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Pre-Budget Analysis

Setting the Context for the Budget

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Pre-Budget Analysis: Setting the Context for the Budget

The forthcoming budget speech on Thursday 8 June by Finance Minister Pravind Jugnauth is of paramount importance because economic operators and the population in general have high expectations from this exercise. This paper analyses the prevailing context of the Mauritian economy from an evolutionary perspective, highlighting critical issues and consequently proposing possible remedial strategies. The reader is at the outset reminded of considerable ongoing turbulence on the global political and economic stage, including 'Brexit' in Europe, 'America First' in the United States, military manoeuver in North Korea, difficult climate change discussions by G7 and cyber attacks on corporations worldwide. The Mauritian authorities would need advanced dexterity and appropriate guidance to effectively tackle these high-impact issues, which are not the subject matter of this analysis. Key macroeconomic indicators are hereby examined whilst taking into account their trajectories over the last three or four decades, with the hope of enlightening readers on some critical aspects of the Mauritian economy.

Figure 1: Economic Growth: Actual, Trend and Residual (%)

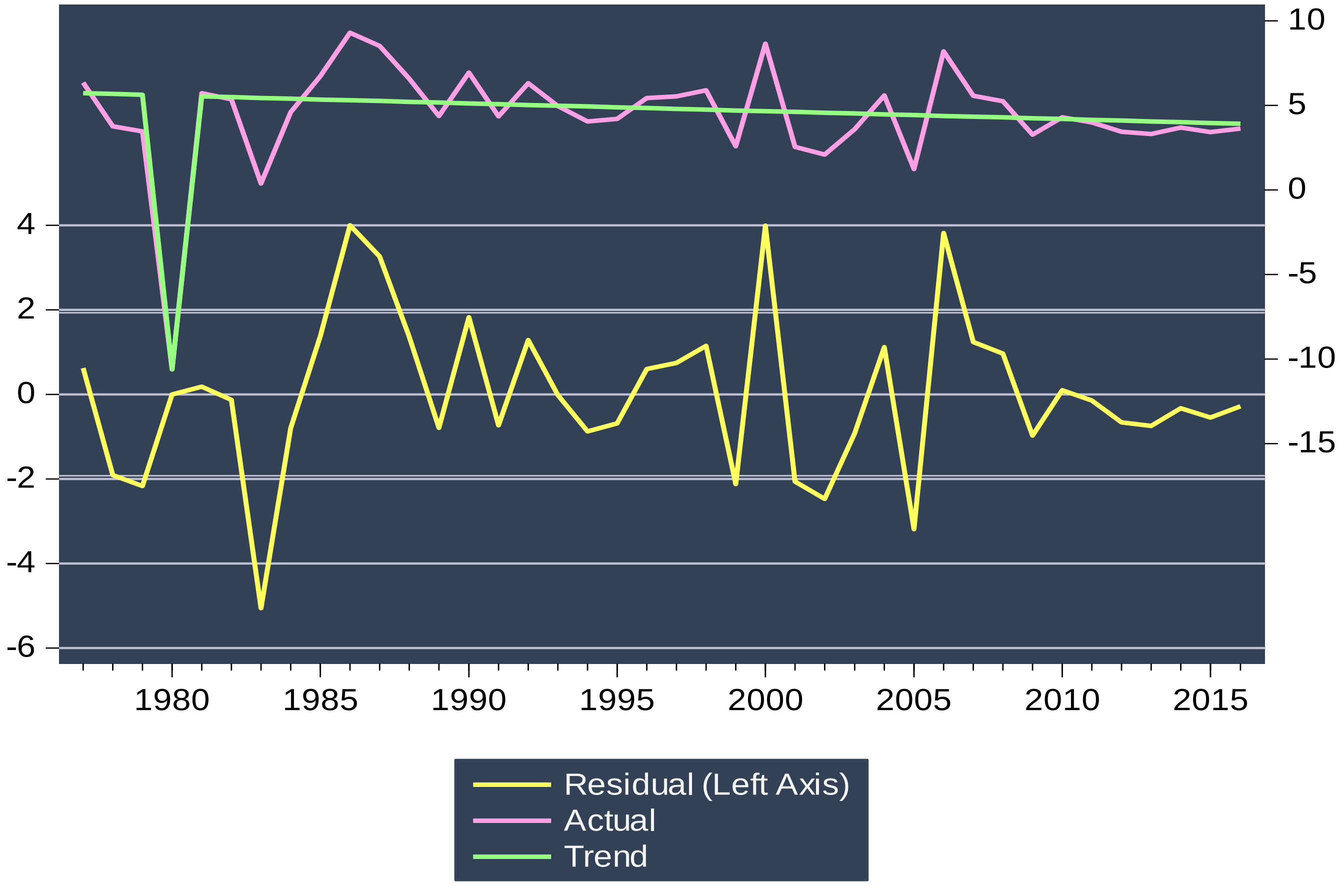
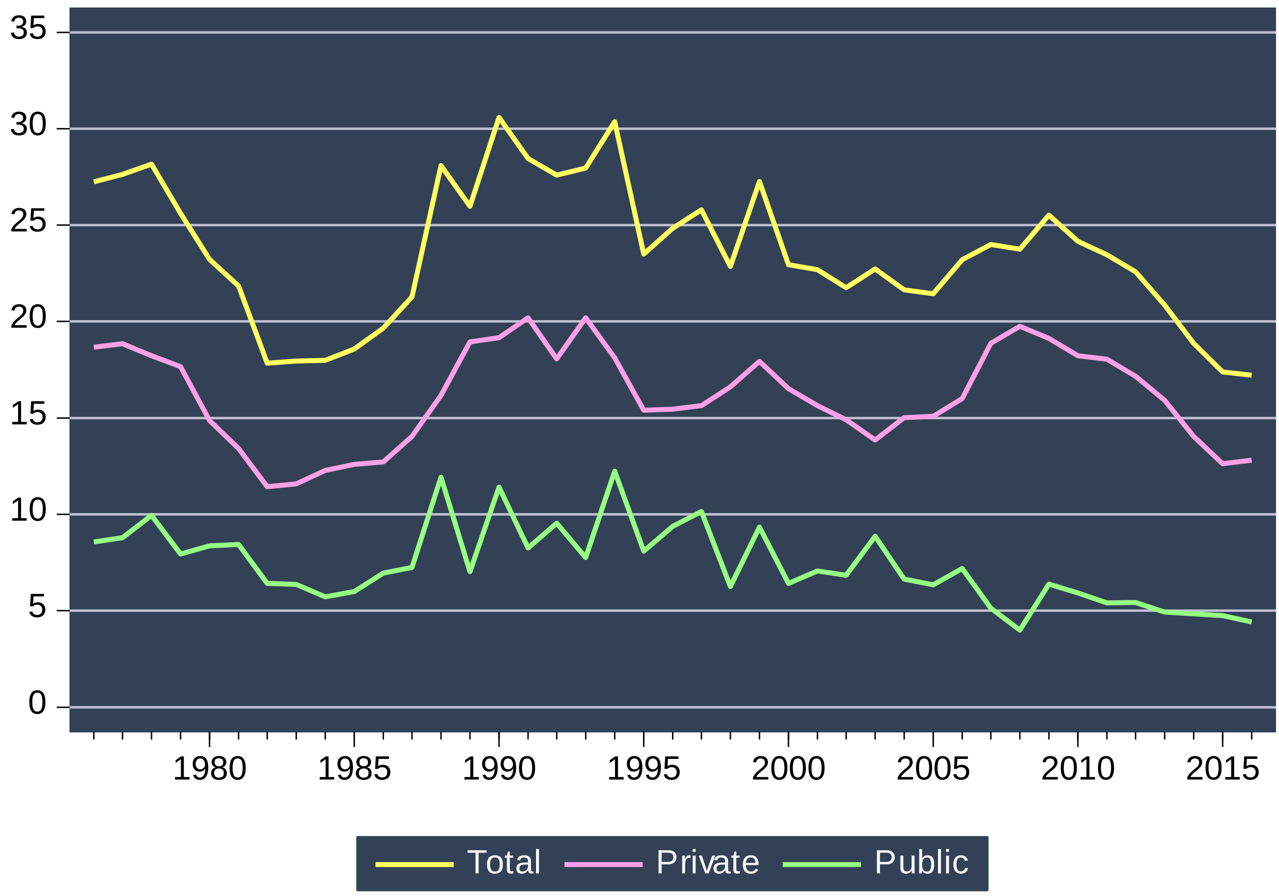


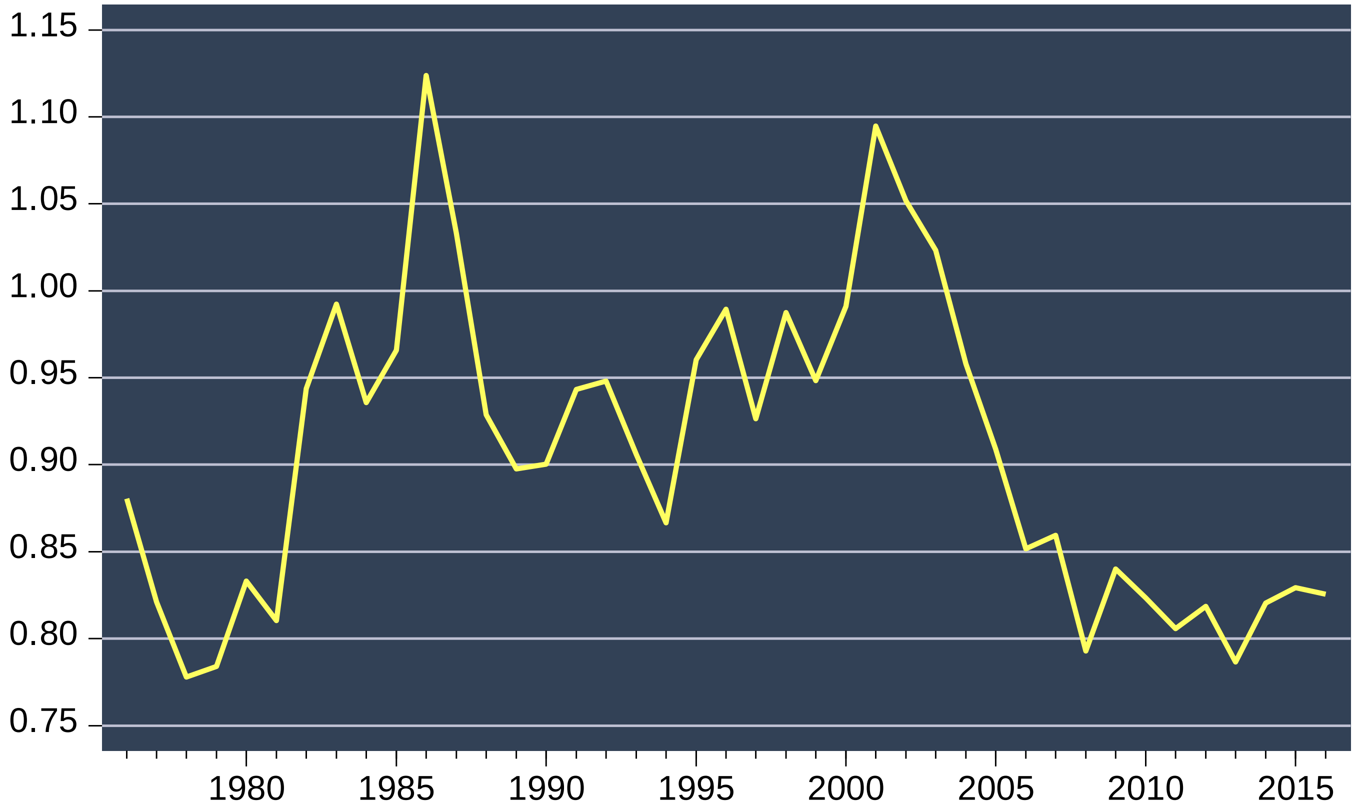
Figure 1 shows the outcome of an econometric model that estimates the trend growth rate of the Mauritian economy. Interestingly the trend growth rate declines over time, albeit at a small rate. Actual growth has been below trend growth since 2011, emphasizing the adverse effect of the global economic crisis on the domestic economy. Trying to raise actual growth beyond trend growth with lightweight measures for a couple of years may not be adequate. The budget should ideally attempt to reverse the declining trend growth by addressing structural bottlenecks and infrastructural gaps and by enhancing digitalization and productivity nationwide. Total Public Sector Debt currently at 65% of GDP has been above the usually-cited threshold of 60% since late 2014, but this should not act as a constraint to public spending on viable growth-enhancing projects that have the ability to generate sufficient return to pay back debt while simultaneously improving productivity and welfare. Of course, projects would require well-designed feasibility studies to ensure financial viability prior to injection of funds and implementation.

Figure 2: Total, Private and Public Investment (%of GDP)



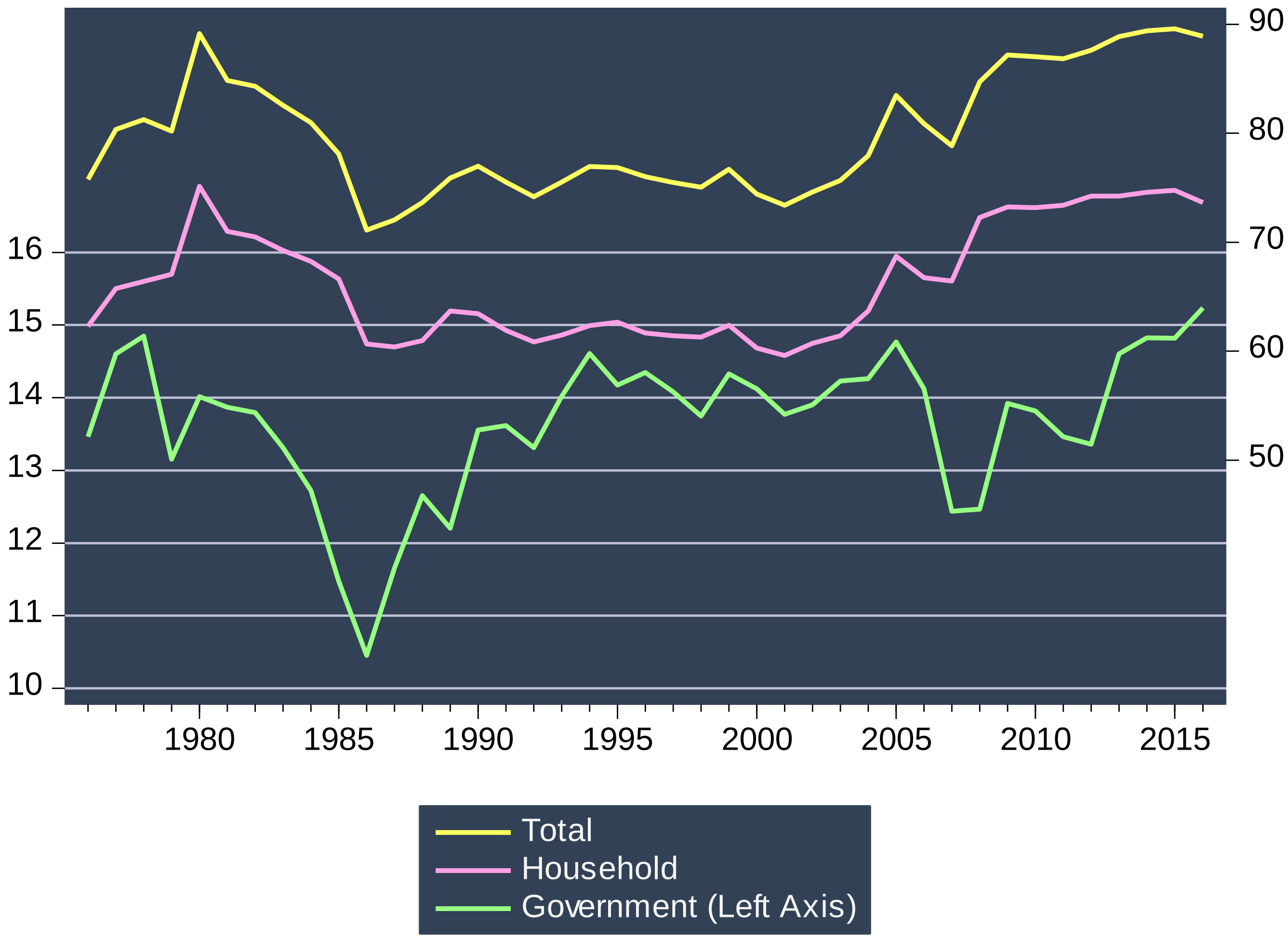
In reference with Figure 2, total Investment-to-GDP ratio shows a declining trend since the early 1990s. The decline in both Private and Public Investment-to-GDP ratios post the global financial crisis of 2008 has undoubtedly contributed to the lower domestic growth experienced recently. In addition, concentration of foreign direct investment (FDI) in the real estate sector has exacerbated the situation by encouraging the financing of imports, thus deteriorating the current account deficit. Mauritius needs investment that would promote jobs, exports and growth in targeted high value-added sectors, similar to what occurred in the mid 1980s to early 1990s in the textile and tourism sectors. A reform of the post-secondary educational sector aiming to producing super-specialists in niche areas would definitely catch the attention of foreign direct investors operating in fields at the frontier of knowledge.

Figure 3: Exports-to-Imports Ratio



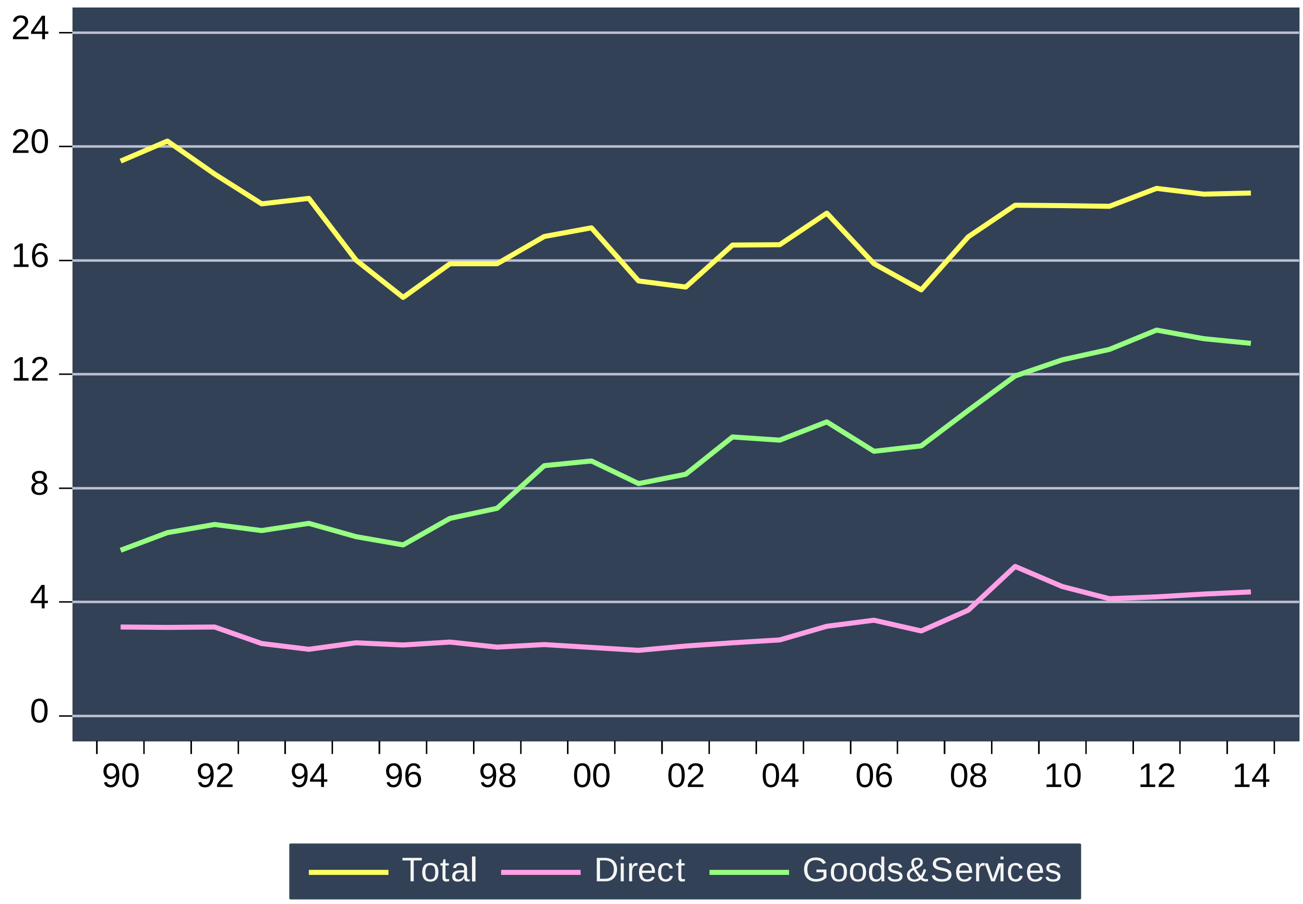
The remarkable economic development that occurred in Mauritius in the 1980s is largely due to the emergence of a vibrant export sector, promoted by a mix of sound fiscal, monetary and industrial policies, as depicted in Figure 3. The country consequently became an international reference as an export-led economy. The sustained decline in the exports-to-imports ratio since year 2001 is, however, cause for concern and warrants corrective actions by policymakers. Exports, which accounted for 60% – 65% of GDP in the golden years, have lately dropped in the range of 45% – 55% of GDP. Notwithstanding prolonged economic recession and fragility in the main export destinations of Mauritius over the last decade, recent lacklustre exports performance may, in part be, attributed to falling labour, capital and multifactor productivity in the export sector over the last five years. Injection of public funds to support export companies may be linked to addition of capital expenditure by these companies, in an attempt to reverse the recent observed reduction in capital input by the sector.

Figure 4: Total, Household and Government Consumption (%of GDP)



Consumption is a major component of aggregate demand in Mauritius but cannot be relied upon to bring about higher sustained economic growth since a considerable portion leaks out in the form of imports. Figure 4 reveals that total consumption declined and stabilized at around 75% of GDP during the Mauritian economic miracle, but has resumed an uptrend since year 2000. The pick-up in both household and government consumption ratios since year 2007 was not been associated with higher economic growth, implying the need to focus on investment and exports in order to boost the economy.

Figure 5: Total, Direct and Goods&Services Tax Revenue (%of GDP)



Total Tax Revenue over the last two and a half decades has been in the range of 15% – 20% of GDP, with Goods and Services Tax Revenue (GSTR) as a percentage of GDP on an uptrend. Direct Tax Revenue (DTR) has been beyond 4% of GDP since 2009. Over the last decade, the budget deficit has hovered around 3% to 4% of GDP. With a prevailing budget deficit ratio of around 4%, Government may be able to maintain tax neutrality in order to promote a stable and conducive business environment.

With changes in the international tax landscape since the inception of the OECD BEPS Project, Mauritius needs to adopt a holistic approach to review its fiscal regime. Revision of taxation regime would require a deep and thorough analysis of the effects of potential policy changes on budget deficit, investment and work effort whilst retaining the attractiveness of Mauritius as an international financial centre of substance and value creation.

Figure 6: Domestic Credit (% of GDP) and NPL Ratio (%)

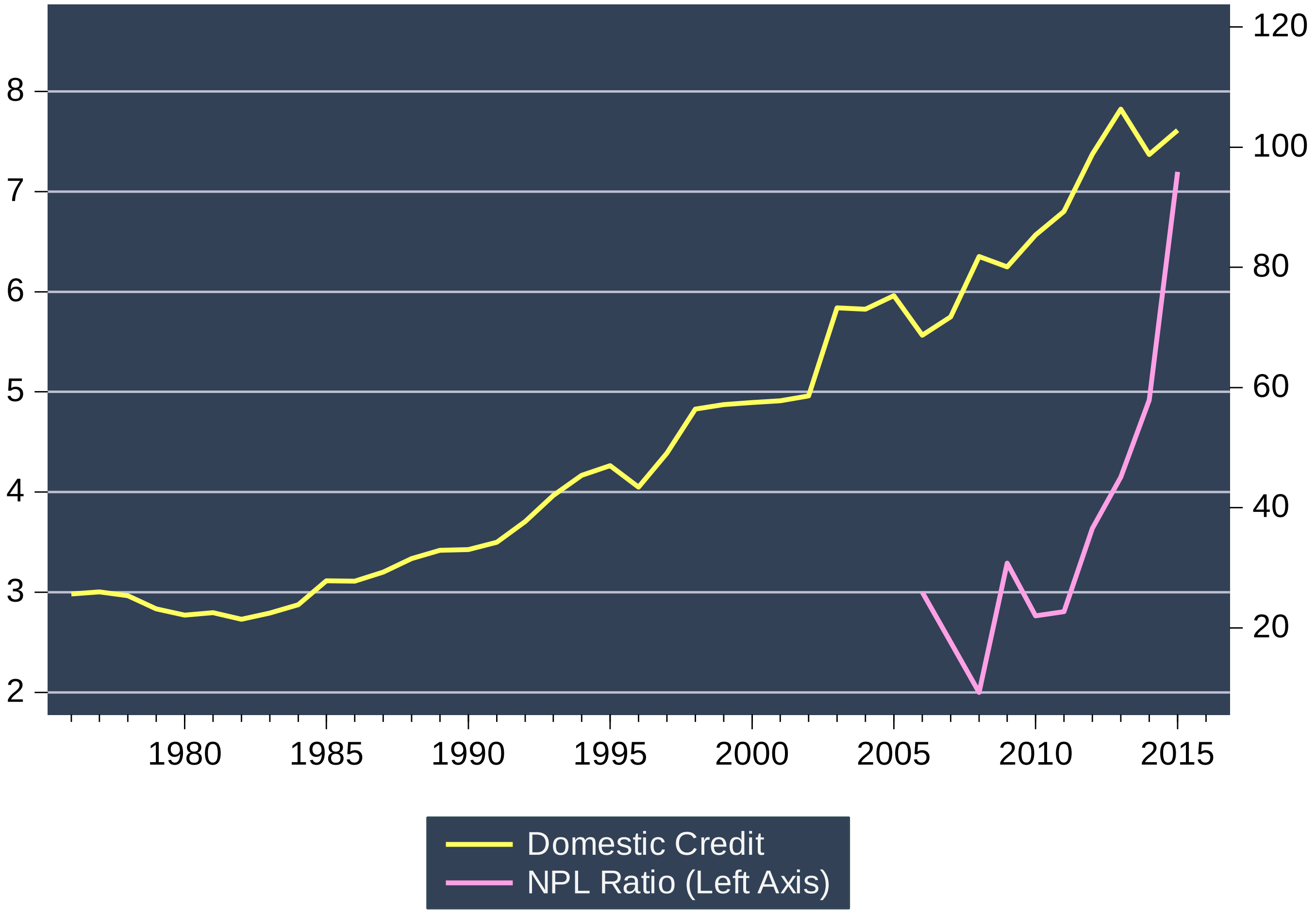


Figure 6 shows that domestic credit has been rising faster than GDP, thereby implying a deepening of the financial services sector, as evidenced by the exponential trend in the graph. Of concern, however, is the sustained rise in the ratio of non-performing loans to gross loans (NPL ratio) over the last decade which may pose a threat to financial stability. The domestic financial system is also exposed to disruptive operators using modern technology, mobile applications, distributed ledger, big data and artificial intelligence.

In conclusion, the Mauritian economy is faced with a number of challenges and the Government needs to come with policy measures to address structural bottlenecks, infrastructural gaps, promote investment and exports as opposed to consumption. Productive investment with less reliance on real estate would result in better prospects for exports and employment. The export sector holds the key to prosperity of the nation. Policy measures should also be able to accelerate digitisation and innovation across all sectors thereby uplifting productivity, efficiency and overall economic growth.

Next week's Budget is an opportunity for the Government to adopt a structural, bold and visionary approach in order for Mauritius to break free from a decade of anemic economic growth and usher in a period of higher sustained growth.

Data Sources: Ministry of Finance, Statistics Mauritius, Bank of Mauritius and World Bank