

MAURITIUS - EC MULTIANNUAL ADAPTATION STRATEGY

SUMMARY

The Mauritian economy has developed rapidly over the last two decades; during this period, its key economic sectors, particularly sugar, benefited substantially from preferential trade arrangements. Mauritius is now facing a changing global trade environment, which is set against a backdrop of soaring oil prices, current supply-side capacity constraints, an unsustainable deficit and public debt and human skills' shortages coupled with a high unemployment rate. In this context, structural reforms are now urgently required to increase the country's economic competitiveness in previously protected sectors and to create a conducive environment for the diversification of the country's economic base.

In so far as sugar is concerned, the EU sugar reform is primarily an unavoidable internal market reform that brings the sugar sector in line with the reform that has been taking place with other agricultural products (i.e. towards sustainable production for the market). It will reduce the price paid to ACP countries by 5% in 2006 and a total of 36% by 2009. It is in this context that the Multi-Annual Adaptation Strategy, has been jointly defined by the Government and the private sector; this Adaptation Strategy is an integral part of the Mauritian Government's overall economic reform programme.

The Adaptation Strategy aims at establishing a more competitive sugar sector, although at a significant but unavoidable social cost during the transitional phase. This should be attained by a concentration of the industry, rightsizing of the labour force and optimising the use of sugarcane by-products for energy production. This Adaptation Strategy will be jointly funded by the private sector, the Government and other financial partners: the EU will play a significant role through the EC Accompanying Measures. For 2006, the Accompanying Measures will support the Government in contributing to the social packages linked to the right-sizing of the workforce as a consequence of factory closures. Activities to support the small planters shall also be initiated. EC Accompanying Measures will support the Government's ten-year economic restructuring programme, including the bold sugar reform process.

In order to maximise aid delivery effectiveness, the EC Accompanying Measures will be disbursed through budget support via sector budget support initially and moving gradually to general budget support in line with the 10th EDF.

I FRAMEWORK OF RELATIONS BETWEEN THE EC AND MAURITIUS

1.1 General Objectives of the EC's external policy

In accordance with Article 177 of the Treaty establishing the European Community, Community policy in the sphere of development shall foster: (i) the sustainable economic and social development of the developing countries, (ii) the smooth and gradual integration of the developing countries into the world economy and (iii) the campaign against poverty in the developing countries.

1.2 Strategic Objectives of Cooperation with Mauritius

The Treaty objectives are confirmed in Article 1 of the ACP-EU Partnership Agreement signed in Cotonou on 23 June 2000 and revised on 25 June 2005. The overarching objective of the Cotonou Agreement is to promote the development of a common strategic approach to poverty reduction. Cooperation between the Community and the Republic of Mauritius shall pursue these objectives, taking into account the fundamental principles set out in Article 2, in particular the encouragement of ownership of the strategy by the country and populations concerned. In addition to the Treaty and the Cotonou Agreement, the recently adopted European Consensus on Development sets the general policy framework at EU level. The main objective of the EU development policy remains the eradication of poverty in the context of sustainable development. Moreover, through the EU Action Plan for Agricultural Commodities adopted in April 2004, the EU is engaged in helping economies

dependent on commodities such as sugar to address the challenges related to these sectors. In this context, the Commission produced an "Action Plan on Accompanying Measures for Sugar Protocol Countries by the Reform of the EU Sugar Regime" which was then transformed into EC Regulation No. 266/2006.

II COUNTRY DIAGNOSIS

2.1 Analysis of the Political, Economic, Social and Environmental Situation in Mauritius

2.1.1 Economic and Commercial Situation

Since 1990, Mauritius has experienced accelerated economic growth, with annual growth rates averaging 4.9%. This, combined with a significant reduction in the population growth rate, has allowed the country to move from a low-income country, based on a single revenue earner – sugar¹ – to a middle-income country with a diversified economic base and a GDP per capita of slightly above US\$ 5,000.

The economic success of the past is today under threat as key economic sectors, previously protected under preferential arrangements, now face major economic challenges due to the changing global environment. The reform of the EU sugar regime, the dismantling of the Multi-Fibre Agreement in January 2005, and the increase in energy/oil prices have led to a slowdown of economic activity. The economy is currently marked by several economic imbalances: below-potential growth rates (2.7% in 2005), a high budget deficit (-5% for FY 2004/05) and increasing public debt (58.3% of GDP in 2005), the deterioration of the current account deficit (-5.4% of GDP in 2005), a rising unemployment rate (from 7.3% in 2002 to 9.6% in 2005) and continued inflationary pressures (4.9% in 2005). Furthermore, an estimated 12% of the population is currently living below the poverty line². As a result, and in recognition of the changing economic realities, *Government is proposing a comprehensive economic reform programme, of which the sugar sector forms an integral part.*

Sugar has traditionally been viewed as a multifunctional pillar of Mauritius' economy, given its direct contribution to economic growth, rural stability, increased social welfare provision and the protection of the environment. Net sugar revenues under the preferential terms (well above the world market price) of the Sugar Protocol have been estimated at some €4 billion over the last 30 years. The country has judiciously used these revenues for investment not only in the sugar sector but also to transform the economy from a mono-crop to a five-pillar-based economy (manufacturing, tourism, sugar, financial services and more recently ICT).

Even though the sugar sector's contribution to GDP is now comparatively small (4% of GDP in 2005), it still accounts for a significant share of total exports (17% of total exports in 2005 and 30% of net export earnings from merchandise trade) as well as a large proportion of employment and self-employment (approximately 12% of the active population). Consequently, sugar remains an important pillar of today's economy, but the EU price reduction and the sectoral restructuring will lead to a reduction of its overall economic weight, albeit mitigated by the emerging cane-related energy sector.

Sectoral plans for improvement of the industry's competitiveness have been designed and partly implemented in the recent past, but these measures are not sufficient to face the market conditions following the EU reform. There are high risks that *if* Mauritius continues to confine itself to being essentially a raw sugar exporter it will no longer be in a position to satisfy changing international demands. Further, Mauritius' sugar industry is highly vulnerable to the "sugar-related trade shock" owing to its heavy dependence on one specific market (i.e. the EU). The sugar reform is primarily an unavoidable internal market reform that brings the sugar sector in line with the reform that has been taking place with other agricultural products (i.e. towards sustainable production for the market). It will reduce the price paid to ACP countries by 5% in 2006 and a total of 36% by 2009.

2.1.2 Social Situation

¹ Mauritius is by far the prime beneficiary of the Sugar Protocol, with 38% of the quota. Over the last 30 years the revenue earned from sugar exports to the EU market has been judiciously invested in diversifying the country's economic base.

² Equivalent to 50% of the median of the monthly household expenditure.

The country has accomplished notable results over the last 15 years in terms of the MDGs, with 4 out of 8 specific goals already achieved³; it has also made further progress in terms of Human Development, moving from 0.779 in 2001 to 0.791 in 2005⁴. In addition, Mauritius's Gini coefficient, which is a measurement of a country's income distribution, has improved from 0.387 in 1996/97 to 0.371 in 2001/02. The general state of health of the population of Mauritius is good and has been improving steadily over the past decades: in the last 30 years, life expectancy has risen from 63 years to 72.2 years and infant mortality has fallen from 64 to 14.8. Mauritius, being one of the most densely populated countries (700 inhabitants per sq km), has also successfully managed its population growth rate over the past decades (from 3% in the early 1970s to around 0.9% today).

Today, Mauritius is characterised by an extensive welfare system, which provides free education and health care, universal basic pension for persons of 60 years old and specific social benefits for the vulnerable groups. In this context, sugar earnings have contributed significantly to the development of social sectors. The sugar sector is a direct provider of social benefits to some 60,000 workers (around 12% of the active population), which includes the factory and field workers, and small planters, who are employed by the industry. Nonetheless, the provision of social services by sugar companies means that such benefits are at risk when the sugar industry is weakened; the mitigating factor remains, however, that Government provides the bulk of social services in the rural areas.

Rising unemployment remains a major concern for Government, which has placed *education and re-skilling high on its agenda*. Despite remarkable progress in the education sector (adult literacy rates now attaining 84.3%), a major challenge for Government lies in creating a sufficient pool of qualified and adequately trained labour to meet the demands of the evolving economy.

In terms of employment within the sugar sector it is anticipated that, if no reforms are carried out, 20,000 workers would keep their jobs and 40,000 persons would have to be redeployed in other sectors of the economy. This decline in employment would affect in particular the most vulnerable groups of the society, including the small planters.

2.1.3 Political situation

Since its independence in 1968, Mauritius has been a parliamentary democracy based on the Westminster model. This parliamentary democracy has ensured a high level of political stability, which has been fundamental to the country's sustained economic progress. This political stability has also enabled a regular dialogue between Government, private sector and civil society, which is becoming more active in decision-making processes.

Following the general elections in July 2005, the country is governed by a multi-party coalition (the Labour Party holds the majority). The elections were free and fair and the transition to the new government was smooth. Given the intense lobbying across European capitals at the time of the electoral campaign, and the fact that the EU sugar reform is a key element of each Party's manifesto, there is a strong public focus and expectations regarding the transformation of this sector are high.

Despite the change in Government, the political commitment to re-engineer the sugar industry has remained the same given the multi-functional role of the sugar industry and its significant social and ethnic cross-linkages.

2.1.4 Institutional situation

Good governance remains a priority of Government and is implemented via a comprehensive regulatory framework: Government has defined an anti-corruption framework and enacted "The Prevention of Corruption Act (2002) and "The Financial Intelligence and Anti-Money Laundering Act (2002). In addition, in order to monitor the integrity of financial reporting and compliance with international standards of accounting and auditing, a Financial Reporting Council was established in 2005.

³ Universal primary education; reduction of child mortality; improvement of maternal health through the reduction by ¾ of maternal mortality ratio; gender equality through equal enrolment in primary and secondary education.

⁴ Mauritius was ranked 65 out of 177 countries for the Human Development Index (HDI)

Public Finance Management (PFM), in particular, is well integrated within a clearly defined regulatory framework. Specifically, it provides for the separation of executive and legislative functions in the preparation and appropriation of the Budget as well as the necessary mechanisms to ensure rigorous oversight of public funds. In order to further improve the management of public finance, a Medium Term Expenditure Framework (MTEF) was introduced in 2004 for the 'Education and Training' sector and extended to five other sectors in 2005; the aim of Government is to adopt this budget planning tool in all sectors.

2.1.5 Environmental Situation

Mauritius is an island of volcanic origin, with a total land area of 1,860 sq km. High population density, urbanization and also industrial, commercial and tourism development have exerted severe pressure on its scarce land and water resources over the past decades. The island has a fragile ecosystem and is prone to occasional droughts and to tropical cyclones. Sugarcane, due to the current trade regime, is the most profitable cash crop and, given its cyclone-resistant characteristics, accounts for 40% of all land use and 89% of cultivated land. Sugarcane prevents soil erosion and is thus beneficial to the protection of the lagoons on which small-scale fishermen depend for their livelihood and which is critical to the country's tourism industry. In addition, the extensive cultivation of sugarcane on the island and the use of carbon-neutral bagasse in electricity generation enable Mauritius to generate carbon credits under the Kyoto Protocol of an estimated value of US\$ 8.5 million/p.a. If the current sugar industry structure were to be maintained, there is a high probability that marginal sugarcane producers would shift away from sugar. This could, if not properly managed, result in an increase in unsustainable land management. There would also be a risk of over-development on certain prime agricultural land which is sold for commercial purposes and this would impact adversely on the environment. There is also an urgent need to explore alternative, environmentally-safe ways of exploiting marginal lands and, in this context, the Adaptation Strategy envisages the cultivation of other crops and reforestation in particular with endemic species that existed prior to sugarcane.

2.2 Mauritius's Development Strategy

In order to address the country's unfavourable macroeconomic environment and the exogenous shocks, the Government has recently drafted, with the support of the IMF and the World Bank which have conducted several missions in 2006, a comprehensive ten-year economic reform programme. This programme focuses on fiscal consolidation, improvement of the investment climate (including proactive efforts to attract foreign investment), as well as the restructuring of sectors affected by trade shocks (including sugar and textiles) and development of new emerging sectors such as the seafood hub and ICT.

One key aspect of the economic reform programme is to increase the competitiveness of its key economic sectors (in particular export sectors), including sugar. Government and the population still value the sector for its multifunctional role⁵ in Mauritius. Further, the economic reform programme addresses the problem of human skills shortages in growing service sectors and recognises that this issue can be resolved by increased education and training. In this context, the economic reform programme includes the setting up of an "Empowerment Programme"⁶, estimated at MUR 5 bn (€135 million) over the next five years.

The overall assessment of the economic situation concludes, via the Multi-Annual Adaptation Strategy, that sugar still remains competitive, with a bold reform process; however, further sectoral adjustments may be required after 2013.

The main concern of Government, due to its persistent budgetary deficit, is its current financial constraint to finance the economic restructuring programme (including the sugar sector reform). In this respect, the major objective of Government is to attract sufficient investment and financial

⁵ The multifunctional role of the sugar sector includes the significant multiplier effects for the economy as a whole – social, environmental and commercial (sugar export earnings contribute to financing the country's food import bill).

⁶ This Programme focuses on provision of training and includes on-the-job-training; re-skilling activities for women...

assistance from multilateral and bilateral organisations, to fund, together with the Mauritian private sector, the economic restructuring programme which is estimated at MUR 150 billion (€4 bn) over 10 years.

2.2.1 Mauritius' Multi-Annual "Sugar" Adaptation Strategy

In April 2006, the Government presented its Multi-annual strategy and Action Plan 2006-2015 for the re-engineering of the sugar industry following an impact assessment study on the competitiveness of the sugar industry commissioned in late 2004. The Adaptation Strategy aims at re-engineering the sugar industry into a "sugarcane cluster" in order to reduce production costs and enable Mauritius to remain a competitive supplier for the EU market after the 36% price reduction that is due to become fully effective as from 2009.

The overall objective of the Adaptation Strategy is to ensure the commercial viability and sustainability of the sugar sector for it to continue fulfilling its multi-functional role in the Mauritian economy, but at a significant social cost. In this context, the Adaptation Strategy has five specific objectives: (a) transformation of the sugar industry into a sugar cane cluster (production of several types of sugar, of electricity from bagasse/coal and ethanol); (b) establishment of a competitive, viable and sustainable sector; (c) fulfilment of the country's trade commitments; (d) reduction of the dependency on imported fossil fuels; (e) continuing the multifunctional role of sugar and in particular the support to national environment and social objectives.

The assumptions underlying the Adaptation Strategy are as follows: (i) production of 520,000 tonnes of sugar by small and large producers; (ii) labour downsizing strategy; (iii) increase in the proportion of direct consumption sugars⁷ in total exports; (iv) optimisation of by-products of cane⁸; (v) adequate provision of energy to meet the sugarcane cluster requirements⁹; (vi) a long-term parity of US\$/€rate of 1.175 and (vii) long-term crude oil price of at least US\$ 60/barrel.

The Strategy provides for a set of measures/projects aiming at increasing the country's revenue, optimising the use of by-products, maintaining the social welfare of low income groups of the sugar industry, while fully taking into account the social and environmental implications. In addition, the development of the energy sector is fundamental to the setting up of the sugarcane cluster in the light of the soaring price of oil on international markets.

The principal measures/intervention areas outlined by the Adaptation Strategy are as follows:

- a) *Improving the cost competitiveness of the sugar milling sector via mill centralisation.* The decrease in the number of factories from 11 to 4 will mean the laying-off of some 2,000 workers. These workers will receive a compensation package: 2½ months per year of service, a plot of land, a training grant of MUR 5,000 (€135) and a business grant of MUR 50,000 (€1,350) or be redeployed into the remaining factories;
- b) *Rightsizing of the labour force* in order to reduce labour costs and create a more flexible workforce. This will entail the voluntary retirement of an estimated 6,000 persons. Voluntarily retired workers will be provided with a compensation package¹⁰ of maximum 2 months' salary per year of service and a plot of land with basic infrastructure. In addition, the regulatory framework will facilitate the use of seasonal labour. Moreover, prior to the voluntary retirement of an employee, he/she would be provided re-skilling/training opportunities for eventual redeployment into other economic sectors or support for the setting up of a small enterprise within the agricultural or non-agricultural sector; this will be implemented under the Government's new Empowerment Programme.

⁷ Direct consumption sugars accounts for 15% of sugar exports in 2005 and is expected to increase to 50% by 2015.

⁸ Doubling of the production of electricity from bagasse and conversion of molasses to ethanol

⁹ The timely commissioning of power plants will be essential for the provision of steam and electricity to the sugar factories and the national grid.

¹⁰ Voluntary Retirement Scheme (VRS II)

- c) *Mechanisation of field operations* which includes: mechanical derocking of an additional area of 14,000 ha, mechanisation of cultural practices on 19,000 ha and the irrigation of an additional 7,000 ha of land. The aim of mechanisation of field operations is to improve the cost competitiveness of sugarcane production and to increase sugarcane yield per hectare;
- d) *Regrouping of small planters* to enable them to benefit from economies of scale and improved sugarcane yields through modernised growing practices;
- e) *Sustaining difficult areas* (steep and/or rocky land of 5,000 ha) in order to prevent adverse environmental consequences (sugarcane helps to prevent soil erosion) and social consequences (cultivation by the poorer income groups of the sector). The objective is to maintain sugar cultivation on 2,000 ha and the remaining 3,000 ha will be reforested or used for Integrated Resort Schemes (IRS)¹¹;
- f) *Increasing the contribution of the sugarcane cluster to national electricity production* with the installation of new power plants in the remaining mills. Electricity will be generated using bagasse, one of the main by-products of sugarcane; the present production of 300 GWh (16% of national electricity output) will be doubled to 600 GWh¹²;
- g) *Producing 30 million litres of ethanol* from molasses in two of the four remaining sugar factories to be used locally for blending with gasoline¹³. This would provide additional revenue to the sugar industry and reduce total gasoline imports.
- h) *Reducing institutional expenditure*¹⁴;
- i) *Undertaking Research and Development* in areas of sugarcane crop improvement, biotechnology, by-products and biomass utilisation in order to increase sugar cane yield;
- j) *Optimising the use of sugarcane lands* via production of horticultural crops on rotational land and in sugarcane interlines, as well as the lands freed up from sugarcane production;

With the re-structuring of the sugar industry and the creation of the cluster, revenue from sugar will account for 75% of the cluster's total revenue, whilst electricity, ethanol and carbon credits will account for 15%, 7% and 3% respectively. This compares to the current proportions of 93% from raw sugar and 7% from electricity generation.

The cost of the Adaptation Strategy, according to Government figures, amounts to MUR 25 billion (€75 mio) over the period 2005-2015, of which 43% is capital investment in the energy sector and around 23% is social costs. It is estimated that 87% of the global amount will have to be frontloaded and be disbursed before 2010. Frontloading of investment is fundamental given the sequencing, timing and inter-linkages of all the projects defined in the Strategy. The core expenditures in the initial years relate to measures, on the one hand, to reduce sugarcane production costs (factory closures and associated social costs) and, on the other hand, to develop the energy sector, which entails significant private sector capital investment.

2.3 Analysis of the Adaptation Strategy

2.3.1 *Economic and Commercial*

From a macroeconomic perspective, the reformed sugar sector is fully integrated into the larger vision that Government has for the Mauritian economy. With an accelerated and comprehensive re-engineering of the sugar industry, the country would continue to be a competitive supplier on the EU market. The interlinking of all the actions defined in the Adaptation Strategy makes for a coherent and technically feasible reform process; nonetheless, this intertwining of actions means that if one action is not successfully implemented this could impede implementation of other actions ('domino effect'). That is why the strong public-private partnership has to be maintained and further strengthened.

¹¹ Properties sold to foreigners for residential and recreational purposes.

¹² Greater capacity could be generated through the use of cane trash as fuel and the cultivation of high-fibre canes.

¹³ This will be used in a 20/80 gasoline mix.

¹⁴ Many institutions of the sugar industry secure their funding through a levy (cess), representing 6%-8% of sales proceeds.

The detailed feasibility analyses give relative confidence that the sugar industry restructuring should be successful. However, considerable socio-economic and environmental resources will continue to be tied up in a single sector in the future, leaving the industry still relatively vulnerable to further reductions in the price of sugar.

After 2009, there is a high risk that Mauritius's sugar industry could be vulnerable to the normal commodity market fluctuations; this vulnerability is compounded by the small size of its industry which is marked by high wage rates and limited economies of scale; this means that it will most probably never achieve the low costs of production figures of large sugar exporters. This is a commercial risk which the Government is endeavouring to address by exploiting new emerging sectors and hence looking beyond the sugarcane cluster.

2.3.2 Political, Social and Environmental

The social and political implications of the reform remain highly sensitive, given both the historic role of sugar for the country's development and the underlying ethnic structures of the sugar economy.

Although VRS II and centralisation involve the laying off of some 8,000 persons, who come from the poorest segments of the population (unskilled, very low literacy rates and large rural families), the Adaptation Strategy comprises a set of measures to compensate and assist the affected populations (pro-poor dimension). The proposed VRS II social package is significantly larger than in any other sector of the Mauritian economy. Nonetheless, there is a risk of increased poverty for families that are directly dependent on the sugar industry unless alternative employment opportunities are created. Indeed, the redeployment of the sugar workers into other economic sectors will be a challenge for the Government, since they are generally low-skilled and hence will need time to be trained. There is thus a need for swift and comprehensive intervention on the part of Government.

It is in this context that the Adaptation Strategy provides for increasing empowerment and welfare schemes, with a special focus on women (pro-gender). This will include programmes to support re-skilling as well as incentives for small farmers to regroup for better economic efficiency. In addition, the Adaptation Strategy provides funds to Trade Unions from the Empowerment Schemes and provides for the welfare of the rural groups who depend on the sugar sector.

Although the environmental dimension is well integrated in the Adaptation Strategy, in particular through projects to be implemented in 'difficult areas', environmental impact assessment studies will need to be carried out more systematically to ensure that the country's environment is not further adversely affected.

2.3.3 Institutional

The implementation of the Adaptation Strategy will be supervised by a High Powered Committee (HPC) chaired by the Minister of Finance that will meet on a regular basis. The set of projects will be implemented under the umbrella of the relevant ministries (e.g. Ministry of Agro-Industry, Ministry of Public Utilities) wherein several specialised government and semi-state organisations will be brought in for technical matters. In addition, the private sector and civil society (including farmers' groups) will be collaborating directly with Government. So far, there has been a good relationship between the private sector, the Government and the small planters' community and an equitable sharing of responsibilities within the sugar industry.

2.3.4 Medium Term Challenges

The main challenge for the country is to attract significant investment to finance the macroeconomic reform programme, including the sugar reform process. Although the overall investment climate remains positive, this has not resulted in the level of Foreign Direct Investment (FDI) required to spur growth. In the light of this trend, Government policy to stimulate investment and its commitment to create a business-friendly environment will be critical. In the case of sugar industry re-structuring, the most "difficult" years for the sugar sector are likely to be 2007-10, as (i) the industry would still be in a transitional state and (ii) around 90% of the Strategy's funding requirements will need to be frontloaded during this period. Indications are that the private sector should in principle fund its own investment projects (focused particularly in the energy sector), but it is less clear whether it can fully

finance the social dimension. It would appear that the urgency is for Government to provide bridging finance to the private sector for the centralisation process (in particular the social costs) that will occur this year; bridging finance that could then be reimbursed by the Government's budget from EC accompanying measures. One immediate challenge for Government is to adopt a gradual liberalisation of the price of sugar on the local market, which is still highly subsidised by the sugar industry, in order to reduce revenue losses¹⁵ to the sector.

Another key challenge for Government is to address the country's human skills shortages in order to support the development of emerging sectors, such as the seafood hub and SMEs. In this context, a specific challenge will be to either redeploy (in the remaining sugar estates) or appropriately re-train the 8,000 persons who will be laid off in the process of re-engineering the sugar industry.

A medium-to-long term challenge is to implement measures to make the country less dependent on preferential trade arrangements by further diversifying its economic base. Although the analysis of the viability of re-engineering the sugar sector has already been carried out, government is currently undertaking further analyses on other sectors in order to better define the corresponding sectoral strategies.

Support, through EC accompanying measures, will be instrumental in the implementation of the key elements of the Adaptation Strategy and of the overall macroeconomic restructuring programme. During this period, there will be a need for a regular assessment of further developments, in particular in the energy sector and the international (not only EU) markets for processed sugars, plus a constant follow up of emerging alternatives for sugarcane land use.

III OVERVIEW OF PAST AND PRESENT EC COOPERATION

3.1 Overview of Past and Present EC Cooperation - lessons learned

Mauritius has, under the 9th EDF, demonstrated a good overall performance – 94% of funds committed of which 50% had been disbursed as at mid-June 2006. Further, the Mid Term Review in 2004 rewarded the good financial, sectoral and macro-economic policy performance of the country as well as the promising prospects in the medium term with an additional allocation of €10m to the Waste Water Sector Policy Support Programme (WWSPSP) for the fiscal year 2006/2007, implemented through sector budget support. With this programme, the Government has implemented the necessary measures for the improvement of Public Finance Management, such as the introduction of the Mid-Term Expenditure Framework, as well as a new law on public procurement - which is due to be enacted. These measures should ensure the appropriate use of EC funds under future budget support programmes. Despite its relatively recent experience in the ongoing sector budget support programme, Government has the human resource capacity to utilise this aid delivery mechanism.

The implementation of the EC strategy under the accompanying measures could also benefit from the experience gathered under previous projects and use complementarities under ongoing projects. The EC is currently financing a Decentralized Cooperation Programme (DCP) under the 9th EDF which includes activities to support SMEs and develop innovative economic activities, as well as social projects in rural areas. These will complement projects envisaged under the Adaptation Strategy for the sugar sector. The Government has also gathered significant experience in agricultural diversification, including micro-project schemes for small planters, which have already been successfully introduced in the framework of the 7th EDF Northern Plains Irrigation Project.

In terms of possible financing of the Adaptation Strategy, it is worth noting that, as part of the significant financial assistance it has provided to the private sector in Mauritius, the EIB has already been involved in the sugar sector via a loan of EUR 10m to finance the setting up of the first cogeneration (bagasse/coal) power plant in Bellevue. To date, total EIB investments in Mauritius in both the private and public sectors amount to €216 mio.

3.2 Description of the Political Dialogue with Mauritius

¹⁵ Ever since 1995, the Mauritius Sugar Syndicate imports sugar and sells it on the local market at the institutional prices which are lower than the import price.

Political dialogue on the government strategy for the restructuring of the Mauritian sugar sector began as early as June 2005, with the EC Delegation having formal discussions with the Government, the private sector and other stakeholders of the sugar industry. In parallel, throughout 2005, the Government undertook an intensive lobbying campaign with respect to the EC proposal of reforming its sugar market.

The Government set up a High Task Force Committee, under the chairmanship of the Minister of Finance, to elaborate the Multi-Annual Adaptation Strategy. In this framework, extensive discussions have been carried out with the EC Delegation. Key (public and private) stakeholders of the sector have also actively participated in these consultations.

Discussions on the EC response Strategy for the Accompanying measures are also being held, in parallel, in the framework of the 10th EDF programming. At present, it is envisaged that the 10th EDF will be channelled via a General Budget Support (GBS) to accompany Mauritius in its ten-year macro economic reform programme. In this context, the EC dialogue with the Mauritian authorities on the Country Strategy Paper (CSP) could also serve as a basis for the intervention of other partners such as the World Bank to support the macroeconomic reform.

IV RESPONSE STRATEGY

4.1 General Objective

In line with the EU's development policies defined in its Strategic Partnership for Africa and European Consensus for Development and the 10th EDF Country Strategy Paper, the aim of the EC response strategy under the accompanying measures is to contribute to the sustainable economic development of Mauritius.

The overall economic restructuring programme of the Government, which includes the sugar sector and its reform process, supports the improvement of the competitiveness of the sugarcane sector and attempts to ensure a smooth social transition. The principal areas of intervention in the Adaptation Strategy are fully in line with the 10th EDF CSP, within which the focus will be on poverty reduction, and in particular on widening access to economic opportunities and social issues. This complementarity will ensure full coherence of the EC Response Strategy for Accompanying measures and the 10th EDF CSP during the period 2008-2013.

The EC will seek to ensure that the resources available under the 10th EDF national indicative programme, regional indicative programme, resources from all-ACP instruments and any resources available from the EC budget (Development heading) will complement each other in supporting the restructuring programme of the Government. Further, in order to ensure that the economic welfare of the small planters is adequately safeguarded in the context of the sugar reform process, the EC will seek to undertake a comprehensive assessment on the viability of sugarcane production by small planters compared to alternative income-generating activities. In addition, given the impact on the environment from the sugar sector reform process, the EC will seek to elaborate jointly with Government, in the medium term, a Strategic Environmental Assessment¹⁶ (SEA) the recommendations from which will be used to mitigate the possible adverse impact of the implementation of the Adaptation Strategy.

As outlined above, the key development challenge facing Mauritius is the need to restructure its economy in order to maintain a sustainable growth economic rate and to expand the good social development it has already achieved. The restructuring of the economy will cover all sectors of the economy, and include a number of new emerging growth sectors. This will require major investments by both the Government and the private sector in productive infrastructure, communications infrastructure and human resources.

The total costs of the restructuring plan 2006-2015 for the sugar sector reform have been estimated at MUR 25 billion (€675 million). In the light of the significant financial needs, the Government has

¹⁶ The SEA will be a reference document during the formulation phase of the Financing proposals as well as during the review of the EC Response Strategy.

carried out a prioritisation and sequencing exercise for the projects defined in its Adaptation Strategy: giving first ranking to those projects that have both the economic and social dimensions and second ranking to projects relating to the energy dimension of sugar industry restructuring.

In view of the financing requirements of the Adaptation Strategy and Mauritius' good and longstanding collaboration with the European Investment Bank (EIB), which has a significant projects portfolio in the country, the EC will seek - where appropriate - to develop synergies with the EIB, in particular for financing the energy component.

As regards coordination of the implementation of the Adaptation Strategy, this is already in place with the creation of a HPC of which the EC Delegation is also a member. This could, in the future, include other potential financial partners (e.g. AFD, EIB...).

The Government is planning to undertake a full review of the Adaptation Strategy in 2009. Since it is indispensable that there is a single EU strategy for each ACP country covering all Community instruments, the EC Multiannual Adaptation Strategy will be incorporated into the Mauritius CSP and subject to the system foreseen for the CSP monitoring and review process under the Cotonou Agreement.

4.2 Areas for EC Support in 2006

The specific objective of the EC Response Strategy is to accompany, over the transitional period, the restructuring of the sugar industry in order to diversify its revenue base and reduce production costs. In this framework the Government will, as a first priority, act as a facilitator for the downsizing of the industry via strategic investments that facilitate factory consolidation. In this context, the proposed plan is to close one factory in 2006 and two factories in 2007. These closures would provide a substantial cost-saving to the industry through economies of scale and, in addition, would allow the setting up of a power plant, mainly fuelled from bagasse during the cane harvesting season and only coal during the off-season. The factory closures would also trigger the rightsizing of the sugar workforce (first phase of the VRS II) - wages currently make up some 50% of total sugarcane production costs and about one-third of factory operating costs.

For these two measures, the private sector will finance 25% of total blueprint costs associated with factory closures and 30% of the VRS II overall costs; the remaining funding requirements would be met by Government through EC accompanying measures. Furthermore, in late 2006, de-rocking operations will be initiated on small planters' fields. For the 2006/07 and 2007/08 financial years the funding requirements for these three projects are estimated at MUR 1.08 billion (€29 million) for VRS II, MUR 608 million (€16 million) for centralisation and MUR 120 million (€3.2 million) for de-rocking. The EC Accompanying measures (amounting to €6.543 million for 2006) will focus on actions of a social dimension: (i) VRS II (ii) centralisation and (iii) field operations (de-rocking) and shall continue as from 2007 onwards.

During this period, the private sector is already undertaking significant capital investment for the generation of electricity and the modernisation and expansion of sugar factories such as Savannah Sugar Estate (€140 million of investment already committed).

In order to ensure sustainable investment in the sector, as a pre-condition for the FY 2006/07, Government will need to be firmly committed to maintaining a coherent national Energy Sector policy in particular as regards (i) electricity generation using bagasse, including the sequencing and timing for the setting up of new power plants and power purchase arrangements with energy suppliers, and also (ii) ethanol development¹⁷.

The implementation of the Adaptation Strategy will be supervised by a High Powered Committee (HPC) chaired by the Minister of Finance that will meet on a regular basis. The set of projects will be implemented under the umbrella of the relevant ministries (e.g. Ministry of Agro-Industry, Ministry of Public Utilities) wherein several specialised government and semi-state organisations will be brought

¹⁷ At present blending of the ethanol with gasoline is being undertaken on a pilot basis.

in for technical matters. In addition, the private sector and civil society (including farmers' groups) will be collaborating directly with Government.

4.3 Areas for EC Support for 2007 onwards

In view of the challenges facing several key sectors of the Mauritian economy (including sugar), the Government has requested that resources under accompanying measures and the 10th EDF be made available as GBS to accompany its economic restructuring efforts. As from FY 2007/2008, the Accompanying Measures could be channelled via a GBS since, by that time, the ten-year macro economic reform programme should, have been defined for all the economic sectors (current and new), and discussed with the Commission, EU Member States, other donors (IMF and World Bank) and partner countries. Indeed, using GBS for the Accompanying Measures could facilitate the dialogue process, as GBS would also be used in complementarity to the 10th EDF to support Mauritius' overall macroeconomic reform programme. It is also expected that, by 2007, the policy dialogue on budget support should be well advanced in terms of the selection of indicators, in particular those related to the sugar sector. Monitoring of progress in sugar sector restructuring will be carried out through a continuous policy dialogue with the Government and specific indicators, focusing in particular on social outcomes and measures undertaken by the Government in the sector.

Moreover, during the period 2007-13, the EC will encourage research and development institutions in Mauritius to participate in the 7th Research Framework Programme, in particular in theme 2 "Food, Agriculture and Biotechnology, building the knowledge based economy".

4.4 Proposed Delivery Mechanism

During the period 2006 to 2013, the EC Accompanying Measures will be implemented under Financing Agreements that will be formulated in accordance to the Response Strategy and in conformity to EC Regulation No. 266/2006¹⁸.

With a view to achieving a clear sectoral policy for the sugar sector, it is proposed that the EC response strategy will initially focus on accompanying the sector adaptation strategy through Sector Budget Support (SBS) for the financial year 2006/7. As of 2007/8, the EC response strategy will focus on the wider economic restructuring needs of the country, through GBS, provided the economic reform programme has been agreed upon.

The EC budget support as from 2007/8 will assist the Government to implement important public investment projects in the context of the wider economic restructuring, while at the same time setting objectives to maintain macroeconomic balance, in particular with regard to government revenues, budget deficit and efficient debt management. From 2008 onwards, the Accompanying Measures will be in direct complementarity to 10th EDF funds.

ANNEXES

- I. Table of Acronyms
- II. Mauritius' Multi-Annual Adaptation Strategy (not included - available upon request)
- III. Funding Requirements of the Sugar Industry
- IV. Logical Framework

¹⁸ The Financing Agreements will ensure, in conformity to Article 10 of EC Regulation 266/2006 that the Community's financial interests are protected, in particular with respect to fraud, corruption and any other irregularities.