, financial stress arising from mounting debt, persistent inflation, and trade-related tensions. These risks may translate into slower GDP growth in Mauritius, higher inflation, and a deterioration in the country's external position (IMF, 2024a).

Domestic risk factors: Domestically, Mauritius has witnessed a series of extreme weather events, notably cyclones and flash floods, since the beginning of the year and remains vulnerable to climate risks. Tightening labour market conditions, characterized by a sharp increase in the NMW and growing labour shortages alongside an aging population, could also hinder growth prospects.
Risk mitigation Measures: On the other hand, 2024 is an election year, and it is likely that the government will increase its spending, especially on social measures, and accelerate the completion of projects currently in the pipeline. These may raise the growth rate by a notch above the projected 6.5%.

Tailwinds: Over the medium term, tax reforms, fiscal consolidation and an effective targeting of social aid could strengthen public financial management. The government's aim is to maintain long-term growth at 5% through continued structural transformation, ongoing improvement in the business environment and sustained investment in infrastructure.

1.4 Policy options to foster high and resilient growth: Supporting macroeconomic stability and economic transformation

Mauritius has shown a resilient economic recovery post-COVID-19, characterized by strong GDP growth, declining inflation, and prudent fiscal management. To sustain growth and foster economic transformation, policymakers should consider a range of targeted policy options, including:

In the short term:

[3]The CSG was introduced in 2020 in replacement of the National Pension Fund (NPF), which was meant to provide an income stream to private sector employees upon retirement. Currently, the CSG is paid at the rate of 1.5% and 3% by employees and their employer, respectively, on monthly salaries below Rs 50,000 and at the rate of 3% and 6%, respectively, on salaries above Rs 50,000. While intended to be universal in coverage, the CSG currently applies to the private sector only.

Managing inflation. Persistent imported inflation and domestic wage-price spirals require ongoing vigilance. Beyond the new Monetary Policy Framework, the central bank should continue to employ a mix of monetary instruments, including interest rate adjustments, open-market operations, and effective exchange rate management to control liquidity and maintain price stability.

Implementing a fiscal consolidation plan. Fiscal policy should strike a balance between supporting economic recovery and maintaining fiscal sustainability. Strengthening efforts to contain the fiscal deficit and manage public debt through expenditure rationalization, tax reforms, and innovative financing is necessary without compromising social spending and infrastructure **investment.**

In the medium to long term:

Boosting economic diversification and long-term growth. The government should support emerging sectors like pharmaceuticals and the blue economy while addressing the perennial food security issue.

Addressing the trade deficit. The widening trade deficit underscores the urgency of diversifying exports, enhancing export competitiveness, and reducing import dependency. Supporting import-competing industries and investing in high-growth sectors such as renewable energy and agribusiness can help. Revisiting incentives for foreign investors, currently biased towards real estate, is also recommended.

Accelerating structural reforms. Addressing skills mismatches, labour market rigidities, and regulatory barriers is crucial to unlocking Mauritius' growth potential. Investing in education and training, promoting innovation and entrepreneurship, streamlining regulations and continuously improving the business environment can help attract larger FDI inflows, enhance productivity, and facilitate economic transformation.

Tackling climate change. Proactive climate risk mitigation and resilience measures are imperative. Integrating climate considerations into planning, sustainable land use practices, and investing in adaptation measures can protect infrastructure and promote sustainability. Reforms of the global financial architecture, including easier access to climate funds, can further support Mauritius' efforts to address climate change.

2

TAKING STOCK OF MAURITIUS' STRUCTURAL TRANSFORMATION

Mauritius has exhibited impressive economic growth and structural change, transitioning from a sugar-based economy to a diversified, services-oriented economy. The services sector currently accounts for about three-quarters of GDP.

Structural transformation in Mauritius was driven mainly by productivity growth in the services sector since 1990. However, productivity in many service sectors has declined and is currently low relative to the economy-wide average, indicating potential areas for improvement.

Strong political leadership, good governance, proactive policies, and a favourable regulatory framework have been pivotal in Mauritius' economic success. The government also prioritized investment, notably FDI, and technology transfer, and human capital development.

Current challenges to further structural transformation include an aging population, causing acute labour shortages and rising wages; climate risks to infrastructure, agriculture, and beach tourism; and a decline in governance and institutional quality in recent years.

Mauritius faces small but important financing gaps to achieve a desired level of structural transformation by 2030 (1.25% of GDP per year), and to address climate change (1.6% of GDP per year until 2030).

To achieve fast-paced structural transformation in the future:

• The government must mobilize higher revenues through tax reforms and efficient public spending; prioritize investment in digital infrastructure and in vocational training to meet emerging industry needs; support private sector development; and tailor industrial policy to industry 4.0, including modern services and high-value manufacturing.

• The private sector should step up investment in training, technology and innovation, and leverage on trade agreements, such as the AfCFTA, to increase and diversify exports.

• Regional institutions can further enhance market access for Mauritian exports, support institutional capacity-building, and promote greater cooperation in areas of common interest among member-states, such as climate change and structural transformation.

• DFIs and MDBs should provide enhanced financial and technical support for sustainable infrastructure and facilitate access to climate finance.

Introduction

This chapter presents a comprehensive overview of economic transformation in Mauritius, discussing its drivers and challenges, and pointing out opportunities to further the process. Drawing on the Bank's estimates, it presents the financing needs for achieving a level of structural transformation commensurate with best practice by 2030 and 2063, identifies the financing gap, and discusses the scope for enhanced domestic resource mobilization for plugging this gap. The chapter concludes by offering policy recommendations for the government, the private sector, regional institutions, and DFIs, including MDBs, for fast-tracking structural change. In line with Mauritius' unique experience, by African standards, the chapter's focus is on the services sector, and a key finding is that the financing requirements are relatively small, given that Mauritius has already achieved an advanced level of structural transformation.

2.1 Taking stock of structural transformation

Mauritius' economic growth performance has been robust since 1980. During 1980-1989, real GDP grew on average by 6.1% per annum, higher growth than in peer countries like Cabo Verde, Madagascar, and Seychelles, all of which are SIDS, and well above the African average of 2.5% (Figure 2.1). Much of this stellar performance occurred in the second half of the decade, which saw a sharp increase in clothing exports on the back of massive spurts of foreign direct investment, notably from Hong Kong, into the export-processing zone (EPZ). By 1984, Mauritius had successfully completed a structural adjustment program, including two episodes of currency devaluation, and major trade and macroeconomic reforms. Growth was also supported by the return of political stability, better governance, and a favourable regulatory framework that encouraged investment, both foreign and domestic (Zafar, 2006). However, progress on the SDGs has been slow, with only SDG 1 (No poverty) achieved by the end of 2022 (Sachs et al., 2023).

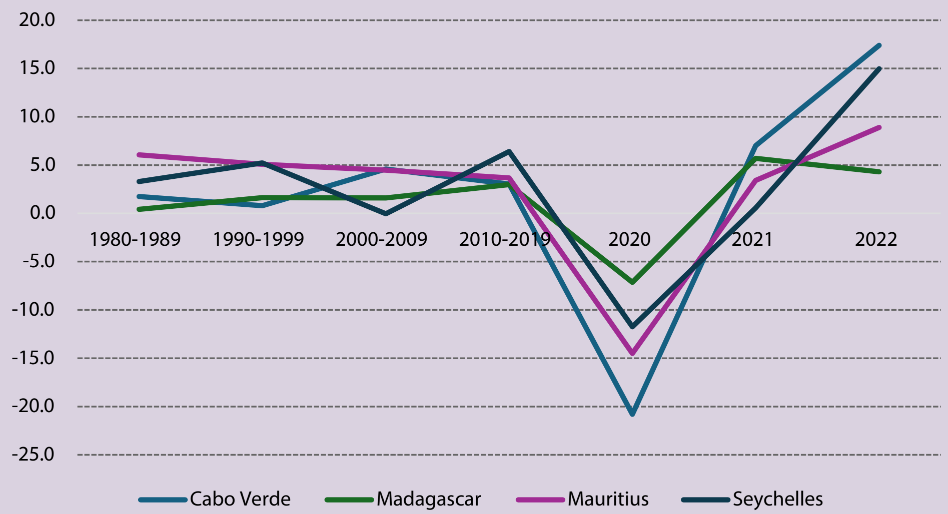
Average GDP growth fell by a notch to 5.1% in the following decade but stayed well above the African average. As EPZ exports slowed, Mauritius diversified into services, including offshore financial services and business processing outsourcing (BPO), and reoriented the traditional tourism product. In fact, the consistently high growth rates between 1985 and 1995 earned the country the coveted label of an 'economic miracle' (Subramanian and Roy, 2001; Frankel, 2010). Crucially, much of this growth was inclusive, as garment factories encouraged thousands of women with few alternative employment opportunities to join the formal labour market.

The turn of the millennium dealt a blow to the clothing industry as the impending expiry of the Multi-Fiber Arrangement at the end of 2004 encouraged foreign investors to relocate elsewhere, including to Madagascar. Mauritius diversified by upgrading along the apparel value chain and into new markets, with the signing of the Africa Growth and Opportunity Act (AGOA) in 2000, opening the US market to Mauritian garments. Initiatives such as tuna-processing and the transformation of the sugar industry into a sugarcane industry with an emphasis on sugar by-products (such as refined sugar, rum, and ethanol) further diversified the manufacturing base. The launch of the Integrated Resort Scheme (IRS) in 2004, which allowed high net-worth foreigners to acquire property in Mauritius subject to initial investments of US$ 500,000, would later emerge as a magnet for FDI, but it did not make much of an impact on growth. Real GDP growth declined further – to 4.5% – during the decade 2000-2009 as the financial crisis also took a toll on the economy. Nevertheless, economic performance remained commendable by African standards, with only Cabo Verde showing a (slightly) higher GDP growth rate among Mauritius' peers.

The growth slowdown continued into the next decade, which saw Seychelles posting above-average performance (6.4%). However, in per capita terms, average GDP growth in Mauritius

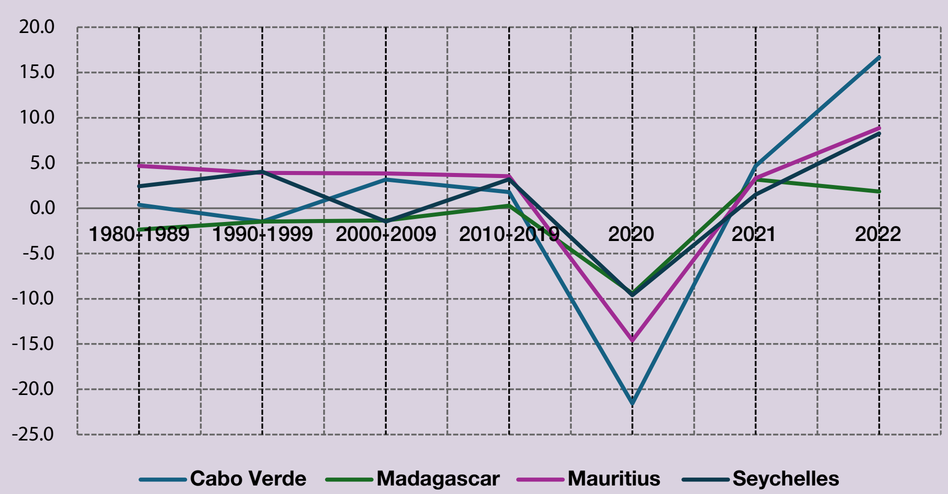
(3.5%) was higher than in Seychelles (3.2%) (Figure 2.2). The Mauritian economy was buffeted by a series of external shocks and domestic structural weaknesses. The European debt crisis of the early 2010s caused a significant drop in tourist arrivals and in merchandise exports to Europe, reflecting the region's weight as a market for Mauritian goods and services. Rising commodity prices in the first half of the decade and geopolitical tensions, such as the US-China trade war, and Brexit in the latter half caused growth to remain subdued globally and in Mauritius (IMF, 2019). In response, Mauritius diversified its tourism markets by focusing on emerging economies, such as China and India, and leveraged on African trade agreements to increase exports to South Africa. Monetary policy

Figure 2.1: Mauritius' real GDP growth vs. African peer countries



Source: AfDB

Figure 2.2: Mauritius' real per capita GDP growth vs. African peer countries



Source: AfDB

became accommodative, with the repo rate slashed progressively from 5.75% in March 2010 to 3.35% in November 2019.

The COVID-19 pandemic caused a dramatic 14.5% decline in output as lockdowns and border closures impacted all key sectors of the economy, notably the travel and hospitality industry, and manufacturing. The government responded with a massive fiscal stimulus package comprising wage assistance to employees and the self-employed, and tax deferral, debt moratorium, grants and subsidies, and flexible loans to affected firms, which pushed the budget deficit to a record 13.2% of GDP in 2020/2021. The repo rate bottomed out at 1.85% in April 2020. These measures proved effective in saving livelihoods and prepared the economy for a robust recovery, with growth rebounding to 3.4% in 2021 and 8.9% in 2022. By the end of 2023, Mauritius had fully made up for the loss of output in 2020 (IMF, 2024b). With population growth grinding to a halt in recent years, the gap between GDP growth and per capita GDP growth has disappeared.

Mauritius has moved from a sugar-based, monocrop economy in the 1960s to a modern, diversified, services-oriented economy. The development trajectory has been a classic one – from agriculture through manufacturing to services – and this is evident in the changing shares of the three sectors in GDP.

2.2 Mauritius' structural transformation: Drivers, bottlenecks and opportunities

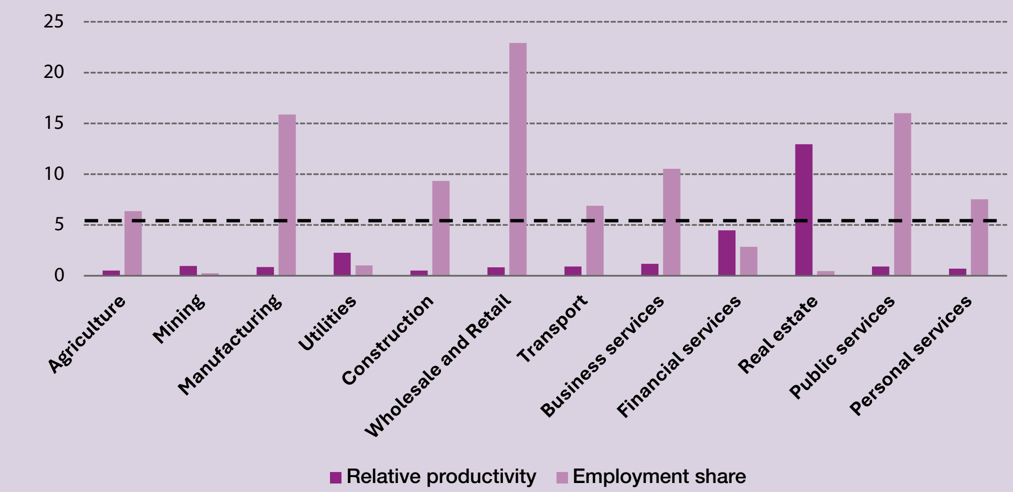
Structural transformation can be described as a process of economic growth through the reallocation of labour from low-productivity to high-productivity sectors. Mauritius has moved from a sugar-based, monocrop economy in the 1960s to a modern, diversified, services-oriented economy. The development trajectory has been a classic one – from agriculture through manufacturing to services – and this is evident in the changing shares of the three sectors in GDP. In 1976, agriculture accounted for about 20% of GDP; this was down to 4.4% at the end of 2023. During this period, services' share climbed from 55% to 74.2%. The manufacturing sector, on the other hand, has experienced mixed fortunes; the sector's share of GDP peaked at 24.5% in 1998 but then declined steadily to 12.9% in 2023.

Figure 2.3 shows the relative productivity and employment share of 12 key sectors of the Mauritian economy. Relative productivity is measured as the ratio of each sector's labour productivity to the economy-wide average labour productivity, shown by the dash line. A number less than 1, suggests the sector exhibits below-average labour productivity. In Mauritius, only two sectors – financial services and real estate – have significantly higher labour productivity than the economy as a whole. Not surprisingly, relative productivity is very low in agriculture, but it is lowest in the construction sector. Several service sectors also show low relative productivity – somewhat of an anomaly given Mauritius' status as a predominantly services-based economy.

In 2018, four sectors – wholesale and retail trade (22.9%), manufacturing (15.9%), public services (16%), and business services (10.5%) – each accounted for more than 10% of total employment. Sectoral employment shares have changed markedly over the years in testimony to the structural transformation that Mauritius has experienced in a relatively short time. Agriculture absorbed a mere 6.4% of the workforce in 2018, a steep decline from 16.7% in 1990 (Figure 2.4). The manufacturing sector has also downsized; in 1990, almost one out of every three workers had a 'factory' job, many in the EPZ. This share was down to 15.9% in 2018 and is projected to fall further as the clothing industry continues to shrink while new manufacturing activities remain elusive. On the other hand, all the service sectors have witnessed an increase in their employment share. The wholesale and retail trade sector has seen its share of employment double from 11% to 22.9% during the period under study. Finally, the financial services and real estate sectors together reported a mere 3.3% of employment despite their huge relative productivity advantage. However, these sectors have significant potential for growth and job creation.

Overall, the analysis suggests that there is little scope for Mauritius to gain in aggregate productivity and achieve a higher degree of structural transformation

Figure 2.3: Relative productivty and employment shares of key sectors, 2018



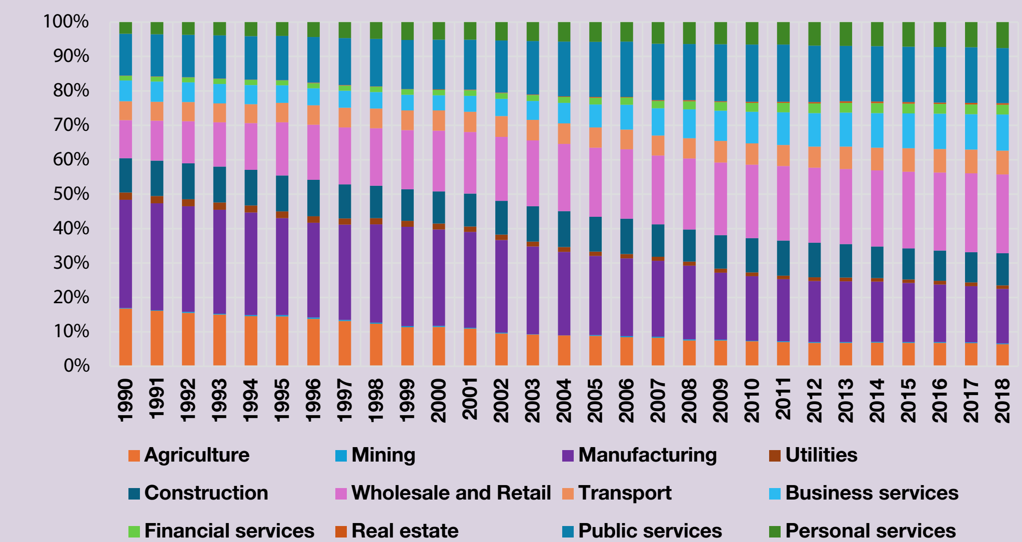
Source: AfDB

by reallocating labour between sectors. Confirming this is the fact that Mauritius is one of nine countries in Africa that is classified as structurally developed already. Moreover, Mauritius features among the top five in the economic complexity index (ECI) ranking in 2021, which suggests that its exports are relatively sophisticated and well diversified, as is also confirmed by the low export concentration ratio. This contrasts with the situation in Africa, where relative productivity is higher than the economy-wide average in all but the agriculture and personal services sectors, and where most countries are structurally under-developed or developing, and thus significant potential for accelerating structural change exists.

Unpacking Mauritius' structural transformation through labour productivity decomposition

The reallocation of labour from low- to high-productivity sectors should cause aggregate labour

Figure 2.4: Sectoral employment shares, 1990-2018



Source: AfDB

productivity to increase. This 'structural change effect' can be separated from other productivity-enhancing factors, such as capital investment, technological change, and efficiency gains using a decomposition method based on McMillan and Rodrik (2011). Figure 2.5 shows this decomposition for Mauritius and Africa for the three decades since 1991.

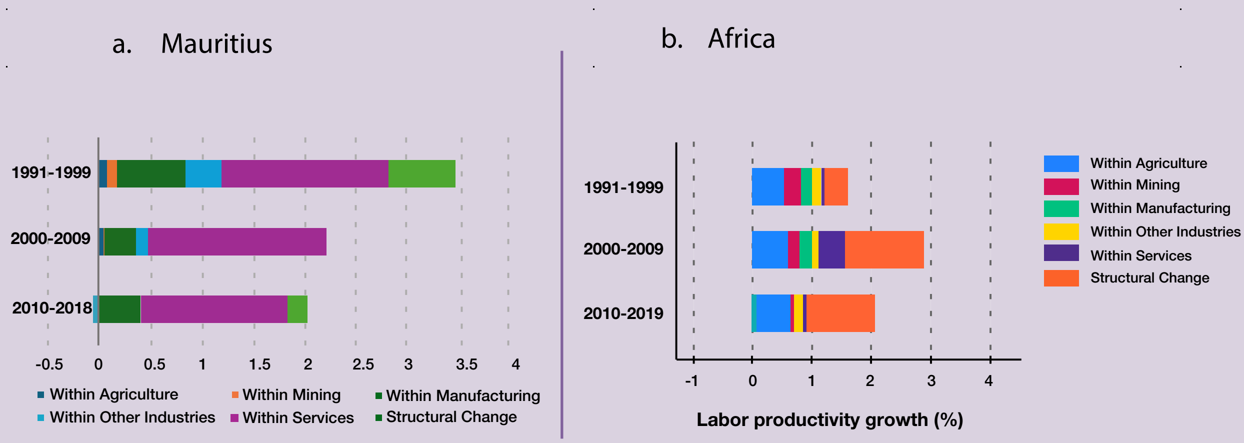
Figure 2.5a shows that labour productivity growth in Mauritius declined progressively over the three decades – from 3.5% per year to 2.2% to 2.0%, respectively. This trend is consistent with the notion of 'convergence' in growth theory. The 1990s were a period of rapid productivity growth, driven mainly by exports of the labour-intensive apparel sector. Rodrik (2011) has argued that 'manufacturing is special' in that labour productivity in manufacturing exhibits a clear tendency towards unconditional convergence. In other words, manufacturing sectors in developing countries, which typically start off with significantly lower productivity levels compared to industrialized economies, experience faster productivity growth regardless of country-specific factors. Without attempting to investigate this hypothesis, Figure 2.5a reveals that productivity growth in manufacturing slowed from 0.65% per year in the 1990s to 0.35% during 2010-2018.

The services sector has contributed most to productivity growth in all three decades and, unlike manufacturing, its impact has diminished only marginally over time – from 1.6% per year in the 1990s to 1.4% most recently. Sustained productivity growth in the services sector can be attributed to the emergence of new services over time, value upgrading in traditional service sectors, such as tourism, continued investment in infrastructure (including internet infrastructure and e-government services) and innovation, regulatory enhancements (e.g., tax treaties and improved investor protection in financial services) and targeted market and product diversification (especially in the tourism sector).

Conversely, productivity growth due to structural change, which is small to begin with, has dissipated across the three decades, falling from 0.65% per year in the 1990s to 0.2% in the decade 2010-2018. This finding should not be surprising given that structural transformation in Mauritius has a long history, predating the 1990s (see Box 2.1).

The Mauritian story stands in sharp contrast in relation to the rest of Africa. In the rest of Africa, labour productivity growth was highest in the decade 2000-2009, and was driven mainly by

Figure 2.5: Structural change in Mauritius vs. Africa, 1991-2018



Source: AfDB

structural change and by productivity growth in agriculture (Figure 2.5b). This suggests that structural transformation arrived decades later in much of the rest of Africa and, therefore, it still has much scope to drive productivity growth on the continent.

Rapid growth in income and jobs embodied in services export: new evidence.

Mauritius is a major player in services exports. Tourism, a traditional service export, has evolved, shifting from beach tourism to niche markets such as eco-tourism and cultural tourism, supported by innovative marketing strategies and sustainable tourism practices. At the same time, new service sectors, such as financial services and IT-enabled services, have emerged and grown into major pillars of the economy. Mauritius' services trade has more than doubled over the past two decades. It represented 35.7% of total trade in 2022, among the highest in Africa. However, transport and travel alone accounted for 67.6% of service exports in 2022, suggesting a high degree of concentration in the services sector.

Mensah and de Vries (2024) employ the African Supply and Use Tables and a method proposed by Los et al. (2016) to determine the value added and jobs embodied in the exports of 11 SSA countries, including Mauritius. They find, inter alia, that an increasing share of value added comes from the export of manufactured goods and services, and that a growing number of manufacturing jobs is sustained by exports. The latter finding, however, does not apply to Mauritius, which seems to have de-industrialized in the past two decades (Rodrik, 2016). Therefore, manufactured exports have not sustained as many jobs as during the heyday of the EPZ in the late 1980s and early 1990s. Their contribution to value added has also declined dramatically over time. In 2019, manufacturing exports accounted for just 5.9% of value added, a steep decline from 16.9% in 1990 (Table 2.1). On a positive note, the value-added content of services exports has increased from 20.1% in 1990 to 28.2% in 2019, confirming Mauritius' status as an export-oriented services economy.

Drivers of structural transformation

The 2024 AEO report has used regression analysis to identify the main determinants of structural transformation in Africa. Many of these factors, and several others that are difficult to quantify, are relevant to Mauritius. They include:

Strong political leadership and good policies at the right time have undeniably been the most important drivers of economic transformation in Mauritius (Ramdoo, 2014). The government has, throughout history, embraced difficult reforms and made decisive policy choices that set the Mauritian economy onto the path of robust long-term growth and structural change. They include the successful completion of a structural adjustment program (SAP) in the early 1980s, including two major devaluations and trade liberalization to reduce and correct the anti-export bias of the import-substitution regime, and new policies and incentives to support diversification into high value-added sectors at different nodes of the country's development.

Institutional quality and good governance have been hailed as a key factor in the Mauritian 'miracle' (Subramanian and Roy, 2003; Frankel, 2010). Successive governments in Mauritius have leveraged the role of the private sector for growth and economic transformation through a long-established tradition of public-private collaboration. The business environment has been continually improved to attract FDI and technology, with the Business Facilitation Act of 2006 bringing about far-reaching reforms that significantly improved Mauritius business environment. Over time, several public sector institutions have emerged to promote business development, innovation, industrialization, and exports.

The government has traditionally acted as a **catalyst for technology and investment.** It has made large initial investments in major

Table 2.1: Value added of exports by sector as a % of GDP

	Agriculture	Mining	Manufacturing	Business & fin. services	Other services	Total
1990	9	0.1	16.9	6.4	13.7	46.1
2007	1.9	0.1	10.8	8.4	20.7	42
2019	0.8	0	5.9	13.3	14.9	34.9

Source: Mensah and de Vries (2024)

Box 2.1: Learning from successful experiences in supporting growth and structural transformation

Mauritius has emerged as a case of successful growth and structural transformation and is itself an example for the rest of Africa.

The country's industrialization journey began with import-substitution policies in the 1960s, marked by the Development Certificate (DC) scheme in 1964, which encouraged domestic production through high tariffs and quotas. While this inward-focused strategy spurred some industrial growth, it had limited success in job creation and economic growth due to the small domestic market. A significant strategic shift occurred in the 1970s with the introduction of the EPZ, aimed at attracting FDI and boosting exports (Ancharaz, 2006). In the 1990s, Mauritius diversified into services while initiatives like tuna canning and transforming the sugar industry into an integrated industry producing a wider range of products (including energy from bagasse) consolidated the manufacturing sector.

Mauritius' economic trajectory was inspired by the experiences of the East Asian Tigers and successful Latin American countries such as Chile. These regions demonstrated that strategic government intervention, human capital development and diversification were critical to economic success. The EPZ, for example, was modelled on the success of Hong Kong and Taiwan with this strategy. Their governments cleverly used industrial policy (a mix of fiscal incentives, subsidies, and public investment in infrastructure) to attract investment into the export sector (Stiglitz and Yusuf, 2001). Singapore's and Taiwan's success highlighted the key role of education, training, and innovation (World Bank, 2018) while Singapore also emphasized the need for business facilitation reforms. Finally, Chile's shift from copper dependency to a broader export base underscored the importance of industrial diversification to build economic resilience and global competitiveness (OECD, 2020).

new projects, providing land, infrastructure, and seed capital, to crowd in private investment. The success of the EPZ, for example, rests in part on the subsidized industrial space that the government put to the disposal of firms in specific clusters across the island. In 2001, Government laid the foundations for a cyber-city to house companies operating in the IT-enabled services sector and has, over the years, built and operated several business parks. Recent years have seen massive public investments in a tramway line and its extensions, and in road and ICT infrastructure, including 'technopoles'. The government has also put forth legal frameworks to encourage the adoption of modern technologies, such as fintech, AI and green energy. Mauritius stands 2nd (out of 54 countries) in Africa on the ICT Development Index 2021 and 86th (out of 185 countries) on the Global Quality Infrastructure Index 2023.

Moreover, the government has prioritized **human**

capital development through free education and healthcare. Secondary education was made tuition-free in 1976 and, since 2019, tertiary education up to an undergraduate degree at a state university is free of all charges. In parallel, the government has continually invested in vocational and lifelong training through institutions such as polytechnics, the Academy of Design and Innovation, the Human Resource Development Council, and the Civil Service College, Mauritius. Free education underpins the country's structural transformation from unskilled agriculture to modern, high-skill services. School enrolment rates are near 100% and Mauritius has the second highest Human Capital Index (0.62) in Africa. However, challenges remain. Mauritius is yet to achieve SDG 4 (quality education). High school enrolment rates mask the stark reality of low pass rates in national exams and a lack of attention given to students with special needs.

Key challenges to fast-paced transformation

Several challenges, both current and future, could hinder the country's efforts towards sustainable development and structural transformation. Many of these challenges are systemic. They include demographic shifts, climate change, persistence of an informal sector, political issues, and financing constraints.

Demographic shifts. Mauritius is facing the spectre of a declining population due to a combination of an aging population and below-replacement birth rates. In 2023, the population growth was -0.06%, but the decline is projected to become steeper in the future. Beyond their implications for the pension system and healthcare, the current demographic trends mean that the working population will shrink. Growing labour shortages and rising wages are an explosive cocktail for labour-intensive industries, such as clothing, and some service sectors. Imported labour can provide some short-term relief, and the government has responded positively to companies' demand for foreign workers. However, some political issues have recently surfaced, prompting the government to reconsider its expatriate employment policy. If these issues are not addressed swiftly, sectors such as healthcare, tourism and ICT will come under pressure of labour shortages, with adverse impact on Mauritius' competitiveness in the near term.

Climate change. As a SIDS, Mauritius is particularly vulnerable to climate-related hazards, which pose significant risks to infrastructure, resources, and productivity. Climate change can impact structural transformation in several ways. Extreme weather events, such as cyclones and flooding have caused material damage to infrastructure and diverted resources into reconstruction and the building or rehabilitation of drains, at significant opportunity cost. Long spells of dry weather and flash floods have devastating effects on agriculture and crop yields, underscoring the need for greater food security but, at the same time, increasing agricultural investment risks. Sea-level rise and coastal erosion present major challenges to the model of Mauritian tourism, based on sun, sand and sea. These challenges highlight the urgency for Mauritius to diversify its economy away from climate-vulnerable sectors, such as tourism and low-value agriculture into modern farming practices and higher value-added services.

Informality. The existence and persistence of a large informal sector can also compromise the process of structural change by limiting productivity, innovation, and access to financial services. In Mauritius, informality is a ubiquitous feature of SMEs (predominantly micro- and small enterprises), which, the evidence suggests, lack technological capability, and exhibit a low propensity to innovate (Wignaraja, 2001; IIT, 2015). Mauritius ranked 57th among 132 economies on the 2023 Global Innovation Index (GII), and first in Africa (WIPO, 2023). However, it has slipped from 45th place in 2022, and does not compare favourably with international peers like Singapore and Ireland. Notably, a breakdown of the 2023 GII score suggests that the country invests little

Box 2.2: Potential and existing opportunities

Mauritius has significant opportunities to accelerate structural transformation, particularly through AI, the digital economy, renewable energy, and the blue economy. The government can, as usual, lead by providing the infrastructure and regulatory and incentive frameworks to spur private investment in existing sectors or new activities. Improving the export complexity of Mauritian products – through increased investment in human capital, R&D and innovation – is another avenue, as current exports are less sophisticated than those of competitors like Singapore, Ireland, and the UAE (IMF, 2019).

Several missed opportunities highlight challenges in economic diversification that need to be revisited. In the blue economy sector, for example, the Land-Based Oceanic Industry (LBOI) failed due to a skewed incentive regime favouring real estate investment, and local firms' risk aversion. Renewable energy development and recent attempts to establish a pharmaceutical industry post-COVID-19 have similarly lagged. Government should overcome investors' lack of interest in these sectors by proposing attractive PPPs and risk-sharing schemes and targeted incentives.

Finally, Mauritius is a major regional player, home to the Indian Ocean Commission, and is implementing the African Continental Free Trade Area (AfCFTA) agreement alongside bilateral cooperation accords with China and India. Mauritius' exports to the rest of Africa have increased 30-fold since the entry into force of the SADC Trade Protocol in September 2000. Going forward, Mauritius can leverage the full potential of the AfCFTA to boost Mauritius trade with the rest of Africa.

in R&D and advanced skills – only 0.2% of GDP according to a recent IMF report. Fortunately, the scale of informality in Mauritius is low, especially in contrast to regional peers, and has declined over time as business registration procedures have improved and the tax burden lightened.

Political issues. Mauritius has long been an example to Africa in political stability and good governance. The country ranked 55th on the Corruption Perceptions Index 2023, just behind Seychelles, Cabo Verde, and Botswana in Africa. However, there are reports that corruption seems on the rise. The National Audit Report 2024 has revealed numerous cases of dodgy procurement deals, lack of transparency and accountability in the use of public funds, and waste due to mismanagement and political interference (National Audit Office, 2024). The country's reputation as a vibrant democracy has also taken a hit, with the V-Dem Report 2024 classifying Mauritius as an 'emerging autocracy' (V-Dem Institute, 2024). Corruption and nepotism can slow economic development and structural change by reducing both the financing and the human capital needed to drive the process.

Financing constraints. As discussed below and in the next chapter, Mauritius will need financing of the order of 1.3% of GDP per year to achieve a target level of structural transformation by 2030, and much more to reach the SDGs by 2030. Moreover, climate finance needs (excluding loss and damage) up to 1.6% of GDP per year until 2030. While the tax system in Mauritius is buoyant and efficient, further reforms can help mobilize more revenue domestically just as there is some scope for debt and external financial flows, including FDI and aid, to rally much-needed finance. Nevertheless, the financing gaps will remain, and without the active support of the international community, and greater efforts by the government to access existing climate funds, there is a risk that the business of structural change will remain unfinished.

2.3 Finance to fast-track Mauritius' structural transformation: How much is at stake?

Mauritius does not have a valid national development plan (NDP) per se. There are sectoral plans, and a Public Sector Investment Program that is updated annually on the presentation of the Budget. Perhaps Vision 2030, a strategic plan launched in 2015 with the overarching goal of escaping the 'middle-income trap' and achieving the high-income country status, comes closest to an NDP. However, Vision 2030 has not been costed, nor implemented to any major degree. Moreover, there is no mention of 'structural change' or 'structural transformation' in the document. Similarly, the SDGs too have not been budgeted or mainstreamed into any strategy, which is one reason why their implementation remains patchy. Nevertheless, there is an understanding among stakeholders that Mauritius must relentlessly pursue economic transformation through diversification, technology adoption, and value upgrading. This understanding permeates government policies and actions.

Financing needs and financing gap

Accelerating structural transformation requires enhancing enabling factors such as policies and the regulatory environment, human capital, energy, infrastructure, innovation, technology, and multifactor productivity. Most of these factors can be mapped to a specific SDG: human capital (education) to SDG 4, energy to SDG 7, infrastructure, innovation and technology to SDG 9, and productivity to SDG 8. Thus, the cost of achieving a desired level of structural transformation can be estimated by the financial resources needed to meet the above four SDGs.

The Bank has estimated the annual financial needs and the financing gap for each African country if it were to achieve a level of structural transformation that would put it at par with high-performing developing countries by the year 2030 or by the year 2063 (corresponding to the AU Agenda 2063). For Mauritius, the annual financing needs are US$ 334 million and US$ 58.5 million, respectively (Figure 2.6a). Infrastructure accounts for the bulk of the financing needs – about 60% and 88% for the 2030 and 2063 targets, respectively. The annual financing gap amounts to US$ 128.9 million and US$ 22.5 million, respectively, representing 1.25% and 0.2% of GDP, respectively (Figure 2.6b). Only Seychelles (0.7% and 0.1%, respectively) and South Africa (1.2% and 0.2%, respectively) have a lower financing gap than Mauritius, which is testimony to the advances that Mauritius has made on the SDGs and on structural transformation.

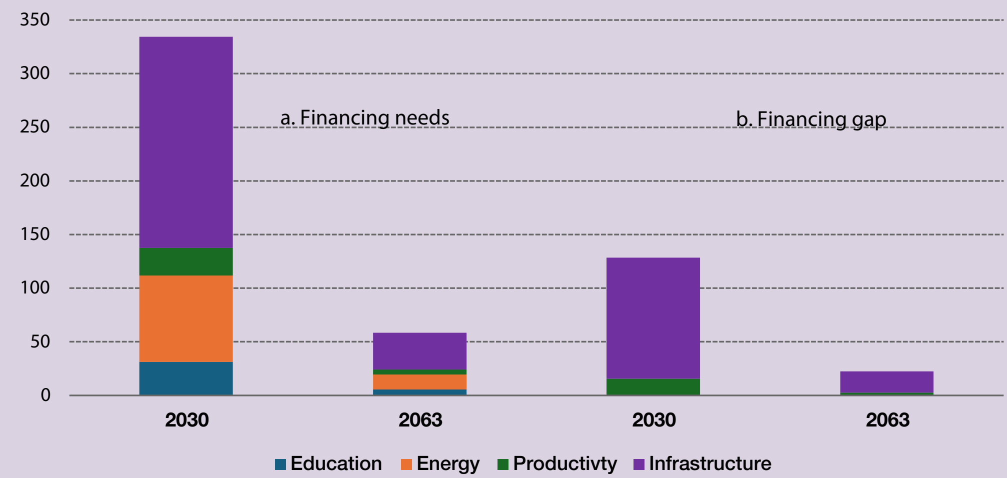
Closing the financing gap through domestic resource mobilization

Mauritius needs to raise its tax-to-GDP ratio by less than 0.77 and 0.13 percentage-points to close its structural change-financing gap by 2030 and 2063, respectively – the third lowest in Africa (Figure 2.7). Government revenue in Mauritius has increased constantly over the years (except for the pandemic year of 2020) (Figure 2.6). Taxes as a share of GDP have also increased steadily – from 17.8% in 2016 to 20.2% in 2023. This trend confirms the buoyancy of the Mauritian tax system, suggesting that increasing the tax-GDP ratio by another percentage-point by widening the tax bracket is totally feasible.

The structure of government revenue in Mauritius is typical of developing countries. Taxes on goods and services (comprising value added taxes and excise duties) make up the bulk of government revenue – 56.6% in 2023 (Figure 2.8). However, the share of income taxes has increased – from an average of 20% in the early 2010s to 29% in 2023 – thanks largely to continuous reforms over

[4]According to World Economics, the informal economy represented 20.6% of GDP in 2024, placing Mauritius as the 33rd smallest among 152 countries.

Figure 2.6: **Estimated annual financing needs and financing gap to fast-track structural transformation in Mauritius by 2030 and 2063**



Source: AfDB

the years to make the tax system more progressive and to exempt low income-earners from any tax liability. As Mauritius graduates towards a high-income economy, there is scope to mobilize increased revenue from direct taxes and gradually reduce reliance on the VAT, which has proved efficient but is regressive in its effects. Reform of the universal pension system, long demanded by the Bretton Woods institutions, can also free up tax resources for financing structural transformation.[5]

2.4 Concluding remarks and policy recommendations

The Mauritian economy has exhibited remarkable resilience and transformation over the past decades, shifting from an agriculture-based economy to a diversified services-oriented one. However, Mauritius needs to reinvent its economic development model, which, until now, relied on labour-intensive manufacturing exports as a key driver of growth. This model has become a victim of its own success as labour shortages, rising wages and stagnating productivity have eroded export competitiveness. But emerging technologies, such as artificial intelligence can help rescue and re-engineer manufacturing, while new approaches (like the green economy) and new sectors (such as modern services and the blue economy) can support the long-term structural transformation of the Mauritian economy. Going forward, the government, the private sector, regional and multilateral institutions can all play a role in this process.

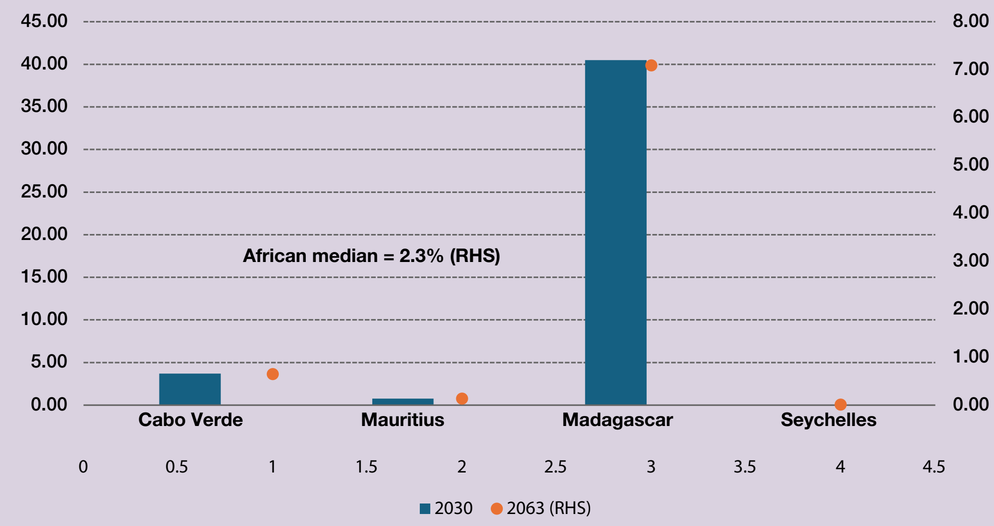
The Government should

- Mainstream structural transformation and the SDGs into policies, sectoral plans, strategies and the national budget, and leverage partnerships for the effective implementation of the SDGs, especially SDGs 4, 7, 8 and 9, which are closely related to economic transformation. A well-crafted national development plan can be a great support to long-term structural change and achievement of the SDGs. This should be a government priority.

- Prioritize investment in critical infrastructure, particularly ICT and renewable energy to support the digital economy and the green economy.

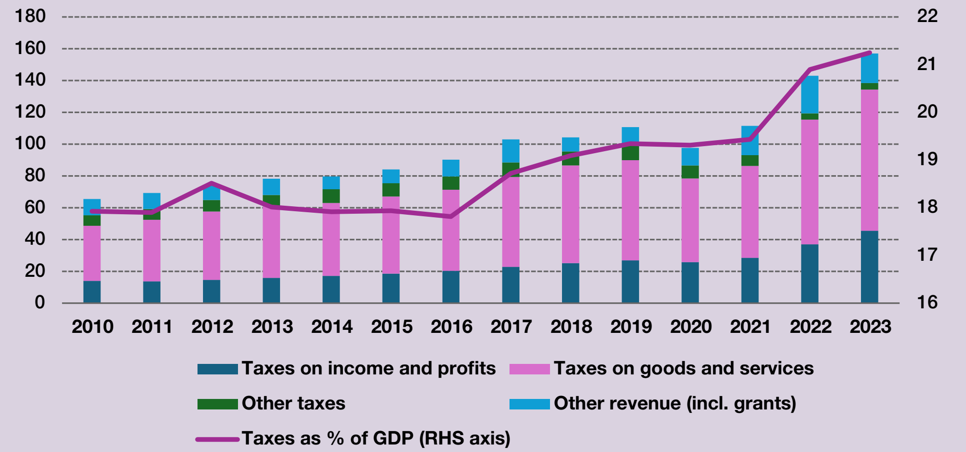
- Enhance revenue mobilization by introducing progressive income tax reforms and broadening

Figure 2.7: Required increase in tax-to-GDP ratio to close financing gap in Mauritius vs. peers (percentage-points



Source: AfDB

Figure 2.8: Government revenue by source (Rs billion) and taxes as % of GDP



Source: Ministry of Finance, Economic Planning and Development (MoFEPD) data

[5]All Mauritian citizens are entitled to a non-contributory basic retirement pension (BRP) at age 60 even though the retirement age is 65. This pay-as-you-go system consumes a substantial amount of government resources (5.25% of GDP in 2022) and has come under pressure from an ageing and shrinking population. Reform proposals include raising the eligibility age to 65 and targeting the BRP to the most vulnerable elderly while reforming also the under-funded pension schemes for both public- and private-sector employees (IMF, 2024).

Box 2.3: Bank's support to economic transformation in Mauritius

The Bank continues to play a central role in supporting sustainable development and structural transformation in Mauritius. In recent years, this support has been primarily focused on building resilient infrastructure and promoting economic diversification.

A significant element of the Bank's assistance is the US$240 million loan approved in May 2024 to finance the second phase of the Economic Competitiveness and Resilience Support Program, which proposes fundamental reforms to improve the business environment and strengthen the real economy. The program addresses key sectors such as fisheries and agriculture, supporting national legislative frameworks and strategic plans to boost productivity and resilience. Notably, the Fisheries Framework Bill aims to regulate unregulated fishing, while a strategic plan for the agriculture sector focuses on increasing production and promoting agribusiness and sustainable practices (AfDB, 2024a).

Moreover, the loan will support renewable energy development by financing the installation of rooftop solar panels for low-income households. This initiative not only promotes the green economy transition in Mauritius, but also reduces electricity costs for beneficiaries.

The Bank's support is in line with the Mauritius Country Strategy Paper 2022-2027's focus on enhancing economic resilience, sustainable infrastructure, and environmental protection. It will support Mauritius' transition to a high-income economy by 2030 unleashing the country's potential in agriculture, ICT, financial services and the blue economy (AfDB, 2024b).

the tax base. Restructure and reform the unfunded pension system and introduce a degree of targeting in welfare programs to free up resources.

- Support export growth and diversification through appropriate exchange rate policy, subsidization of freight, and trade facilitation
.

- Promote innovation by providing scaled-up funding and targeted incentives for R&D, particularly in technology-intensive and high value-added sectors.

- Increase investment in human capital by emphasizing vocational training. Expand and modernize vocational training programs to align with industry needs, focusing on emerging sectors such as IT, renewable energy, and manufacturing 2.0.

- Lead the private sector to invest in new sectors through dialogue and improved PPPs, risk-sharing mechanisms, and incentive frameworks.

- Support the continued development of the services sector through targeted industrial policy aimed at 'picking winners' and promoting them. Implement regulatory reforms to attract FDI in emerging sectors.

The private sector must play their part by responding more fully to government policies and incentives. Companies should adopt innovative and sustainable practices to enhance productivity and competitiveness; continuously invest in capacity-building, and leverage on trade agreements, such as the AfCFTA, to explore new export opportunities. Constant dialogue between the government and Business Mauritius should underscore the broader corporate social responsibility of the private sector in contributing to the economy's resilience through continued structural transformation.
Regional institutions can support trade, FDI and

technology transfer among African countries. The AfCFTA, for example, has significant potential to boost trade between Mauritius and the rest of the continent, and spark greater complexity of Mauritian exports. Regional institutions can also enhance the institutional capabilities of their member-states through technical assistance and capacity-building programs. Finally, they should promote greater collaboration among member-states in areas of common interest, such as climate change, technology transfer, and structural transformation.

DFIs and MDBs should scale up sustainable lending to developing countries like Mauritius and provide innovative financing solutions, such as guarantees and blended finance, to encourage investment by the private sector in emerging sectors with higher perceived risks. They can also assist Mauritius in accessing climate funds and support initiatives aimed at building economic and climate change resilience.

3

FINANCING STRUCTURAL TRANSFORMATION IN MAURITIUS: THE NEED FOR REFORMS OF THE INTERNATIONAL FINANCIAL ARCHITECTURE

KEY MESSAGES

Mauritius, one of Africa's most dynamic economies, needs minimal but continual structural transformation to align with high-performing developing countries. The financing gap for achieving this by 2030 is 1.25% of GDP, the third lowest in Africa. This amount must be mobilized from external sources.

As a SIDS, Mauritius could benefit from the reforms of the global financial architecture. Reforms should focus on increasing the level of sustainable financing by MDBs, making access to financing more equitable and affordable. Access to financing for climate action and for implementing the SDGs needs also to be enhanced. The specific challenges facing Mauritius require special and differential treatment by multilateral donors and agencies.

Mauritius can also rely on FDI flows and, to a lesser extent, on ODA in pursuit of the SDGs and structural transformation. However, there is a need to review the incentive framework to encourage FDI to flow into dynamic and emerging sectors, such as renewable energy, blue economy, pharmaceuticals, and sustainable agriculture.

The current debt level in Mauritius is sustainable. There is some scope to use debt (both domestic and foreign) as an instrument to finance structural transformation.

Mauritius faces a financing gap of 1.6% of GDP per year (excluding loss and damage) until 2030 to implement its NDC. Adaptation is a priority for Mauritius, requiring about 60% of total climate financing. Closing the financing gap calls for mobilizing scaled up resources from external sources. Mauritius must build its domestic capacity to access multilateral climate funds directly. Sustainable bonds, currently under consideration by the government, are a viable option as are local initiatives to attract private investment in the green and blue economy sectors.

3.1. Introduction

Mauritius' financing gap to achieve structural transformation by 2030, estimated at 1.25% of GDP, is the third lowest in Africa. This low gap reflects Mauritius' dynamic economy and minimal need for further structural transformation to match high-performing developing countries. Access to domestic finance is not a major issue, and the cost of finance is comparable to peer countries (IMF, 2019). As an upper-middle-income economy with strong governance and an investment-grade credit rating, Mauritius is well positioned to attract foreign financing. However, despite its progress, Mauritius remains vulnerable to external shocks, as revealed by the COVID-19 pandemic. Increased external support, including access to innovative financing mechanisms, is essential for further economic diversification and social resilience. This chapter evaluates Mauritius' capacity to mobilize external resources for structural transformation and discusses necessary reforms in the international development finance system to support this goal.

3.2. Need for reform of the international financial architecture

The evolving global landscape challenges the current international financial architecture. First, the Global South, including Africa, now commands a much bigger share of world GDP, yet the international financial system continues to be dominated by advanced economies, resulting in unequal power and inequitable access to financing by developing countries. Second, non-state actors like regional organizations and private philanthropies are increasingly influential in development financing, but mechanisms to leverage these resources are lacking. Third, there is a substantial financing gap for global public goods, such as climate action and pandemic preparedness, with Africa facing high borrowing costs and poor debt restructuring.

There are growing calls for reform of the international financial architecture to ensure more inclusive access to development finance, and fairer pricing of sovereign debt. Equally, there are demands on MDBs to increase their sustainable lending levels to help their members deal with more-frequent crises and address their long-term development needs, including financing for structural transformation. Finally, there is a pressing need to provide dedicated financing for the implementation of the SDGs in developing countries and to scale up financing for climate change, and ease African countries' access to these funds.

Like other countries, and more so as a SIDS, Mauritius stands to gain from an overhauling of the international financial architecture. The Bank has estimated the annual financing gap for achieving SDGs 4, 7, 8 and 9 alone at 1.25% of GDP until 2030. Additionally, the potential climate financing gap, excluding loss and damage, amounts to 1.6% of GDP per year until 2030. The financing gap for attaining all the SDGs and address climate change comprehensively will be much higher than these estimates. Financial resources of this scale are out of reach of the government, and without external support and improved access to development finance and climate funding, the financing gaps will remain unplugged. However, there is no global fund to help developing countries like Mauritius implement the SDGs, which partly explains why the country's track record on the SDGs has been poor. Mauritius can benefit from additional resources from MDBs specifically directed to investment in the SDGs, notably SDGs 7 and 9, which are also intimately linked to structural transformation.

Climate finance (discussed in chapter 3) remains a major issue for Mauritius, with a financing gap of 1.6% of GDP until 2030. Access to global climate funds is constrained by burdensome administrative requirements and, even then, most of the available funding is for mitigation rather than for adaptation, which is a priority for Mauritius. The country could benefit from enhanced accessibility to adaptation finance, including grants, simplified procedures, and the operationalization of the Loss and Damage Fund agreed at COP27 in Egypt.

Domestic borrowing represents about 80% of government debt, suggesting that Mauritius' recourse to external borrowing has been limited by choice rather than by credit constraints. As one of the two African countries with investment grade credit rating, Mauritius does not face the same external borrowing constraints as its African peers. In recent years, Mauritius has borrowed more from bilateral partners, such as India and Saudi Arabia, on better terms than would be available on international credit markets. This means that easier access to finance from IFIs, and on concessional terms, could encourage Mauritius to seek development finance from MDBs and multilateral donors than from bilateral partners.

Moreover, there are several factors that could complicate Mauritius's ability to attract financing, thus compromising structural transformation in the future. First, as a global financial centre (GFC), Mauritius must maintain strict anti-money laundering (AML) and counter-terrorism financing (CTF) standards to safeguard its reputation as a trustworthy jurisdiction that inspires investor confidence. Any slip-up in compliance can harm the country's goodwill as a GFC and impair its capacity to mobilize external financing. The global financial architecture takes a one-size-fits-all approach, imposing the same standards on all countries, developed and developing. This exerts disproportionate pressure on countries with weaker administrative capacity like Mauritius.

Second, Moody's long-term credit rating for Mauritius has continuously deteriorated from Baa1 in June 2012 to Baa3 (with stable outlook) in July 2023. This is the lowest investment-grade rating; any further decline will push Mauritius' sovereign rating into 'junk' status, with adverse implications for the country's ability to borrow on the international market. The credit downgrade will also have wider impacts on Mauritius' global business sector and on FDI inflows as foreign investors become more nervous about investing in Mauritius. A sudden cut in external financial flows to Mauritius can seriously jeopardize the country's future path of economic development and structural change.

Finally, Mauritius had briefly attained the status of a high-income country in July 2020 before the dramatic fall in GDP that year sent the country back to the upper-middle-income category. However, with economic recovery on its way, it will not be long before Mauritius is upgraded to the high-income countries group again. While that achievement may not translate into short-term gains, it may cause a backlash in aid flows to the country and raise borrowing costs as Mauritius may no longer qualify for concessional finance.

Yet, Mauritius will remain a SIDS and, as such, will continue to be subject to climate risks and other exogenous shocks. From this perspective, the rules of the game are not fair to countries like Mauritius, which are prosperous but nevertheless remain vulnerable due to their geography. The international financial system must account for this innate vulnerability and provide adequate climate finance to help developing countries address it. The international financial architecture must also conceive a measure of special and differential treatment, as applied to international trade, for developing countries with specific vulnerabilities to help them advance their sustainable development and structural transformation agendas.

3.3. Mobilizing additional resources for Mauritius' structural transformation

Policy and regulatory reforms

The policy recommendations made in chapter 2 to support fast-paced structural transformation in Mauritius included fostering R&D and innovation, prioritizing public investment in digital infrastructure and green energy, and scaling up investment in vocational training to meet current and future industry needs. In all these areas, policies or strategies currently exist, but are either inadequate or inadequately implemented. For example, on

Mauritius is uniquely positioned to enhance its resilience through strategic policy interventions and targeted investments. Climate action financing, particularly through the issuance of green and blue bonds, offers a significant opportunity to support sustainable blue economy and renewable energy initiatives.

innovation, there is an array of initiatives, such as a National Innovation Framework 2018-2030, and several innovation schemes operated by the Mauritius Research and Innovation Council. However, the National Innovation Policy is considered "very weak" (IIT, 2015:17).

In the area of entrepreneurship, the government launched a 10-year Master Plan for the SME sector in 2017. However, there are indications that the Plan is not being effectively implemented. Similarly, while a Digital Mauritius 2030 Strategic Plan was published in 2018, the ongoing digitization of government services (or e-Government) is moving very slowly, creating much frustration in the public about government service delivery. Thus, the challenge for the government is to demonstrate the political will to implement existing policies, or to strengthen them where needed.

Mobilizing external resources for Mauritius' structural transformation

ODA, FDI inflows and net inward remittances can also support a country's economic development and structural transformation efforts. In Mauritius, these external resource flows have been erratic and, except for FDI, not very significant.

Aid flows to Mauritius, as a percentage of gross national income, have averaged a mere 1.3% during 2018-2022, compared to 3.3% for sub-Saharan Africa. Bilateral aid from DAC donors has generally dominated ODA flows to Mauritius. In recent years, however, Mauritius has been receiving substantial amounts of aid and grants from non-DAC countries, notably India, China, Saudi Arabia, and the UAE, on which no reliable published data exists.

FDI inflows have historically outstripped ODA but have been particularly volatile. As a share of GDP, FDI inflows to Mauritius averaged 2.5% during 2018-2022, higher than the Africa average of 2.0%. FDI received a boost in 2004 when the government introduced the Integrated Resort Scheme (IRS). The scheme (and subsequent variants of it) attracted a spurt of FDI into the real estate sector, which continues to date. In 2023, real estate activities alone accounted for 57% of FDI inflows, with the manufacturing sector receiving a paltry 0.4%. It seems that the IRS and innovations on it, such as the Property Development Scheme, most recently, have distorted the risk-return trade-off so much in favour of investing in luxury villas that investing in other sectors has become unattractive for foreign investors. Unless the incentive framework is re-adjusted, FDI will continue to flow disproportionately into real estate, at the expense of the productive sectors.

With labour shortages become a binding constraint in many sectors, including services, Mauritius has become a coveted destination for migrant workers from Asia and the rest of Africa and expatriate employment has increased sharply. Mauritius has historically been a net sender of remittances, but net outward remittances have increased exponentially since 2013. While foreign workers contribute to the economic development and structural transformation of Mauritius, remittances cannot be relied upon as a source of external resources to finance this process.

3.4 Dealing with Mauritius debt

The Government of Mauritius has traditionally employed public borrowing to stimulate growth, fund infrastructure projects, and enhance social welfare programs. However, government debt has become a critical development financing instrument since 2014. The evolution of debt and the debt-to-GDP ratio in recent years reveals both the benefits and potential adverse impacts of this strategy.

[6]The IRS allowed high net-worth foreigners to acquire property in Mauritius subject to initial investments of US$ 500,000 (later reduced to US$ 300,000).

Box 2.4: Opportunities to strengthen resilience

Mauritius is uniquely positioned to enhance its resilience through strategic policy interventions and targeted investments. Climate action financing, particularly through the issuance of green and blue bonds, offers a significant opportunity to support sustainable blue economy and renewable energy initiatives. These bonds have the potential to attract private sector investment, fostering a robust framework for public-private partnerships and blended finance initiatives, which are crucial for sustaining long-term growth and resilience against climate and economic shocks.

In this context, Mauritius must prioritize direct access to climate funds by building robust administrative and project management capacities. This will ensure efficient planning, implementation, monitoring, and reporting of adaptation and mitigation projects, ultimately enhancing the country's ability to secure and effectively utilize climate financing.

Promoting social inclusion is equally critical for long-term resilience in Mauritius, especially given its transition to a diversified, services-oriented economy. The government's focus on enhancing its investment in social infrastructure through vocational training and aligning it with industry needs, particularly in IT and renewable energy, offers tremendous opportunities to create decent employment and equip the workforce for a modern economy. Additionally, reforms to attract foreign direct investment into diverse sectors beyond real estate remains a promising pathway to drive inclusive growth. These policies are essential for reducing income inequality and mitigating vulnerability to shocks, ensuring sustainable development and the social stability the country enjoys.

Historically, Mauritius maintained a prudent approach to managing its public debt. In 2008, the Public Debt Management Act set a cap on the debt-to-GDP ratio at 60%. However, the onset of the COVID-19 pandemic led to the temporary abandonment of the debt ceiling as the government implemented emergency measures to support the economy. Consequently, public sector debt ratio, which had stabilized at an average of 62.5% before 2020, soared to a peak of 91.8% in 2020/21, before falling off to 78.6% at the end of 2023 (Fig. 3.1). In the space of a decade – between 2014 and 2023 – the level of the public debt has doubled, crossing the half-a-trillion-rupee mark to reach Rs 512.1 billion in December 2023.

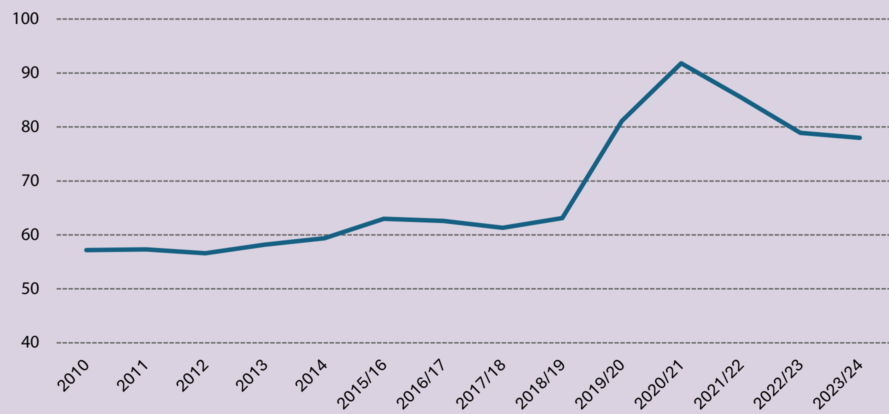
This raises the question: is the public debt sustainable? There are several indicators that suggest that it is. First, in 2022, the IMF determined that Mauritius could sustain a higher debt ceiling of 80% of GDP (inclusive of a 15% safety buffer) in the medium term (IMF, 2022). The government has endorsed the new debt anchor and is on track to complying with it: the debt ratio is estimated to fall continuously to 78% by June 2024.

Second, the public debt is predominantly domestic, with external debt representing about 20% of total debt. The external debt-to-GDP ratio for the central government is even lower, averaging 13.6% post-pandemic (Figure 3.2).[7] This reduces exposure to the exchange rate risk and the risk of default.

Moreover, the debt affordability ratios are low and on a downward trend after the pandemic. For example, interest payment as a share of government revenue has declined from a peak of

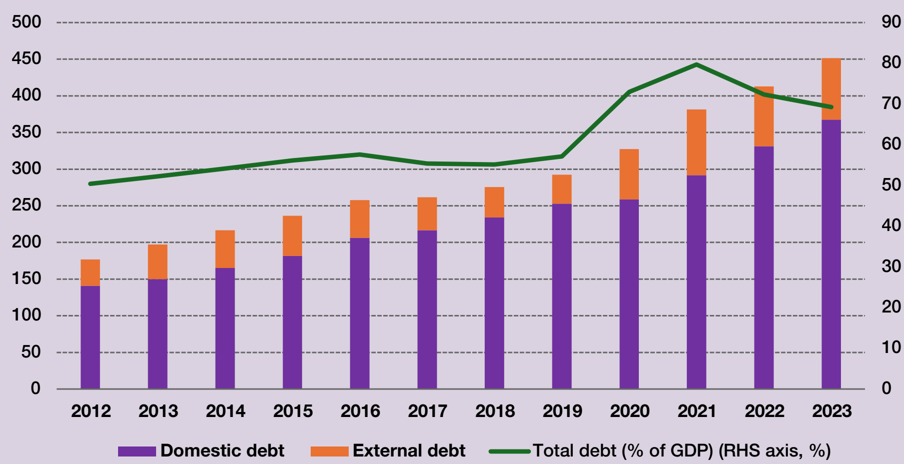
[7]The comparison is based on 4-year averages for 2020-2023 and 2016-2019.

Figure 3.1: Public sector gross debt, 2010-2023/24 (% of GDP



Source: MoFEPD data

Figure 3.1: Public sector gross debt, 2010-2023/24 (% of GDP



Source: MoFEPD data

12.9% in 2019/20 to 9.5% in 2021/22 while, as a share of GDP, the interest charge on public debt has remained under 3% over the past ten years. These ratios suggest that debt servicing does not impose too heavy a burden on the budget or the economy.

If the debt level is sustainable, there is scope for Mauritius to borrow more in the future to finance structural transformation. Confirming Mauritius' healthy debt-carrying capacity, the African Development Bank approved a US$240 million loan in May 2024 to help finance the country's second phase of the Economic Competitiveness and Resilience Support Programme, focused on renewable energy development, food security and agro-industry – all of which are key elements of structural adjustment.

However, the government's reliance on domestic rather than foreign debt is a strategic choice dictated by its capacity to borrow locally, and the need to relieve pressure on the external account and minimize exposure to currency risk. It does not necessarily reflect any challenges in accessing external development finance other than climate funds. Therefore, Mauritius will still benefit from structural reforms that increase MDBs' financing levels, reduce borrowing costs, and make climate finance more inclusive.

3.5 Financing climate action

As a SIDS, Mauritius is exposed to rising sea levels, increased frequency of extreme weather events and biodiversity loss, with profound impacts on a food-insecure economy dependent on tourism. Between 1960 and 2022, Mauritius experienced 22 extreme weather events, causing major socioeconomic disruptions and reducing the growth rate by 1.3-2.5 percentage points on average in the event year compared to the preceding and following years (IMF, 2023).

The Government of Mauritius has signaled its intention to tackle climate change through various initiatives. The Climate Change Act came into force in April 2021. In May 2022, the Ministry of Environment launched a 10-year Master Plan for the Environment and a National Environment Policy, providing a comprehensive approach to environmental sustainability. The Master Plan includes an updated Nationally Determined Contribution (NDC), with plans to reduce GHG emissions by 40%, phase out coal, and increase the share of renewable energy to 60% by 2030. Despite contributing only 0.01% of global GHG emissions, Mauritius is committed to mitigation but prioritizes adaptation, with 78% of its climate financing during 2011-2018 directed to adaptation measures (GoM, 2023).

Implementing its NDC is estimated to cost Mauritius US$ 6.5 billion (excluding loss and damage amounting to US$ 970.3 million), with US$ 4.5 billion allocated for adaptation (AfDB, 2023). Mauritius aims to mobilize 35% of the total amount locally, including from the private sector. The 2024-25 budget provided for the setting up of a Climate and Sustainability Fund (CSF) with an initial endowment of Rs 3.2 billion , mostly from an innovative Corporate Climate Responsibility (CCR) levy at the rate of 2% of company profits (GoM, 2024). All these efforts will still leave a financing gap of US$ 264 million per year from 2014/15 to 2029/30 to meet its climate goals. Considering current levels of spending, the IMF estimates a financing gap of about 1.6% of GDP per year until 2030, split between adaptation and mitigation in a 3:2 ratio.[9]

Addressing this financing gap calls for increased external resource flows. Despite the existence of several climate funds, access has been hindered by complex application processes, challenging countries with weak administrative capacities like Mauritius. Additionally, most funding targets mitigation rather than adaptation. Between 2008 and 2020, Mauritius received US$ 58 million from four climate funds, with less than 20% for adaptation (IMF, 2023).

Mauritius should explore diverse financing options and bolster its policy framework, debt management, and project monitoring capabilities. First, several SIDS have issued green or blue sovereign bonds successfully. Green bonds fund sustainable agricultural practices, resilient infrastructure, and green energy transition, while blue bonds target ocean-related projects such as blue economy development and offshore

[8]About US$ 69 million at current (July 2024) exchange rates.
[9]The Bankís estimate is slightly lower at 1.3% of GDP (AfDB, 2023).

wind farms. Mauritius has significant potential in both areas. In June 2021, the Bank of Mauritius published a guide on issuing sustainable bonds, setting the stage for future green bond launches by the government (SPI, 2024). Integrating Diaspora bonds with climate bonds should also be explored.

Second, Mauritius should secure more financing by directly accessing existing climate funds rather than relying solely on multilateral agencies. This requires seeking accreditation to climate funds, demonstrating capacity and commitment to planning, implementing, monitoring, and reporting adaptation or mitigation projects. Since the benefits from mitigation are global while gains from adaptation are local, presenting a robust case for adaptation projects is crucial. Over time, as Mauritius builds its reputation in climate project implementation, access to climate finance will improve.

The recent G20 summit highlighted the critical role of regional and multilateral development banks in financing developing countries' transitions to net zero. The approval of a US$ 240 million loan to Mauritius for energy transition illustrates the bank's 'green' role. The bank could expand this role by guaranteeing loans for local 'climate entrepreneurs' and sharing expertise for issuing green bonds (SPI, 2024).

Finally, the focus on external financing should not overshadow efforts to mobilize domestic resources. Mauritius has yet to fully leverage domestic and foreign direct investment for the green energy transition or blue economy activities. The failure of the land-based oceanic industry underscores the need to review the fiscal incentive framework and for the government to de-risk innovative projects through PPPs, blended finance initiatives, and debt-for-climate swaps.

3.6 Policy recommendations.

Mauritius, a dynamic upper-middle-income economy with strong governance and an investment-grade credit rating, faces a financing gap of 1.2% of GDP to achieve structural transformation by 2030. While access to domestic finance is not a major issue, the country's vulnerability to external shocks and climate risks necessitates further economic diversification and enhanced social resilience, underscoring the need for external financing on a significant scale.

Policy recommendations for the way forward can be organized around three themes, as follows:

Reform of International Financial Architecture

- Leveraging the country's meaningful integration into the global capital market, advocate for equitable access to financing and fairer pricing of sovereign debt.
- Urge MDBs for increased sustainable lending and press DAC countries to meet their ODA commitments.
- Advocate for some form of 'special and differential treatment' for SIDS in consideration of their unique vulnerabilities.

Mobilizing External Resources

- Increase government borrowing while maintaining debt sustainability.
- Review the incentive framework to encourage FDI diversification beyond real estate to stimulate broader economic growth.

Enhancing domestic resource mobilization:

- Implement new measures being taken to enhance revenue mobilization. Tax compliance is being improved through the use of advanced IT tools.
- The incentives under the Tax Arrears Settlement Scheme, which is being reconducted for another year, could be extended further to increase collection of arrears.

Climate Action Financing

- Mobilize additional resources for the CSF, included through periodic and graduated CCR levy rates.
- ssue green and blue bonds to finance sustainable and ocean-related projects.
- Seek direct access to climate funds by building robust administrative and project management capacities.
- Promote private sector investment in green energy and blue economy activities through PPPs and blended finance initiatives.

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