ORAL ANSWER TO QUESTION

SAVINGS AND DEPOSITS – INTERESTS - TAXATION

The Leader of the Opposition (Mr N. Bodha) (By Private Notice) asked the Deputy Prime Minister, Minister of Finance and Economic Development whether, in regard to the measure announced in the Budget Speech 2006-2007, relating to the taxation of interest earned on savings and deposits, he will state –

(a) the amount of capital, if any, that has been transferred from the country as a consequence thereof since June 2006;

(b) the increase in interest rates, if any, since June 2006 and the quantum of increase needed to check capital outflows;

(c) its impact, if any, on the exchange rate of the rupee, and

(d) its consequences, if any, on the economy.

The Deputy Prime Minister, Minister of Finance & Economic Development (Mr R. Sithanen): Mr Speaker, Sir, economic theory and economic practice tell us that there are many factors that determine –

(i) capital inflows and outflows;
(ii) the rate of interest in an open economy, and
(iii) the foreign exchange value of the currency in an open economy.

Mr Speaker, Sir, let me remind the House of two very fundamental factors that seem to have escaped the attention of many, including those who are well intentioned. First, interest on deposits was taxable before the 2006 Budget except for a given threshold and for deposits with maturity exceeding three years. All other interest income which represents the overwhelming amount of interest income was taxable. But, let me be honest, whether people were paying the tax on interest is a totally different matter altogether, but they were taxable.
Second, interest on bank deposits was taxable whether it was held in rupees and currencies locally or held in currencies abroad. What the Budget of 2006/2007 has done is essentially a change in collection method. Instead of voluntary reporting, where we all know that there was massive tax evasion, we have introduced a tax at source as it exists in many developed and developing countries. In fact, only some Rs53 m. of interest income was declared by individuals in the income year 2004/2005. It is precisely because of such massive evasion and underreporting that my predecessor, the then hon. Minister of Finance said, I quote the Budget 2004/2005 –

“(…) I must add that all interest income will be taxable, regardless of the maturity of deposits and instruments.”

And will be taxed at source.

It should also be clear that our policy regarding taxation of interest income is in line with our policy to simplify tax and reduce overall tax rate. It must be seen in the context of the lowering of income tax to a flat tax rate of 15 percent. Mauritius will become one of the lowest tax jurisdictions in the world.

Mr Speaker, Sir, it is impossible to determine in any accurate manner the impact of budget measures on capital flows, interest rate and exchange rate for the simple reason that there are many factors which are at play. The difficulty to attribute the change in capital flows to any of the many factors stems from the fact that there is significant volatility in the amount of capital flows, but I will still venture to give some figures, Mr Speaker, Sir. For example in February 2006, outward investment which comprises Direct Investment Abroad, Portfolio Investment and Currency and Deposits amounted to Rs956 m. It went up to Rs1.209 billion in July 2006, but then it came back down to Rs841 m. in September 2006. On the other hand, the inward flows show the same type of volatility - Rs903 m. in February, Rs316 m. in July and Rs1.3 billion in September 2006. These volatility are due mainly to the fact that the aggregate data also capture transactions that are exceptional. The Bank of Mauritius is not in a position to follow detailed day-to-day individual transfers of money from local banks to foreign countries.
However, there were major positive developments in capital flows that we need to highlight. An amount of Rs179 m. of the total outflows relates to direct investment abroad by residents. This is a very positive development although it is registered as an outflow because it will generate future streams of investment income for Mauritius. Another positive development regarding capital flows has been the tremendous increase in foreign direct investment in Mauritius during the first ten months of calendar year 2006, which reached Rs3,727 billion. This is already 33 percent higher than total foreign direct investment attained in the whole of last year.

It should be pointed that movements in interest rates reflect the fundamentals of the economy and the influence of external factors. The excessively loose fiscal policy financed by a massive build-up in public debt over the period 2001-2005 took a toll on the Mauritian economy. Following a period of very high budget deficits as we have seen in the last five years to 2005 that need to be financed mostly from domestic sources, it is to be expected that there would be generally upward pressure on interest rates.

This situation has been exacerbated, Mr Speaker, Sir, by the general tendency of world interest rates to go up. In fact, global interest rates have been increasing over the last two fiscal years. For instance, the US Federal Reserve System has increased its Federal Funds Rate by a total of 200 basis points since June 2005. The European Central Bank increased its refinancing rate by a total of 150 basis points over the same period. The Bank of England has hiked its repo rate by a total of 25 basis points since June 2005.

A third factor that caused an upward pressure on interest rates has been the strengthening of most major currencies on the world forex market. The Bank of Mauritius has increased the Lombard Rate on two occasions by a total of 150 basis points. First, on 10 July 2006, the Bank increased the Lombard Rate by 50 basis points to 12.00 per cent and then, on 11 September 2006, by 100 basis points to 13.00 per cent. Since then, the Lombard Rate has remained unchanged.

It must be pointed out that the level of interest rates has an impact on economic activities ranging from consumption, investment, government expenditure, trade and savings. Interest rates cannot therefore be solely used for capital flows and outflows. Therefore, there exists an optimal level of interest rates that is needed to maintain overall macroeconomic equilibrium.
Mauritius has a managed floating exchange rate regime with no pre-announced path for exchange rate. The exchange rate of the rupee responds to market conditions and the exchange rate policy of the country reflects the macroeconomic fundamentals of the country. A number of factors have adversely influenced the path of the rupee. We have inherited from the previous Government a precarious economic situation. All major macroeconomic indicators were in the red with a public debt reaching unsustainable levels. Moreover, the deterioration of the current account balance as well as the overall balance of payments, partly induced by the rising trend in international oil prices and the contraction in the EPZ sector and hence, its lower contribution to export earnings, the build-up of foreign currency deposits by economic agents and speculators and self-reinforcing expectations of a weakening rupee stemming from the reduction of 36 per cent in EU sugar prices over a period of four years starting in the current fiscal year.

Moreover, there are cases, Mr Speaker, Sir, that indicate that projects with large import contents that ought to have been financed through external borrowings are being funded through borrowings in rupees from local banks. International oil prices have been on a rising trend in recent years and have amplified the imbalances on the current account of the balance of payments. Just to give an example - petroleum imports, which used to represent around 9 per cent of our total imports during the recent past, accounted for 15.8 per cent of the total import bill for 2005-06. For the second consecutive year, the current account and overall balance of payments registered a deficit.

The current account of the balance of payments deteriorated significantly to record a higher deficit of Rs10.5 billion in 2005-06. The deficit on the current account represented 5.4 per cent of GDP. The deterioration largely reflected the worsening in the merchandise account, which was to a certain extent offset by the combined surpluses on the services, income and current transfer’s accounts. The current account balance and overall balance of payments are expected to post a deficit in the current fiscal year.

The net foreign assets of banks, which include foreign currency deposits held of behalf of customers, increased from Rs10.3 billion as at end-June 2005 to Rs27.2 billion as at end-October 2006, while foreign currency deposits mobilised by banks amounted to Rs34.8 billion as at end-October 2006.
The consequences on the economy are not easy to single out and to quantify. However, the major macroeconomic indicators are showing signs of improvement. Due to exceptional circumstances, including the soaring oil prices, inflation has risen this year significantly. However, it is expected that inflation next year – I mean next financial year - will go down to around 5 percent. It is also expected that the deficit on the current account of the Balance of Payments will improve significantly, and will be reduced. We have also seen, Mr Speaker, Sir, a major positive change in investor behaviour shifting from passive low return investments to high return – higher risk investment. As a result, the Stock Market has done exceptionally well since June 2006. The Semdex has increased by 43.6% between June 9th an December 12th, and the total, return index, SEMTRI has surged by 47.3% during the same time frame. Total turnover during the period under review amounts to Rs2.3 billion, Mr Speaker, Sir. The good performance of the market is attributable, among other things, to the following factors -

- The market has reacted favourably to the bold reforms announced in the Budget.
- Foreign investors have increased their holdings in local companies, and
- The number of players on the market has increased in recent months.

Mr Bodha: Mr Speaker, Sir, will the Deputy Prime Minister agree that he has sent the worst signal to the business community in adopting this measure of taxation of savings and deposits? Will he agree that because of that single decision that there is no confidence in the country today with two major problems –

1. a depreciation of the rupee, which we cannot control, and
2. a shortage of foreign currency in the country?

Mr Sithanen: Mr Speaker, Sir, I made it abundantly clear in the introductory remarks to the question asked by the hon. Leader of the Opposition, that first, tax was leviable on interest rate, except for a threshold and for deposit with a maturity of thirty-six months; and secondly, interests, wherever obtain either in Mauritius on rupees or in currency or in currency in foreign banks are taxable, but whether people were paying is a different
matter; and that is why I cited the speech of the then hon. Minister of Finance. We all know what has happened. Let me give you an example, Mr Speaker, Sir.

We know that these are official figures that are published in the Annual Accounts of the Bank of Mauritius. What is the maturity profile of deposits in Mauritius? Current account, saving account, six months, one year, two years. We also know, Mr Speaker, Sir, how much interests have been paid on all these accounts in Mauritius and we also know how much interest is declared at the income tax. The share of interest declared at income tax to the interest that is actually paid pales into insignificance, Mr Speaker, Sir. And we all know why the former Minister of Finance wanted to introduce that at source on interest.

Mr Speaker, Sir, let me read the speech of the Governor of the Central Bank and I hope the hon. Leader of the Opposition will ask a question on this. The Bank of Mauritius is independent. It is responsible for the conduct and monitoring of monetary policy. Let me make a confession to this House, Mr Speaker, Sir. The Ministry of Finance cannot appoint someone from the Ministry of Finance to sit on the Monetary Policy Committee of the Bank of Mauritius. This is how independent it is.

Let me now, Mr Speaker, Sir, quote from the speech of the Governor of the Bank that was given, I think, ten days ago –

“Several factors contributed to the tight conditions in the foreign exchange market. First, the current account deficit has been seen expanding at too rapid a pace and hence viewed as being unsustainable in the medium term. Second, the budget deficit was perceived as being too big for Government to be able to contain it in the short term as well as a risk of Government debt ballooning to the point of explosion. The deficit was clearly unsustainable. Third, shortfall in sugar export proceeds, as a result of the announced sugar export price reduction, has given rise to wide expectations about the poor prospects of adequate supply of foreign currencies on the domestic foreign exchange market.”

(Interruptions)
Mr Speaker: Order! Order! Do you have a point of order, hon. Soodhun?

Mr Soodhun: No, Sir.

Mr Speaker: Then, keep quiet!

(Interruptions)

Mr Sithanen: I continue with the speech of the Governor of the Bank –

“Exporters…

(Interruptions)

I am giving answer to the questions.

Mr Speaker: The answer is as a result of the supplementary question that the hon. Leader of the Opposition has put.

Mr Sithanen:

“Exporters have since been holding on to the export proceeds and traders have ……

(Interruptions)

Mr Speaker: Please, keep quiet!

(Interruptions)

Order! Carry on, hon. Deputy Prime Minister and Minister of Finance.

Mr Sithanen: And, fourthly, projects with large import contents that would otherwise have been either partly or wholly financed, through borrowing from external sources are being financed by borrowings in rupees from local banks. These are, in my view, the four most important factors that have given rise to nervousness in the domestic foreign exchange market.
Mr Bodha: Mr Speaker, Sir, the Deputy Prime Minister and Minister of Finance is not answering the question. Insofar as the first part of the question with regard to the amount of capital, can he confirm that every month, since June 2006, Rs1 billion have been leaving this country? We have already lost Rs6 billion in the last six months. Can he confirm this, Mr Speaker, Sir?

Mr Sithanen: This is totally false. This is totally untrue. I have the figures here, Mr Speaker, Sir. If the hon. Leader of the Opposition had cared to listen carefully to what I have said…

(Interjections)

Mr Speaker, Sir, I said the following –

(1) There are many factors that influence how people invest abroad and how people invest in this country.

(2) There is a lot of volatility in the flows and outflows.

I gave the figures, Mr Speaker, Sir.

(3) Outward investment. There are three types of outward investments: Direct Investment Abroad, Portfolio Investment and Currency and Deposits.

I gave the figures. This is a flow. This is not cumulative, because people sell and buy. It is not a stock.

Mr Speaker, Sir, in February 2006, the total outward investment was Rs955.6 m. In June, that is, some weeks after the Budget was announced, these three figures reached to Rs1.2 m. I gave the figures. In September, it was Rs841 m. So, there is a volatility. There are many factors that influence the decision of investors.

On the other hand, there is also Inward Investment. Inward Investment for February 2006 is Rs903 m. In July, it is Rs315 m. and in September, Rs1.282 billion.

Mr Speaker, Sir, the hon. Leader of the Opposition holds a newspaper of this morning and he is talking about confidence. Confidence has increased from 33% to 57%. This is in this morning’s paper that he was holding.

Last time when it was 33% they held a press conference and said that “La confiance est tombée.” Now, it went up from 33% to 47% in November and this morning, Mr Speaker, Sir – I just read it now, because I was in a function with the hon. Prime Minister this morning – it is 57%.
**Mr Bodha:** Is the Deputy Prime Minister and Minister of Finance aware that there is a waiting list in every bank for the transfer of Mauritian rupees into foreign accounts abroad? Is he aware of this?

**Mr Sithanen:** Mr Speaker, Sir, let me be, again, very clear to the House. I have no reason to play politics with exchange rate. I am not happy with what is happening on the market for foreign exchange, but we have to face three factors, two of them are beyond my control; and the third is that some people, some players are not playing the game, Mr Speaker, Sir.

*(Interruptions)*

Let me explain. There is a structural problem in the economy, Mr Speaker, Sir. We know the structural problem. The budget deficit is too high, the current account deficit is too high. There are also external factors that are beyond our control. I just gave the figures, Mr Speaker, Sir, how much more money we are spending for the import of petroleum products. And how in the Export Processing Zone and in sugar, the receipts will come down.

On the other hand, one thing that perturbs me is that there is enough foreign currency in this country, but some people are playing wild game as far as speculation is concerned, Mr Speaker, Sir. Because there are Rs40 billion of currencies held at the Central Banks, there is an equivalent of Rs40 billion also held by Commercial Bank, Mr Speaker, Sir.

I explained what is happening in my answer. Many of them could easily have paid their expenses in currencies with the foreign currencies that they are receiving. But, what they are doing is that they are sitting on the currencies that they are receiving. They are borrowing in rupees and they go to queue in the banks in order to get foreign currencies.

**Mr Bodha:** Is the Deputy Prime Minister and Minister of Finance aware that while the official rate of the dollar is Rs33.18, many importers and business people are asked by the banks to pay a black market rate at Rs35 or more? This is happening every day in all banks for all transactions.

**Mr Sithanen:** Mr Speaker, Sir, I explained very clearly that we have a structural problem. It will take some time before we address this structural problem…

*(Interruptions)*

**Mr Bodha:** The Deputy Prime Minister and Minister of Finance has created the problem!
Mr Sithanen: We have not created the problem, you have created it! You messed around the economy. People who have raped the economy are showing us how to run the economy!

(Interruptions)

Mr Speaker: Order!

Mr Sithanen: People who have “bangoler” the economy are telling us how to do it! Mr Speaker, Sir, I have explained that we cannot rectify what we have inherited from the previous Government in one year. We cannot do that, Mr Speaker, Sir.

(Interruptions)

Unfortunately, at the same time that we are trying to stabilise, we have to restructure the economy. We have inherited a bad economic situation from them, prices of sugar are coming down, the prices of petroleum products are going up, the exports of the EPZ are coming down. We have to contain all these…

(Interruptions)

Mr Speaker, Sir, it is a fact that because many companies in this country have been allowed in the past to retain their currencies, obviously they are playing around with the market with a view to maximizing the return that they can get on their currencies.

Mr Bodha: Can the Deputy Prime Minister and Minister of Finance explain how the currency of Madagascar has appreciated by 4% against the Mauritian rupee?

Mr Sithanen: Mr Speaker, Sir, the hon. Member is picking one country, I can pick twenty-five countries to show….

(Interruptions)

Mr Speaker, Sir, maybe in Madagascar the Government did not inherit such an awful economic situation from the previous Government.

Mr Dayal: Mr Deputy Speaker, Sir, can I ask the hon. Deputy Prime Minister and Minister of Finance whether he will state if all the receipts from our exports of sugar in foreign currency are now received and administered by the Sugar Syndicate?

Mr Sithanen: Mr Speaker, Sir, I mentioned in one of my replies when answering a supplementary question, that there are structural problems, but I think it is also a field day for speculation. I believe that there is enough money for the system to be oiled. But, there are some people who are playing funny game. Mr Speaker, Sir, I cannot play politics with the exchange rate, because there are certain signals also that we need not to send out to the world community.
Mr Speaker, Sir, it is a fact that previous Governments, of all shapes and colours, have taken the decision to allow some firms and some organizations to manage their currency. This is creating some problems also, Mr Speaker, Sir.

Mr Bhagwan: Can we know from the Deputy Prime Minister and Minister of Finance what action he contemplates to take, or has taken, concerning the difficulties faced by parents whose children are studying abroad? Since the past months, these children are suffering pour le retard sur le transfer de l’argent, que ce soit for the subsistence allowance or the end of year expenses. This is very serious. May we know whether the Deputy Prime Minister and Minister of Finance contemplates to set up a special desk at the Bank of Mauritius or elsewhere, at least, to cater for the students who are in difficulties?

Mr Sithanen: Mr Speaker, Sir, I fully understand this problem. I also have children who are studying abroad.

(Interruptions)

I understand the problem that many of these people have to face.

Mr Speaker: Order! The hon. Member is interrupting the hon. Deputy Prime Minister and Minister of Finance. There are so many hon. Members who are standing up to put questions. Do not waste time. Please, carry on!

Mr Sithanen: Mr Speaker, Sir, it is not easy to put in place the mechanism that has been suggested by the hon. Member because then we are going to create a two-tier structure in the currency system. Many countries have tried to have a two-tier structure. If my memory serves me well, I think it is Sri Lanka, at one stage, tried to have a two-tiered structure and it did not work. The solution, Mr Speaker, Sir, is that we need some more patience, that if FDI comes in, if reforms start giving results, we’ll start getting the benefit of these reforms. And we have seen that in some countries. But let me announce very clearly that we are going to monitor the situation very closely. While I respect the independence of the Central Bank, we will have to take some measures in order to protect the national interest of the country if the situation so warrants, Mr Speaker, Sir.

Mr Dowarkasing: Mr Speaker, Sir, can the hon. Minister explain as to why there has been a decrease in the rate of savings coming from 17.4 of the GDP in 2005 to 14.9 in 2006? Is that not a result of the measure he has taken in his budget?

Mr Sithanen: Mr Speaker, Sir, I must say I have difficulty to understand some of my friends in the Opposition. Interest was taxable unless you are making a case for people not to pay their fair share of taxation. Interest was taxable, Mr Speaker, Sir. The saving rate has been coming down. Let me inform the House, Mr Speaker, Sir and my hon. friend, do you know that Mauritius is probably one of the few countries in the world where only – listen to this figure - 7% of the labour force pay taxes. Only 7% of people
pay taxes and on top of that, Mr Speaker, Sir, it is one of the lowest income tax in the world. I indicated in my reply, Mr Speaker, Sir, that possibly there has been a shift from the low risk type of saving to high return and high risk of saving; and I indicated that this is reflected the buoyancy that we are seeing in the Stock Exchange.

Mr Ganoo: Will the hon. Minister confirm whether there will be an increase in interest? And will he agree that with the two past increases in interest and a potential third one coming and its favourable consequences that it has on the economy in terms of cost in manufacture or to companies which render the business community less competitive? What does he intend to do about that?

Mr Sithanen: Mr Speaker, Sir, there is no magic solution, unfortunately. I wish there were; and it is precisely for this reason that the Bank of Mauritius has introduced a new monetary framework as from this month. They are going to shift from the Lombard rate to the repo rate with a view to sending the right signals to the investment community.

To come back to the specific question of hon. Ganoo, Mr Speaker, Sir, all of us know that there are only three solutions to address the problem. Either you raise interest rate in order to make your currency competitive in the event that interest rates in other currencies are increasing and everybody who has been following what’s happened to the euro will know that the euro has appreciated in the last 15 days not only against the rupee but against the dollar. The pound sterling is very close to two dollars. There is an interesting article in the “Economist” of this week on what is happening to the dollar, Mr Speaker, Sir. So, one way to protect the currency is to use interest rate.

The second one, Mr Speaker, Sir, we are not China, you can use your reserves, but there is a limit to what we can do. And the third thing that we can do is to attract foreign direct investment to ensure that money comes in. But in the short term, the best solution would be that if all the stakeholders play the game as there is enough currency to go around.

Mrs Hanoomanjee: Mr Speaker, Sir, several times the Minister of Finance has stated that players are not playing the game or that they are playing funny games. Can the Minister say why these same players did play the game when the previous Government was in power? Is it not because these players have lost confidence in the policy of the Government that they are not playing the game?

Mr Sithanen: Mr Speaker, Sir, I have already replied to this question. In fact, the level of confidence has increased. Mr Speaker, Sir, if the hon. Member wants me to go down memory lane to tell her what was the catastrophic situation that was legated to us and how they played politics…

(Interruptions)

Mr Speaker: Order!
Mr Sithanen: …with the exchange rate, Mr Speaker, Sir, two years before the election and how that same Government, on the eve of the election, suspended the application of the Automatic Price Mechanism.

(Interruptions)

Mr Speaker: Order! Order!

Mr Dayal: Mr Speaker, Sir, in order to avoid any further speculation of foreign currency, will the Deputy Prime Minister strongly consider the advisability of taking steps to have at least 75% of sugar receipts to be received and administered by the Bank of Mauritius?

Mr Sithanen: Mr Speaker, Sir, I don’t want to have an easy way out also because it is also a question of psychology. It is a question about signaling device and that’s why I am making an appeal that there is enough currency and all the stakeholders have to play by the rules of the game.

(Interruptions)

Mr Speaker: Order!

Mr Sithanen: But, Mr Speaker, Sir, we will continue to monitor it while respecting the independence of the Central Bank. If measures have to be taken to protect national interest, we have no choice than to embark down that path.

Mrs Dookun-Luchoomun: Mr Speaker, Sir, the hon. Minister has been talking about funny games, speculation, etc. to use his own words, will he tell us whether he intends to take certain measures to remedy the situation and if among these measures he intends to have some form of control of foreign currency flow in the country?

Mr Sithanen: Mr Speaker, Sir, the hon. Members are trying to put words in my mouth. I can’t play politics, Mr Speaker, Sir. I have a responsibility for the stewardship of the economy, Mr Speaker, Sir. We have a responsibility. I could play politics and say we are going to do a, b, c, d. The only thing that I can say, Mr Speaker, Sir, is that this is a serious matter that should be above party politics. We will continue to monitor it. As I said, Mr Speaker, Sir, psychology is extremely important, signaling device is also important, because we have embarked on a strategy of openness, reform and liberalisation. This carries rights in addition to responsibilities and obligations, Mr Speaker, Sir.

Mr Bodha: Mr Speaker, Sir, will the Deputy Prime Minister agree that, in fact, he has failed miserably after 18 months? May I ask him a few questions in the end? Will he let the Mauritian rupee slide until we reach a no return situation or will he, as we had the wisdom to do, backpedal on the decision of taxation of interests on savings and deposits?
Mr Sithanen: Again, Mr Speaker, Sir, I don’t have the intelligence of my friend, but one thing I can’t understand. We have not changed taxation on interest. It was taxed before. Interest was taxed unless the hon. Leader of the Opposition is making a plea for people who should pay tax, not to pay tax, to continue to evade because this tax is required to fund education, health and to help the poor. Mr Speaker, Sir, everybody must pay the fair share of taxation. It would appear that the Leader of the Opposition is making a case for people to deliberately flout the law of the land to evade tax and not to give money needed for education, etc.

(Interruptions)

Mr Speaker: Order! Next item!

MOTION

SUSPENSION OF S.O. 10 (2)

The Prime Minister: Sir, I beg to move that all the business on today’s Order Paper be exempted from the provisions of paragraph (2) of Standing Order 10.

The Deputy Prime Minister, Minister of Public Infrastructure, Land Transport and Shipping (Dr. R. Beebeejaun) rose and seconded.

Question put and agreed to.