IMPACT OF CHINA – AFRICA INVESTMENT RELATIONS: AN IN-DEPTH CASE STUDY OF MAURITIUS

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1. Introduction

1.1 Problem Statement

Openness to trade goes hand in hand with liberal investment regimes: countries that espouse export orientation are also friendly towards foreign investors at home while encouraging investment abroad. China provides a classic example of this two-pronged approach to economic liberalization. Chinese private and joint-venture firms have become dominant players in global trade since the major privatisation efforts of the 1980s, combined with ensuing trade and investment reforms and China's accession to the WTO.

With FDI inflows surging to a historic high of US$108 million in 2008, China has become the third largest FDI host after the USA and France. China's FDI strategy has evolved significantly since the 1970s. Initially, the Special Economic Zones (SEZs) attracted the bulk of FDI inflows, but a re-orientation of the SEZs through greater emphasis on advanced technology, a bureaucratic overhauling of the FDI process and enhanced incentives to investors resulted in a resurgence of FDI inflows in the 1980s. In recent years, Chinese FDI policy has become increasingly proactive, with incentives targeted to specific sectors. The strategy has proved successful. Data on FDI from UNCTAD show that the inward FDI stock has doubled between 1999 and 2008, amounting to some US$378 billion at the end of 2008. Over 50 percent of the cumulated flows have been absorbed by the manufacturing sector, followed, far behind, by real estate development.

China provides an interesting case of a developing country that has emerged rapidly as a key outward investor even as it continued to attract FDI to its shores. This pattern is rather typical of industrial countries, which attract large amounts of market-seeking inward FDI while investing abroad by vertically slicing their production chains. However, China's outward investments are primarily natural resource-seeking, rather than efficiency-seeking. And, given Africa's rich endowment of oil and minerals, it is hardly surprising that the Chinese have turned to Africa. As a result, Africa has seen a dramatic increase in FDI flows from China over the past two decades. Chinese FDI stock in Africa has grown from US$49 million in 1990 to US$ 2.6 billion in 2006, and the momentum was hardly dampened by the recent financial crisis.

The scale of China's growing presence in Africa through the trade, investment and aid channels has raised concerns about its possible adverse impacts on African development. In the case of investment, these fears are in part fuelled by the underlying motivations of Chinese FDI strategy in Africa. Besada et al. (2008) argue that the recent surge in FDI is a response to the Chinese government's strategic call for a "go out" policy launched in 2000. While the Chinese defend their aggressive investments on the grounds that they yield mutual benefit, promote common prosperity and support learning from each other, many researchers have attacked China's investment strategy as driven by greed and selfishness – that is, the need to feed the hunger for growth back home (Zafar, 2007). More damning is China's practice of bundling together aid, trade and investment, which reduces the real value of an investment project. The so-called 'Angola mode' – whereby aid and investment are paid back in oil – has become a framework for much of China's investment activity in Africa (Kaplinsky and Morris, 2008). This framework is objectionable on the grounds that, by minimizing the local content, it prevents African economies from effectively participating in major investment projects, which reduces not only the multiplier effect on income but also denies them the opportunity to learn and, ultimately, fully own the project.

Besada et al (2008) have argued that the hype about China's engagement in Africa is somewhat exaggerated. They point out that, while the annual growth rates of trade and investment have averaged 30 percent per year since the late 1990s, China's shares of these flows are relatively low and, in some cases, lower than other countries' shares. For example, while China accounted for a lofty $520 million of inward FDI in Africa in 2006, this amount represents less than 1.5 percent of total FDI flows to Africa. Similarly, China represented only 8.6 percent of African exports and 9.6 percent of African imports in 2006, lower than the trade shares of Africa's traditional trading partners. However, African interdependence with China is growing rapidly, the authors conclude.

Moreover, Wang and Bio-Tchané (2008) demonstrate that Africa's trade with China is no different in composition than that of its traditional trade partners, namely the US and the EU, suggesting that Africa-China trade largely reflects the two countries' respective comparative advantages. This finding implies that statements about China exploiting Africa's natural resources are unjustified since all of Africa's other import partners are doing the same.

Be what it may, African countries can see in China's spectacular rise an opportunity to unleash a virtuous circle of trade- and investment-led growth long denied to them by a confluence of historical and political factors. Also, the timing can hardly be better as sub-Saharan Africa has witnessed a return to democracy and peace (Ndulu and O'Connell, 1999) and as the region continues to record sustained high rates of economic growth. Foreign investment, and in particular FDI, is credited for various growth-enhancing benefits to the host country – including technology and knowledge spillovers, economies of scale and of scope, greater efficiency due to competition, creation of backward and forward linkages and access to marketing networks that foreign investors bring along with them (Blomström, and Kokko, 2003).

Mauritius' position is atypical of the rest of Africa. A small island with no exploitable natural resources, growing labor shortages, and poor and declining cost competitiveness, Mauritius offers an unlikely destination for the kind of FDI that the Chinese have generally privileged. Yet, Mauritius is the very first country in Africa to host one of the seven special economic zones that the Chinese government has promised to build around Africa. It is clear that the investment flows into the zone are neither market-seeking, nor resource-seeking nor indeed efficiency-seeking. What could then explain China's choice of Mauritius as a host of its industrial zone? This study argues that Mauritius boasts strong economic fundamentals and, through its various regional trade agreements and its strategic location in the Indian Ocean as a bridge between Asia and Africa, offers the perfect gateway to the emerging African market. It is this opportunity, along with Mauritius' duty free access to its traditional partners, that China is eying.

Chinese FDI flows into the industrial zone, by their very magnitude and sectoral orientation (into high-value sectors such as pharmaceuticals and light engineering), are likely to have important impacts on the economy. The SEZ will generate jobs and foreign exchange earnings even though the real value to the domestic economy is expected to be smaller since the industrial zone is likely to be manned mainly by Chinese expatriate workers and export proceeds repatriated to

China. However, Mauritius could gain from technology spillovers and linkages with the domestic economy. We provide a case study of the Chinese SEZ and examine carefully its potential impacts on the economy.

Finally, much of Africa's investment relations with China are unidirectional: FDI typically flows from China to Africa than vice versa. However, Mauritius has defied its small size to become an important investor in China, with a major spurt of investment in the textile industry by a Mauritian giant. However, whether that episode is a one-off thing or a harbinger of greater – and more diversified – investment flows is yet to be determined. Mauritian apparel producers have been delocalizing to Madagascar to take advantage of its cheap labor. China can offer more: since the bulk of fabrics originates from China, would it not be more profitable to produce there?

1.2 Objectives

This study follows up on an earlier scoping study of China's economic impact on Mauritius in terms of the conventional channels of analysis, that is, trade, investment and aid (see Ancharaz, 2009). It focuses on one of these vectors of influence – namely, investment – and seeks to provide an in-depth analysis of its magnitude, characteristics and impacts on the Mauritian economy. The specific objectives are:

1. To compile and present an inventory of FDI inflows by sector and country;
2. To estimate the extent to which such FDI flows represent the creation of new production capacities (Greenfield investment) as opposed to a mere change in ownership (merger or acquisition);
3. To analyze the extent to which overall Chinese FDI inflows are bundled with aid;
4. To describe the regulatory regime governing FDI inflows in Mauritius and discuss whether it is conducive to attracting FDI generally and from China, in particular;
5. To analyze the characteristics of major Chinese FDI, i.e., to determine whether such FDI is resource-seeking, market-seeking or efficiency-seeking and whether the output is targeted at the domestic or external market;
6. To compare and contrast the characteristics and practices of Chinese FDI and FDI from other sources with a view to determining whether Chinese FDI is motivated by strategic considerations atypical of mainstream FDI;
7. To assess the economic benefits that arise from major Chinese FDI in terms of export expansion, reduction of import dependence, contribution to value added and employment, government revenue, etc.

8. To analyze the ownership structure of incoming FDI, i.e., whether FDI is wholly – owned or is through joint – ventures, in which case the mix of local and foreign equity participation, as well as the identity of the investors, become of interest.
9. To assess the spread effects, if any, of Chinese FDI to other sectors of the economy in terms of skill development and capability building, the use of local inputs, supply chain management and technology transfer.

10. To determine the features, size and sectoral distribution of Mauritius' investment in China (if any) and the nature of support, or lack thereof, that such outward investments have received from the home government as well as from Chinese authorities.

1.3 Organization of the Report

The report is organized as follows. By way of background, section 2 describes the structure of the Mauritian economy; analyzes FDI inflows by country and sector, with an emphasis on Chinese FDI; documents Chinese aid to Mauritius and examines whether such aid has been bundled with FDI (or vice versa); and reviews the investment regime in the two countries. Mauritius' outward investment in China, though much less important in size than Chinese investment in Mauritius, is also explored in this section. Section 3 reviews the theoretical and empirical literature on FDI, focusing on the heated debate that Chinese investment in Africa has engendered. Section 4 presents the theoretical framework and methodology. An empirical analysis, relying mainly on a case study of a specific Chinese FDI project in Mauritius; is attempted in section 5. We conclude in section 6 with a summary of the key findings and a discussion of the policy implications arising there from.

2. Background

2.1 Structure of the Economy

Mauritius is a small island economy with an estimated multi-ethnic population of 1.2 million in 2007. Being a former colony of France and Great Britain, Mauritius exhibits clear features of its colonial heritage in its laws, languages, business ownership and trade structure, among others. Mauritius is a Westminster-type democracy; elections have regularly been held at 5-year, if not shorter, intervals. Its laws are a combination of British law and the French Code Napoleon. English is the official language although French is widely spoken and dominates the written press.

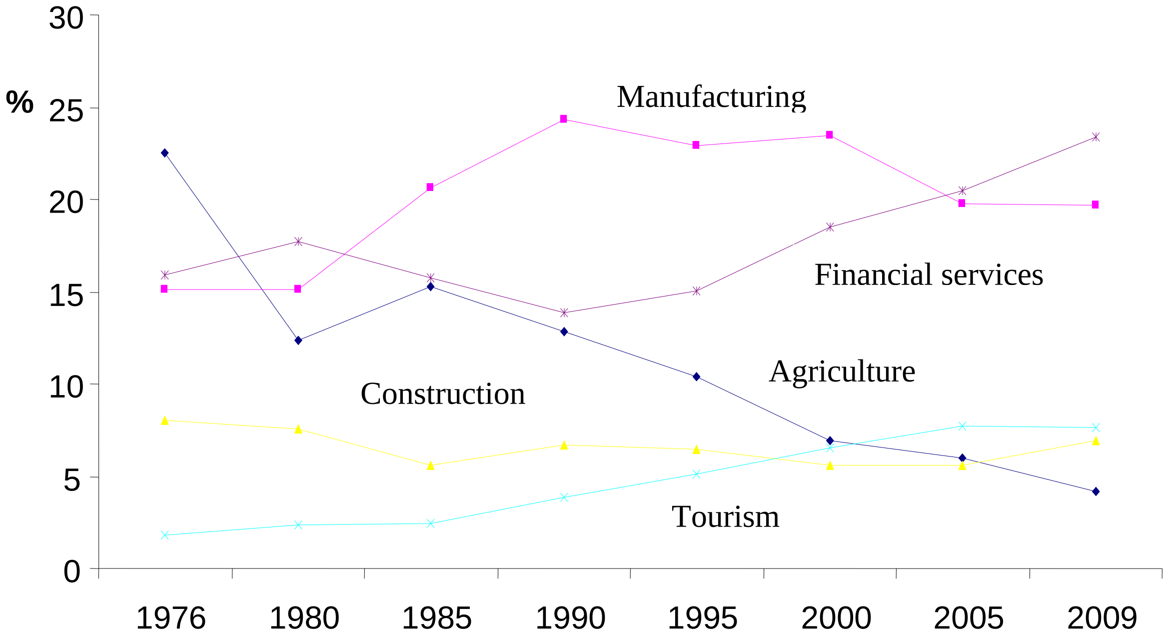
At the time of independence in 1969, Mauritius inherited an economic structure fashioned by its colonial past. The island was primarily a sugar plantation, with much of the acreage owned by the Franco-Mauritians, a very small but economically powerful community. This landed aristocracy has judiciously utilized its proceeds from sugar exports, and opportunistically taken advantage of economic incentives, to diversify into textiles, tourism and financial services. In this, Mauritian exporters have benefited most from the market access privileges under the ACP-EU Lomé Convention. On the downside, however, these preferences have hindered both product and market diversification, with exports dominated by sugar and clothing, and the bulk of these exports still being absorbed by the EU.

The contemporary Mauritian economy rests on three traditional pillars – sugar, textiles, and tourism. Financial services are an emerging sector, with considerable potential to contribute to economic growth. However, the relative significance of these sectors has changed over the years (Figure 1). Sugar, once the backbone of the economy, has declined to a mere symbolic industry – it contributed less than 3 percent to GDP in 2007 – even though one may argue that its multifunctional role is much larger. The clothing industry, which thrived under EPZ incentives and preferential market access, suffered a major setback in the run up to the fateful January 1, 2005, which signaled the end of apparel quotas and the inauguration of a new era of global competition in clothing exports, featuring formidable players like China, India and others. However, export data for recent years give an altogether different reading: the clothing industry has bounced back, with exports in 2007 reaching an all-time peak before the financial crisis took its toll.

Tourism is perhaps the only sector that has been left unscathed by the treacheries of globalization. This sector has posted robust growth since 2000 and has contributed significantly to jobs and foreign exchange earnings. Financial services accounted for some 10 percent of GDP in 2007. Domestic banks have long dominated financial intermediation in Mauritius although efforts have recently focused on promoting offshore banking activities by emphasizing the country's reputation as a safe financial haven. However, offshore banking has yet to prove its potential as a driver of growth.

Current government strategy is to reorient the economy's traditional sectors in light of preference erosion while promoting new growth avenues. Thus, for example, emphasis is shifting away from the sugar industry toward a *sugar cane* industry, which would produce a variety of by-products – such as ethanol, spirits, and electricity from cane waste – as well as specialty sugars. In the textiles sector, efforts are being directed to building a vertically integrated clothing industry encompassing spinning, weaving and dyeing operations, which call for heavy investments in machinery. Being a high-cost country, Mauritius' survival strategy rests on moving into the higher end of the market, where competition is less keen. In tourism, the objective is to attract 2 million tourists by the year 2015, a more than two-fold increase over the current figure of 800,000. In parallel, several schemes have been launched to attract high net-worth individuals to Mauritius by offering them the possibility of owning luxury villas in a sanctuary-type setting. In the services sector, IT-enabled services are emerging rapidly, fed by the availability of a pool of computer-literate and bilingual labor, and by the country's past investments in telecommunications. Finally, new industries (for example, the seafood hub) are actively being sought out and promoted to diversify the economy's industrial and export structures.

Figure 1: Sectoral Distribution of GDP



Mauritius is arguably an outlier among SSA countries. The country was ranked first in SSA on the basis of the Human Development Index in 2008, reflecting notable achievements in education, health and income. Mauritius has the second highest GDP per capita in the region. The composition of GDP is atypical of SSA countries: services make up about 64 percent of GDP, and manufacturing some 20 percent (2008 figures). As a small island economy, with no natural resources, Mauritius understands that its economic survival rests crucially on an openness strategy pushed to its limits. As a result of sustained trade reforms dating back to the early 1980s, the country boasts a very liberal trade regime, and is on course to becoming a duty-free island. Total trade as a percentage of GDP amounted to 133 percent in 2006 compared to an SSA average of 69 percent (Table 1).

Table 1: Structure of the Economy

Variables	**Unit**	**1990**	**2000**	**2008**
Population	000s	1056	1195	1253.0

GDP per capita	US $	2608	3610	5807.0
Annual real growth rate of GDP	%	7.3	9.7	5.6
Inflation rate	%	13.5	4.2	9.7
Budget deficit to GDP ratio	%			-4.1
Unemployment rate	%	2.8	8.8	7.2
Investment rate	%	30.6	22.9	24.6
GDP at market prices	US$	2382.9	4469.3	8651.1
GDP shares by industry group				
Agriculture	%	12.9	7.0	4.4
Of which: sugar	%	8.0	3.6	1.9
Manufacturing	%	24.4	23.5	20.1
Of which: EPZ	%	…	12.0	5.4
Services	%	47.8	59.2	64.0
Of which: Financial and business services	%	4.9	9.7	10.9
Government services	%	15.0	17.5	18.1
Exports of goods and services	US$ (million)	1721.9	2622.4	4943.8
Share of GDP		64.0	63.0	62.0
Imports of goods and services	US$ (million)	1915.8	2706.9	6319.8
Share of GDP	%	71.0	65.0	70.0
Current balance as % of GDP	%	-5.0	-1.0	-11.0
FDI as a % of GDP	%	6.5	14.7	12

Source: CSO

2.2 FDI Analysis

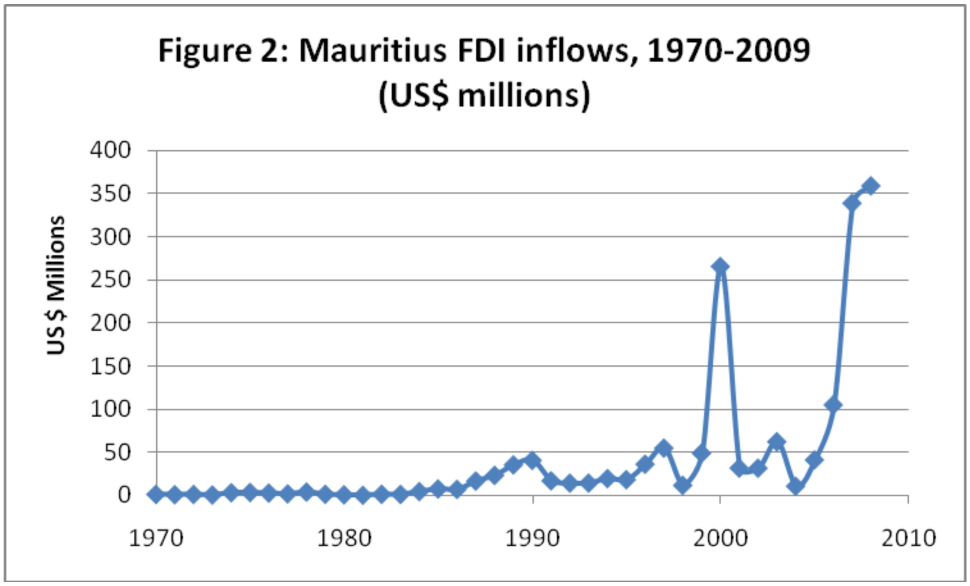
Mauritius boasts a fairly liberal investment climate, and recent reforms have further enhanced the attractiveness of the investment regime by cutting red tape and fast-tracking applications for an investment permit. Fiscal incentives, combined with macroeconomic strength and political stability, have led to important flows of FDI in Mauritius. However, these inflows have been neither steady nor evenly distributed across sectors of economic activity.

2.2.1 Trends in FDI flows in Mauritius

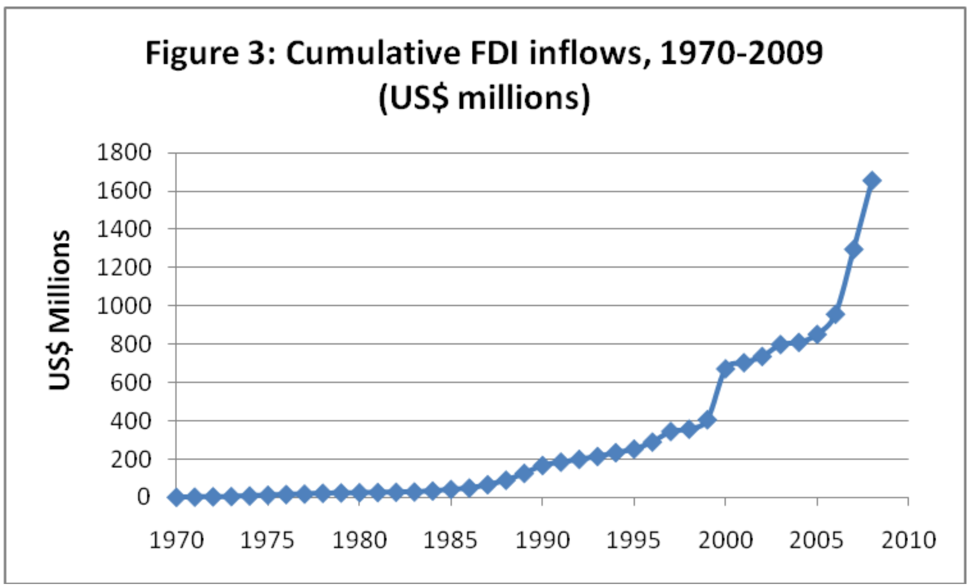
The country became a significant FDI host in the mid-1980s when the EPZ attracted a number of Hong Kong-based clothing firms seeking to relocate in the face of the political uncertainty surrounding the handing over to China. This spurt of FDI inflow started in 1987 but did not last beyond 1990, after which FDI flows took a dip. These same firms exited the EPZ between 2001 and 2005, leading to massive disinvestments, as they saw preferential access to the US market wither away while the scepter of fiercer competition loomed large with the expiry of the Multifiber Arrangement at the end of 2004. Net inflows nevertheless remained positive largely thanks to the performance of services (banking, tourism and property development), which have become a magnet of FDI inflows in recent years

On the whole, FDI inflows have exhibited considerable fluctuations over the years. Until 2004, FDI flows were marginal, with sporadic spikes in 1997, 2000 and 2003 (Figure 2). A clear upward trend in the flows has emerged only after 2004, driven by a structural shift towards services.

Figure 3 shows the cumulative FDI inflows over the period 1970-2008. It appears that the FDI stock has evolved in three distinct stages: it was relatively stagnant from 1970 to 1986; then increased rapidly from 1987 to 2000; and, increased even faster after 2000. The total inward FDI stock in 2008 was estimated at $1.66 billion in 2008, up 147 percent from its 2000 level. The FDI stock is likely to increase further and the pace likely to accelerate, as the country starts to receive spurts of Chinese FDI into the upcoming economic cooperation zone.



Source: UNCTAD (2009)



Source: UNCTAD (2009)

2.2.2 FDI inflows by sector

Mauritius has failed to attract FDI into productive sectors such as agro-business and manufacturing. Over the 10-year period under analysis, about one-third of FDI flows have been absorbed by the banking and financial services sector, and another 30 percent have gone to the tourism industry. Transport and communications come in third position only because of the one-off purchase of a 49-percent stake in Mauritius Telecom by France Telecom in 2000. The real estate sector has received a major boost in recent years through the Integrated Resort Scheme, which seeks to attract financially endowed individuals by offering them the alluring opportunity to acquire a luxury villa on the tropical island of Mauritius. The Real Estate Scheme also works in the same direction.

The manufacturing and agricultural sectors together have attracted a little over 5 percent of total FDI flows over the past decade. In manufacturing, foreign investment has flowed mainly into the textile and clothing industry, with major, albeit erratic, investments in capital-intensive spinning and weaving operations. In the agricultural sector, the processed tuna industry has attracted spurts of FDI in 2004 and 2008. However, despite government's efforts to diversify the manufacturing base by emphasizing light engineering, electronics, pharmaceuticals and agro-processing, among others, little success has so far been registered in attracting the scale and type of FDI that would give a boost to these industries.

It seems that Mauritius is not competitive enough in these sectors due to geographical and systemic factors. The sharp rise in wages and shrinking labor supply as Mauritius witnessed a protracted period of EPZ-led economic boom, starting in the mid-1980s and continuing through much of the 1990s, has made the island economy a victim of its own success. In light engineering and pharmaceuticals, additionally, Mauritius' small size precludes the availability of a critical mass of skilled labor vital to sustaining the industry's development. Also, since Mauritius lacks natural resources and needs to source inputs and intermediates from remote markets, there is little scope to generate significant added value, thus limiting these industries to mere assembly, where the high cost of labor and stagnating productivity confer a further competitive disadvantage. This is true also of the electronics industry in which Mauritius is struggling to make a dent, and now seems to have given up altogether. In the fish processing industry, there are currently only two large firms, one of which is wholly foreign-owned and the other is a joint venture with majority foreign equity participation.

On the whole, it appears that Mauritius has managed to attract the largest amounts of FDI in low-risk, high-return sectors like tourism and banking. In the tourism industry, Mauritius boasts a natural advantage and has traditionally targeted its former colonies, especially France, as tourist markets – a strategy that has paid, given the predominant presence of the Franco-Mauritian community in this sector. Government's policy is to foster a controlled, environment-friendly expansion of the tourism industry and to attract FDI only into large, high-end, high value-added, integrated resorts. Yet, this policy seems to be in conflict with the goal of increasing tourist arrivals to 2 million by 2015.

In the banking sector, where a few large firms dominate and where the scope for excess returns exists, aided by a regulatory framework that has failed to correct the inherent market failures, new, foreign banks have been pouring in recent years, many of them in the nascent offshore banking sector. This trend is likely to continue in the future as Mauritius continues to liberalize trade in services. By virtue of Mauritius' offensive interests in banking and financial services, few, if any, barriers exist to GATS mode 3 delivery in this sector.

To conclude, while FDI inflows have increased over 12-fold between 2001 and 2008, it is worth noting that much of the increase in recent years (especially since 2005) has been driven by the remarkable performance of three service sectors, namely financial intermediation, tourism and real estate business. The productive sectors have failed to attract significant amounts of FDI, which casts doubt on the effectiveness of the national investment strategy as well as raising questions about the country's capability to attract FDI in these sectors. On the one hand, FDI inflows seem to follow the long-term structural shift in the economy towards services. On the other, it appears that government's entrepreneurship has resulted in a process of creative destruction. As new sectors were aggressively promoted, resources have domestically shifted out of traditional sectors into these emerging sectors, and FDI followed suit.[1]

Table 2: Mauritian FDI inflows by Sector, 2000 – 2009 (Rs. millions)

Sector	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**
Agriculture, hunting and forestry		14			484	19	26	12	447	
Fishing				1				6		
Manufacturing	37	5	65	127	387	263	181	271	149	12
Electricity, gas and water supply	9	3		25			17			
Construction		245		1	14	46	11	45	68	174
Wholesale and retail trade; repair of motor vehicles, motorcycles and personal and household goods	1	14	386	288	123	510	198	38	103	
Hotels and restaurants	10		99	103	121	536	2610	5979	3985	448
Transport, storage and communications	7204	21	13	1	47	191	56	18	22	
Financial Intermediation		600	316	1311	392	481	3593	4056	4564	239
Real estate, renting and business activities	3	34	100	109	228	759	473	1030	1888	416
Education						2	55	30	74	49
Health and Social work							2	29	120	
Total	7264	936	979	1966	1797	2807	7222	11514	11419	1338
Exchange rate (MRU/US$)	26.3	29.1	30.1	28.5	28.0	29.8	31.8	31.8	31. 8	31. 9
In US Dollar (million)	276.7	32.1	32.51	69.0	64.1	94.1	226.9	362.6	359.3	41.9

Note: Figures for 2009 is for January to March.
Source: Bank of Mauritius

[1] For example, the Integrated Resort Scheme (IRS) has allowed the sugar industry, hit hard by EU's sugar regime reform, to shed large plots of land for property development targeted at wealthy foreigners who, under the scheme, could become rightful owners of a luxury villa in Mauritius if they could commit $500,000 or its equivalent in foreign currency to investment in Mauritius. While the IRS has brought in foreign exchange and allowed the government to collect larger tax revenues, its real economic value in the long run remains dubious.

2.2.3 FDI inflows by country

Mauritius has received most of its FDI from Europe, with UK and France occupying top spots. UK has invested Rs. 9,812 million (about US$ 309 million at 2008 exchange rates) over the period 2000-08. While FDI from France amounted to Rs 11,739 million over the same period, more than half of this amount (Rs 7,214 million) represented the acquisition of equity stake in Mauritius Telecom by the French counterpart. With investments of Rs. 4,357 million, much of which occurred in the last three years, the United States comes in third position. It would be interesting to know which sectors of activity each of these countries has favored or to determine whether such investor specificities exist in the first place. Unfortunately, data by country and by sector are not available. While all three countries are likely to have invested in the emerging services sector, the UK has also made significant investments in the processed tuna industry, France in business process outsourcing and the US in IT.

FDI inflows from less developed countries have been less sizeable but more diversified than developed countries' investments in Mauritius. For historical and cultural reasons, India has been the largest investor among developing countries, with investments in a broad range of sectors, including textiles and clothing, telecommunications, hotels and banking. South Africans have invested mainly in the last two sectors, and, in recent years, increasingly in large-scale IRS (property development) projects. The United Arab Emirates, virtually absent on the investment scene until recently, has emerged as an important investor, mainly in the tourism industry. Chinese investments have been small and irregular but this is bound to change with the setting up of a $500 million industrial zone in Mauritius, fragments of which have already started to flow in.

The above analysis suggests a high degree of concentration in a few FDI source countries and in a few sectors of economic activity, reminiscent of Mauritius' concentration in export markets and products. Not surprisingly, there is a high correlation between Mauritius' trade partners and its FDI sources. The EU and the US are Mauritius' main export destinations, and they also are its biggest investors. Among the developing countries, India and South Africa are the second and fourth most important sources of imports; they are also significant sources of direct investment. China, which is Mauritius' second largest supplier, is poised to assume an equally important role as an investor in Mauritius in the coming years.

Table 3: Mauritian FDI by Countries 2000 – 2009(Rs. millions)

Region/Economy	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Developed Countries	7221	318	468	406	1548	1807	5505	8316	5740	796
Europe	7219	315	440	369	1029	1732	5338	5936	4676	709
European Union 15	7219	313	440	369	1027	1729	5267	5884	4353	640
Belgium/Luxembourg		10			59	404	81	447	285	23
Luxembourg					29	369	34	69	209	15
France	7214	25	234	157	491	427	523	1176	1167	325
Germany			5		95	46	177	59	172	6
United Kingdom			158	172	143	579	3821	2802	2044	93
Other Developed Europe	5	278		2	42	148	586	1287	606	123

Switzerland	5	278		2	42	148	586	1287	606	123
North America	3	3	29	37	518	75	167	2380	1063	87
United States	3	3	29	37	518	75	163	2380	1063	86
Developing Economies	43	600	416	1498	218	987	1685	3196	5679	542
Africa	32	600	336	1197	32	162	296	1124	1929	160
Other Africa	32	600	336	1197	32	162	296	1124	1929	160
Reunion	30			174	5	130	127	577	49	3
South Africa	1	600	336	1022	19	27	38	498	1415	46
Latin America and the Caribbean					16	34	45	25	552	7
South and Central America					13	4	13		457	7
Asia and Oceania	11		80	301	170	791	1344	2047	3198	375
Asia	11		80	301	164	790	1322	1971	3180	373
West Asia	11		8	45	11	24	998	1285	937	153
United Arab Emirates	11		8	45	11	9	114	1285	847	153
South, East and South-East Asia			72	247	153	766	246	669	2126	220
China			18	33		38	6		78	171
Hong Kong, China			9		4	7	30	18	8	
India			2	143	149	670	160	610	1921	49
Total World	**7265**	**936**	**979**	**1966**	**1797**	**2807**	**7222**	**11514**	**11419**	**1138**
Exchange Rate	26.25	29.13	30.11	28.48	28.021	29.83	31.829	31.75	31.785	31.89
In US Dollar (million)	**276.72**	**32.13**	**32.51**	**69.02**	**64.14**	**94.11**	**226.9**	**362.59**	**359.26**	**41.96**

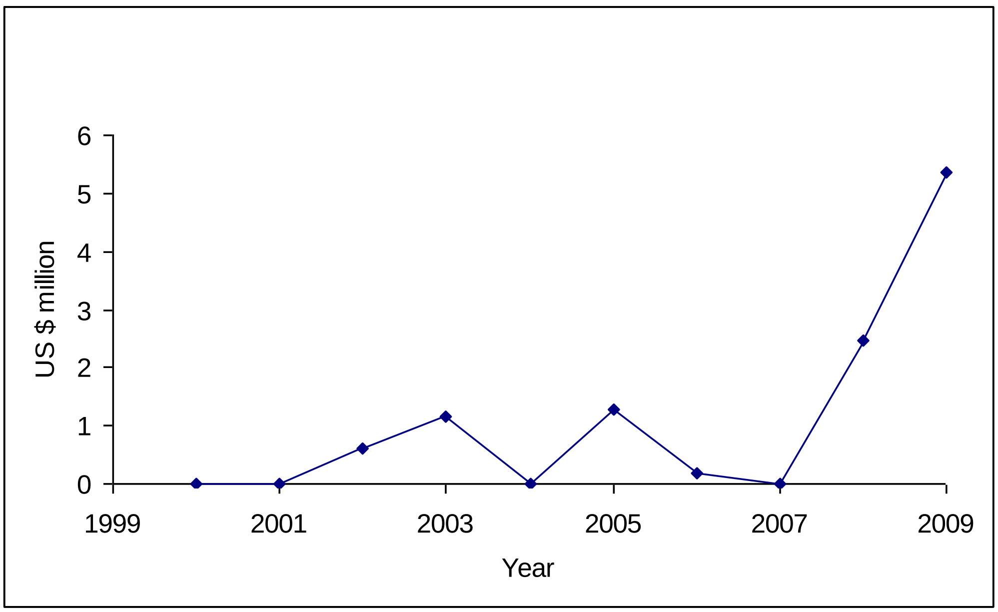
Note: Figures for 2009 is for January to March
Source: Bank of Mauritius

2.2.4 Mauritius-China investment relations

Chinese investments in Mauritius

Figure 4 shows China FDI inflows to Mauritius from 2000 to 2009. There is a clear pattern emerging: Chinese FDI is irregular and one-off. Prior to the period under investigation, Chinese FDI to Mauritius was minimal. For example, no Chinese FDI was recorded during 7 years in a row from 1995 to 2001. From 2002 to the first quarter of 2009, China invested some US $11 million in Mauritius, which is more than four times the amount invested over the entire preceding decade. Chinese FDI from 2001 to 2004 was mainly in the construction industry while Chinese FDI in 2005 has flowed into the textile industry, more precisely into spinning operations.

Figure 4: Chinese FDI in Mauritius (2000 – 2009)



Source: Bank of Mauritius

Figure 4 shows a hike in Chinese FDI for the last two years since 2007. This is the result of the launch of the Jin Fei project, a major Chinese industrial zone in Mauritius. The project, initially named Tianli, will attract Chinese investments from a consortium of Chinese private firms and state-owned enterprises in emerging industries such as light processing, pharmaceuticals, and the seafood hub. The SEZ in Mauritius is the second of its kind to be set up across the African continent following the one established in the Zambian mining town of Chambishi in February 2009.

China's decision to set up the SEZs – of which it boasts over a hundred back home, and which have proved effective clusters for fostering innovation and synergies in a particular industry – reflects an appreciation by the Chinese government that most of Africa now present a host of domestic conditions conducive to FDI. It appears that three objectives underpin China’s SEZ strategy in Africa. First, China wishes to penetrate local African markets with a view to exploiting fully the untapped potential, especially as the purchasing power of African consumers is expected to continue to increase thanks to sustained economic growth and rising per capita incomes. It is precisely for this reason that China is strategically contemplating Nigeria and Egypt, two of Africa’s largest markets, as potential hosts of the remaining SEZs. China exported close to US$50 billion in goods to Africa in 2008. Some of these exports could better be produced closer to their markets.

Second, Chinese investments are also largely resource-seeking. This is certainly the case with FDI in oil-rich Angola and Nigeria and in copper-abundant Zambia. Less visible though are Chinese investments in leather tanneries and shoe production in Ethiopia, and in Ghana’s processed fish industry, capitalizing on these country’s long-standing comparative advantages in the respective sectors. With the SEZs, China will be able to better exploit Africa’s natural resources in the production of goods destined for both the African market and beyond as well as opening up a more efficient conduit for routing these resources to mainland China to sustain the growth momentum back home.

Third, China wishes to develop logistics in Africa. This strategy explains China’s financing, and active engagement in the execution, of a number of infrastructure projects across Africa. The SEZ in Zambia, for example, will develop a cluster of firms producing bars, wires and cables from copper, nickel and other metals (Brautigam, 2009), part of which will feed into Chinese industrial production elsewhere on the continent. In the process, Chinese investments are allowing African countries and firms to travel further down the supply chain – from mere extraction of resources to higher value-added processing. The SEZs are also meant to provide a framework for smoothing the uncertainty and risk associated with investing in Africa, thereby encouraging hesitant investors to join the bandwagon.

Mauritius neither has natural resources nor a large local market to exploit. Moreover, production costs in Mauritius are high, work ethics in the EPZ weak, labor generally scarce and labor productivity stagnant in recent years. Most, if not all, of the African countries earmarked to host the Chinese SEZs (Algeria, Egypt, Ethiopia, Nigeria and Zambia) are more cost-competitive than Mauritius and boast several other alluring advantages. Thus, the question remains as to why China chose Mauritius to host the very first of its foreign SEZs. The answer lies in a careful analysis of Mauritius’ reputation as an FDI host. Mauritius offers a permissive investment framework and the right set of conditions, including strong macroeconomic fundamentals, political stability, rule of law, and good, reliable and extensive infrastructure. These factors offer a counterweight to Mauritius’ poor cost-competitiveness, which is further compensated for by the range of alluring fiscal and other incentives that the country offers to foreign investors. In the case of China’s Jin Fei project, these ‘perks’ arguably went beyond the official, with the government making numerous concessions – many controversial – to its Chinese counterpart.

Moreover, the location of Mauritius, situated in the Indian Ocean between Africa, Asia, and Australia, offers a strategic business base for both regional and international trade. Chinese companies can use Mauritius as a platform to tap regional markets through the country's membership of the Southern African Development Community (SADC) and the Common Market for Eastern and Southern Africa (COMESA), which offers preferential access to a market of 380 million consumers.

China's choice may also be motivated by geopolitical considerations. Several of the economic powers already have strategic partners in the Indian Ocean. For example, France has Reunion Island as its *département outremer* and the UK and USA have military bases on the island of Diego Garcia. The Indian Ocean has become a maritime corridor of great importance with the economic emergence of China and India. Having Mauritius as economic partner will allow China to access and exploit the maritime zone of Mauritius and maintain a strategic presence in the region.

Chinese FDI inflows

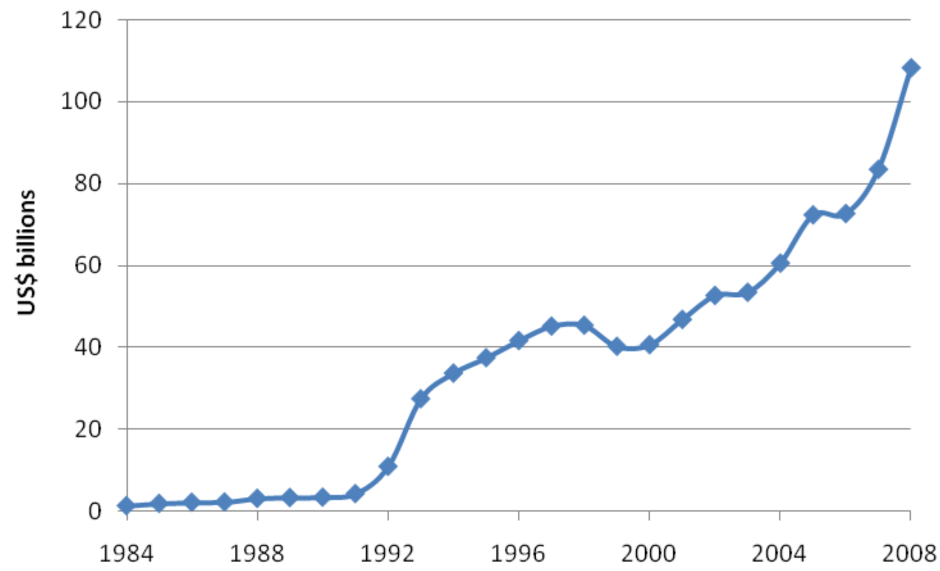
In 2008, incoming FDI in China amounted to US$108.3 billion, about 30 percent higher than in the previous year. Moreover, the latest figures suggest that FDI inflows have proved fairly resistant to the financial crisis. While investment flows fell steadily in the first half of 2009, they have recovered towards the end of the year, and China is now poised to attract FDI flows higher than the pre-crisis levels. China is the world's fifth largest FDI destination after the United States, the United Kingdom, France, and the Netherlands (UNCTAD, 2009).

Figure 5 shows the trends in China's inward FDI flows over the period 1984-98. Three distinct patterns can be discerned from the graph. FDI started to flow into China – mainly from neighboring Hong Kong – following the launch of special economic zones in the early 1980s. While FDI flows grew steadily during the 1980s, they remained low by today's standards. It was not until the government called for greater spurts of FDI to drive China's economic transformation and relaxed restrictions on equity participation – allowing foreign companies to set up wholly-owned subsidiaries – that FDI really took off. This is clear from Figure 4: FDI increased sharply after 1992 and continued on an upward trend throughout the 1990s.

The third phase can be pinned to China's accession to the WTO in December 2001. This process signaled an unprecedented opening up of the Chinese economy, which coincided with the government's effort to promote private initiative. This positive turnaround led to massive flows of FDI, which continued unabated until the onset of the financial crisis. FDI flows fell sharply in the first half of 2009 but, according to reports (in the absence of official data), the year nevertheless ended on a positive note.

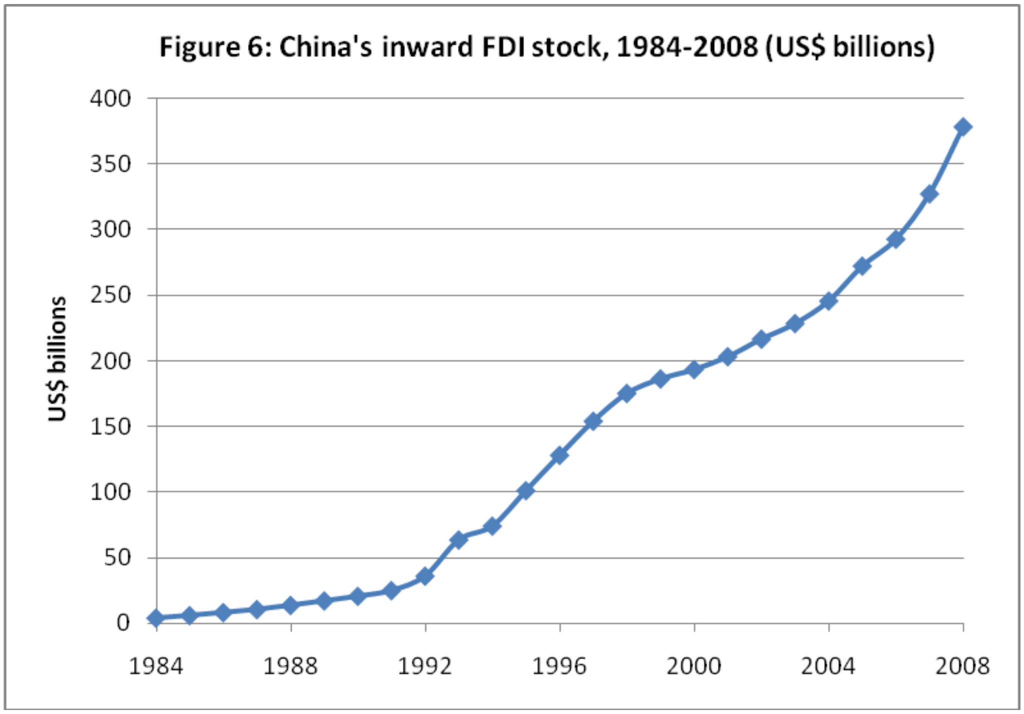
China's FDI originates mainly from the region itself. Hong Kong is, by far, the biggest investor in China, followed by Taiwan and Japan. Outside of East Asia, major companies from United States, UK, Germany and France also have a significant presence in China. FDI through wholly-owned subsidiaries have emerged as the main channel of investment in China in recent years; yet joint ventures outnumber other types of ownership, including cooperatives. Most of the FDI has been Greenfield, has occurred in China's manufacturing sector and is primarily export-oriented. Indeed, FDI has played a crucial role in China's export development. It directly accounted for 55 percent of China's exports in 2003, a share that has steadily increased over the years, and is likely to have exceeded the 60-percent mark at the end of 2009.

Figure 5: FDI inflows in China, 1984-2008 (US$ billions)



Source: UNCTAD (2009)

China's inward FDI stock was estimated at US$ 378 billion as at end-2008. The upturn in the trend and the further spaced-out scatter points in recent years (in particular, after 2004) show the increased dynamism of China as an FDI destination.



Source: UNCTAD (2009)

Mauritius FDI in China

With the Double Tax Avoidance Agreement (DTAA) between China and Mauritius (signed in 1994), followed by an Investment Promotion and Protection Agreement (in 1996), Mauritius has a major chance to become a hub for both inbound investment from, and outbound investment to, China. A Mauritian holding company (MHC) can benefit from a wide range of incentives for doing business in China. These include a range of fiscal incentives such as low tax rates and maximum applicable tax holidays; presumed foreign tax credits for MHCs, resulting in an effective tax of 3 percent in Mauritius; tax refunds on reinvested dividends; and tax-efficient lease financing facilities. Mauritian investors can also benefit from efficient disposal of interest in Chinese-held companies by MHCs and from facilities for licensing and franchising. In addition, any project physically carried out in China for a period of up to 12 months does not constitute a permanent establishment and is not subject to taxation. For consultancy projects, the grace period is 24 months.

These incentives have proved a catalyst in driving Mauritian FDI to China, which increased from US$119,000 in 1994 to US$1.5 billion in 2008. This phenomenal increase in Mauritius' outward investment in China has propelled Mauritius into the ranks of the top ten largest sources of FDI into China. In 2008, Mauritian FDI accounted for 1.62 percent of China's total FDI inflows. The recent hike is attributed to the investment activities of a major company, namely Compagnie Mauricienne de Textile International Trading Ltd, which is case studied below.

Box 1
Case Study: The Compagnie Mauricienne de Textile (CMT)

Established in 1986 by Francois Woo and Louis Lai Fat Fur, the Compagnie Mauricienne de Textile (CMT) portrays an exceptional success story in the Mauritian textile sector. What started as a small business employing 20 workers at its beginning, the CMT has grown into an industrial giant, employing over 10,000 people. Furthermore, the company's operations were hardly affected by the 2009 financial crisis. With economic recovery in sight, CMT is likely to grow further, especially thanks to recent plans for the setting up of a new spinning factory.

CMT's success lies in the fact that the company broadened its horizon to emerge as an active player in the global scene. CMT International Trading (CMTIT) Ltd was incorporated as a Freeport Company in Mauritius in 1995 and started its Freeport activities in January 1996. From its Head Office in Mauritius, CMTIT controls operations in its numerous regional subsidiaries. Indeed, its branches in Zimbabwe (CMTI Zimbabwe (PVT) Ltd), Madagascar (Madatrade Sarl, Madakem Sarl & Plasmad Sarl), China and Hong Kong allow distribution of its wide variety of products over the region. This international network has always been one of the key strengths of CMTIT Ltd as it helped to provide a better and quicker service to customers.

When China emerged as a major competitor to the Mauritian textile and clothing industry, instead of adopting defensive strategies, the CMT promptly invested US$ 65 million in the construction of an integrated production unit in China in 2005 to exploit China's large pool of cheap and adaptable labor, which constitutes its rivals' very competitive advantage. The China office of CMTIT Ltd currently boasts a well diversified range of manufactured items – such as lights and lighting, machinery, office supplies, tools and hardware, and toys – on top of a variety of textile products. The business continues to grow as the unit today employs more than 1000 workers.

Source: Company reports and interviews

2.3 Aid Analysis

Aid can easily be confused with FDI, especially when aid is directed to infrastructure projects or to construction. This confusion often arises from China's financing of numerous infrastructure projects throughout Africa, and is aided by media reports that talk of such financing as FDI. However, there should be no room for confusion if one keeps to the definitions of FDI and aid. FDI results in an equity stake by the investor in the project. This is clearly not the case in large infrastructure projects such as roads, dams, stadiums and buildings where Chinese involvement is limited to financing.

Moreover, there is an ongoing debate on the bundling of Chinese aid with FDI in Africa. This debate is fuelled by the lack of transparency surrounding Chinese aid – including both aid figures and the real motivations behind specific aid projects. Brautigam (2009) argues that Chinese aid has served both as a "tool of diplomacy" and "an instrument to meet political, strategic, and economic goals". It is conceivable that much of the Chinese aid in Africa, especially in the earlier years of China's involvement in Africa was driven by its desire to win over African countries to its political side in the conflict with Taiwan. Later, China preached cooperation for mutual benefit in its aid relations with Africa, and this translated into several aid projects shifting to technical cooperation upon completion.

During the 1980s and early 1990s, the philosophy guiding Chinese aid to Africa was 'cooperation for mutual benefit' (Brautigam, 2009, p. 203), which some may interpret as 'business as usual'. The bulk of aid during this period was tied to the purchase of Chinese goods and services (equipment, materials and energy). More recently, China's policy of aid to Africa has been guided by its silent – and often denied – ambitions of a dominant economic power on the global scene. And China has largely delivered on its aid promises made at the Beijing Summit in 2006. These pledges, intertwined with promises of investment through a dedicated fund and in the form of SEZs, among others, have further exacerbated the confusion between Chinese aid and FDI.

China has considerably scaled up its aid to Africa. Much of this aid has been in the form of technical assistance – with emphasis on advanced training in Chinese institutions –, grants, interest-free loans, preferential loans and debt relief. It is estimated that China's financial assistance to Africa amounted to some $19 billion at the end of 2006. Most of this assistance has been for major projects in energy, telecommunications and transportation. Aid has also been channeled for infrastructure development and for the social sector: China has helped build roads, houses, and hospitals. Invariably, the biggest beneficiaries have been the oil-rich countries of Sub-Saharan Africa, namely Angola, Equatorial Guinea, Gabon, Republic of Congo, and Nigeria.

Chinese aid[2] to Mauritius has not followed the typical African pattern. Mauritius' long-standing cultural and diplomatic ties with China due to the presence of a Chinese

[2] Chinese "aid" data should be interpreted with caution. The OECD's DAC defines aid as loans, grants and associated financing packages with a grant element in excess of 25 percent. The available data on Chinese

diaspora, the country's lack of exploitable natural resources, its strong democratic tradition, and its more advanced economy mean that aid could not be given on the same terms as other African countries. Table A.1 in the appendix provides a comprehensive list of projects that have been financed by Chinese aid.[3] On the whole, Chinese aid has been small relative to total ODA; however, it appears that, in recent years, such aid has become the main instrument of finance for several major projects (Table 4).

Table 4: Aid from China and ODA flows to Mauritius, 1972-2009 (US$ millions)

Year	Aid from China	Total ODA
1972	33.8	54.3
1985	11.9	64.1
1990	5.23	116.8
1991	6.2	89.4
1993	9.3	33.7
1997	13.2	56.0
1999	4.2	55.8
2000	2.4	29.4
2001	5.0	30.5
2002	29	33.7
2003	36.3	-17.7
2004	2.5	34.0
2005	5.0	33.6
2006	15.3	18.6
2007	111.6	68.5
2009	3647.3	117.5

Source: OECD and Ministry of Finance (Mauritius) records.

Chinese aid has been largely project-based and, as such, irregular; the amount given in aid has varied considerably over the years and across projects. Most of the projects financed have been in the areas of construction and social services, including the construction of a football stadium, a marketplace, and a recreational center; upgrading of a hospital; and various low-cost housing projects. Significantly, China loaned RMB Yuan 95 million (about US$4.2 million) to finance the acquisition of a passenger-cum-cargo vessel – the second of its kind – in 1999.

Since 2000, Chinese loans to Mauritius have become more frequent, and since 2007, more sizeable, totaling some US$3.75 billion, well above ODA flows. These loans have

"aid" to Mauritius does not always clearly state the nature and proportion of the grant element. Hence, strictly speaking, such aid does not conform to the official definition of aid. This should be kept in mind while assessing Chinese aid, whether independently or in relation to ODA.

[3] Data on aid is not available by recipient sector, and it has proved tricky to assign the available aid data to specific sectors.

financed large-scale projects, including the construction of the new headquarters of the Mauritius Broadcasting Corporation, the national radio/TV station; expansion of wastewater networks; modernization of the port; construction of dams; and development of a new city. In 2009, Mauritius contracted two of the biggest loans yet to finance major infrastructure works designed to ease traffic around the capital city (about US$830 million) and to build a modern airport terminal (US$260 million).

A key feature of Chinese aid to Mauritius is that most of the loans provided have been on concessional terms, with generous grace periods and repayment schedules. Grants have been few, generally limited to capacity building – both human and technical – and much smaller in amounts. Virtually no conditions have been attached to Chinese aid to Mauritius (as elsewhere). This lack of conditionality has often been criticized on the grounds that it could delay reforms in the recipient countries (Zafar, 2007). Such concerns, however, have little relevance for Mauritius given the country's long-standing tradition of democracy and the current government's commitment to macroeconomic reforms.

While the absence of conditionality can be a welcome relief, China-financed projects have, on the downside, had smaller multiplier effects on the local economy because of their excessive use of Chinese labor and inputs. A potentially more important problem that has received little attention in discussions of the consequences of Chinese aid is the risk of bid-rigging in China-financed project tenders. Lines of credit provided by the Export-Import Bank of China often require that the tenders for the project be open exclusively to Chinese contractors. Armed with this knowledge, these firms, in turn, bid high, which often results in the project incurring a cost overrun. Mauritius fell prey to this kind of collusive bidding when it called for tenders for the construction of a 22-kilometer long road in 2007. The first phase of the project was estimated to cost Rs 1.2 billion (about US$ 40 million), to be financed by a loan contracted by the government with China's EXIM Bank. However, a condition attached to the loan was that the project should be undertaken by a Chinese firm. When tenders were opened in late 2008, it was noted that the lowest bidder had bid Rs 2.8 billion, more than twice the original cost estimate. Amid strong protests, mainly from the Opposition, the government agreed to re-open discussions with its Chinese counterparts. However, failing to get a fair deal, the government finally cancelled the Chinese loan and approached the French AFD for financing.

The above story is rather atypical of Chinese firms, which are known for their competitive bidding. In this case, however, their behavior was anti-competitive, and it could have forced significant losses of taxpayer's money in Mauritius if not averted in extremis.

2.4 Investment Climate

Investment Climate in Mauritius

Mauritius espouses a permissive investment regime that has constantly evolved since the EPZ Act of 1970. Before the advent of the Business Facilitation Act (BFA) in 2006, the FDI regime was complex and burdensome. There was a wide array of sector-specific incentives and administrative requirements imposed considerable hassle costs on potential investors. Although the Board of Investment, established in 2001 to serve as a dedicated investment promotion agency, has implemented a one-stop shop to facilitate FDI, the laws and regulations governing investment by foreigners continued to delay the process of obtaining an investment permit until the promulgation of the BFA.

The BFA brought about far-reaching reforms aimed at remedying macroeconomic imbalances, opening up the economy, facilitating business, improving the investment climate, and mobilizing foreign direct investment and expertise. The Act as well as the accompanying Finance Act 2006 led to amendments in or repeal of numerous Acts as layers of bureaucracy were eliminated. The BFA made it technically possible for a business to start operations – within 3 working days of submitting an application for a permit – on the basis of self-adherence to established guidelines and ex post control.

All incentive schemes established under the Investment Promotion Act 2000 (with the exception of the Integrated Resort Scheme) were repealed in 2006 as incentives were harmonized across sectors and between domestic and foreign investors. However, specific incentives to promote and protect investment in spinning, knitting, weaving, and dyeing are being retained until 2016. Such investments have been critical in building a vertically integrated clothing industry, capable of satisfying rules of origin, especially for exports to the US under AGOA, and generating high value addition.

The corporate tax rate has been progressively reduced from 25 percent to 15 percent between 2005 and 2007. As of July 2008, 20 different schemes spanning all the major sectors of activity were operational. Most of these schemes are aimed at attracting export-oriented investment and promoting exports of manufactured goods. They offer a common package of fiscal incentives, including, in addition to a flat 15 percent corporate tax rate, duty and VAT exemption on raw materials, inputs and equipment. UNCTAD (2001), in its review of Mauritius' investment policy, concluded: "Mauritius presents an attractive low tax regime for FDI in areas where it is welcomed."[4] The FDI regime has surely become even more appealing after the sweeping tax and administrative reforms brought about by the BFA and the Finance Act in 2006.

Mauritius has a strong record of public security and political stability in the democratic tradition. In addition, the laws of Mauritius protect foreign investors against expropriation and other risks. With the lifting of all forms of exchange controls in 1994, investors are guaranteed free and unlimited repatriation of their capital upon cessation of business. The World Bank Doing Business Survey 2010 ranked Mauritius 12th in protecting investors, ahead of many industrialized countries. Mauritius has signed double-taxation avoidance treaties with 33 countries and investment promotion and

[4] UNCTAD (2001), p. 23.

protection agreements (IPPAs) with 16 countries.[5] One of the latest countries to join this club is the United States, with which Mauritius concluded a Trade and Investment Framework Agreement in 2006. Negotiations are under way with several other countries.

When the Government announced the measures contained in the BFA during the 2006/07 Budget Speech, it stated that the aim was to place Mauritius among the top 10 on the World Bank's 'Ease of Doing Business' list. It appears that Mauritius is on course to achieving the set objective. Mauritius moved up 7 spots on this list, ranking 17th in 2010 (and first among SSA economies) compared to 24th the preceding year. Significantly, the country ranked 10th in the "Ease of Starting a Business" category, which confirms the effectiveness of the reforms brought about by the BFA in 2006.

However, important challenges remain. Mauritius was sanctioned with a shameful 87th spot on the "Ease of Getting Credit" indicator, tying with countries like Cambodia, Malawi and Tanzania, with very low overall rankings. This result is not surprising since available evidence confirms that small businesses face severe constraints in obtaining credit through official channels, and that the various government schemes designed to financially assist SMEs have not delivered because of the strict requirements they impose on applicants (see Ancharaz, 2010). Mauritius also received poor scores for registering property, enforcing contracts and closing a business down. Government efforts in the future should be directed to improving these indicators.

Investment Climate in China

The World Bank's Doing Business Report 2010 ranked China 89th in the world in the ease of doing business. In its 2008 Statement of Investment Climate in China, the U.S. Department of State noted: "Investors continued to face a lack of transparency, inconsistently enforced laws and regulations, weak IPR protection, corruption, industrial policies protecting local firms, and an unreliable legal system incapable of guaranteeing the sanctity of contracts."[6] Despite these challenges, however, China remains an attractive FDI destination for multinationals seeking to restructure their global value chains for greater competitiveness. For example, the US Chamber of Commerce reports that American firms' operations in China are more profitable than they are in the United States.

China has implemented significant corporate tax reforms and has engaged in the process of rationalizing its complex system of incentives with a view to complying with WTO requirements for a unified trade regime. However, these reforms have fallen short of addressing a number of weaknesses that foreign investors frequently complain about. Starting a business is ridden with complex, and often inconsistent, bureaucratic procedures that add to the hassle cost of doing business in China. Dealing with construction permits, hiring workers and even paying taxes are particularly difficult.

[5] These treaties and agreements are currently in force. Mauritius has signed IPPAs with 17 other countries but these have not been ratified yet.

[6] See http://www.state.gov/e/eeb/ifd/2008/103668.htm

China scores very low on each of these counts in the World Bank Doing Business ranking. In 2007, China has adopted new laws and regulations to boost continuing inward investment.

The Chinese government announces its FDI objectives, regulations and procedures through its official medium, the Foreign Investment Catalogue. The catalogue lists all the sectors in which FDI is encouraged, permitted, restricted or prohibited and spells out sector-specific restrictions in terms of foreign ownership and permissible types of investment. China emphasizes a "fundamental shift" from "quantity to quality" of FDI flows by 2010, and actively seeks FDI in higher value-added sectors such as high-tech research and development, advanced manufacturing, energy efficiency, and modern agriculture and services, rather than in basic manufacturing. On the other hand, FDI is prohibited in sectors like the media, basic education, mining and processing of certain minerals, processing of green and 'special' tea using Chinese traditional crafts, and preparation of Chinese traditional medicine. It transpires from the Catalogue that China practices the same heavy-handed approach to FDI that it is often blamed for in the domain of trade and industrial policy.

China offers various incentives to companies investing in its special economic zones, provided that the foreign equity stake is no less than 25 percent. These include reduced corporate taxes, better infrastructure, lower export and import duties, free ports and bonded zones. FDI in priority sectors also benefit from fast-tracked processing and special preferences (though these are not clearly stated). In 2008, the Chinese government fixed corporate tax rates for both foreign and domestic firms at 25 percent, following a transitional adjustment period. However, it maintains lower rates of 20 percent and 15 percent for eligible small enterprises and high-tech companies, respectively.

China has gradually relaxed foreign exchange regulations facing foreign-invested firms and, in principle, allows liberal access to foreign exchange for current account transactions. However, capital movements are strictly controlled, especially in recent years, as China has tightened restrictions on capital inflows and eased capital outflows with a view to rectifying the large and growing payments surplus. Chinese law prohibits nationalization of foreign-invested enterprises. Significantly, no foreign-owned assets been expropriated since reforms began in 1979. Nevertheless, the legal system is complex, often contradictory, with several grey areas and poor enforcement, resulting in an investment climate steeped in risk and uncertainty. Indeed, China scores very low in terms of protecting investors, ranking 93rd in the World Bank's Doing Business rankings. Moreover, China remains a very challenging environment for IPR protection and enforcement, with several industry associations, especially those representing software, entertainment, and consumer goods, reporting high levels of piracy.

Bilateral investment agreements can offer foreign investors some re-assurance in the face of the challenges presented by the Chinese FDI regime. China has signed BITs with 121 countries – more than any other developing economy – including most of its major partners. These agreements cover expropriation, arbitration, most-favored-nation treatment, and repatriation of investment proceeds. Negotiations on a BIT between China and the United States started in 2006 but have made little progress so far. Nevertheless, China has signed a Double Taxation Avoidance Treaty with the United States, and a number of other countries.

To conclude, while China has adopted important reforms to bolster its FDI regime, major weaknesses persist. Significantly, China slipped down 3 spots relative to the previous year in the 2010 World Bank's Doing Business survey, scoring very low in such areas as starting a business, employing workers, protecting investors and paying taxes. Conversely, China was credited with a commendable 18th position on the 'enforcing contracts' indicator, this contrary to the common claim that the Chinese are "incapable of guaranteeing the sanctity of contracts" (US Department of State, 2008).

Table 5 summarizes the key features of the FDI regimes of Mauritius and of China.

Table 5: Key features of the Mauritian and Chinese FDI regimes

FDI policy/ incentive	Mauritius	China
World Bank 2010 Doing Business Rankings (select indicators)		
Doing Business	17	89
Dealing with construction permits	42	180
Registering property	66	32
Getting credit	87	61
Protecting investors	12	93
Enforcing contracts	66	18
Foreign exchange policy	• Foreign exchange controls abolished in 1994. • Free, unlimited repatriation of profits, dividends and capital gains. • Full convertibility on both current and capital accounts	• Gradual loosening of foreign exchange regulations. • Easy access to foreign exchange for current account transactions • Tight restrictions placed on capital movements (especially outward)
Expropriation	• Legislative guarantees against nationalization	• Nationalization of foreign-invested enterprises prohibited under Chinese law. • Compensation prescribed by law in case of expropriation, but grey areas surround calculation. • Generally poor enforcement of laws, resulting in risky investment environment.
Protection of Property Rights	• Intellectual property rights protected by the Copyrights Act of 1997 and the Patents, industrial Design and Trade Marks Act of 2002. • Mauritius is a member of WIPO and party to the Paris and Bern Conventions	• The Chinese legal system mediates acquisition and disposal of property rights • Two significant limits on the property rights, namely on land and IPR. • China is a member of WIPO, Paris and Berne convention, Geneva Phonograms, and Universal Copyright Convention
Facilitating foreign investment	• Simple and easy administrative procedures to set up business in Mauritius following far-reaching reforms brought about by the Business Facilitation Act 2006	• Complex, bureaucratic, nebulous, and often inconsistent regulations and procedures, governing FDI.
FDI incentives	Mauritius offers a low tax jurisdiction: • Corporate and income tax of 15%; • Tax-free dividends and no capital gains tax; • Up to 100% foreign ownership and no minimum foreign capital requirement; • Exemption from customs duty on raw materials and equipment.	China offers incentives to FIEs investing in SEZs: • Lower corporate tax rate of 25%; lower rates for eligible small and high-tech companies; • Better infrastructure, free ports and bonded zones; • Reduced export and import duties.
Bilateral Treaties	• Double taxation avoidance treaties signed with 33 countries • IPPAs with 16 countries, including the US	• BITs signed with 121 countries. • Negotiations for a BIT with the US ongoing.

3. Literature Review

3.1 Theoretical Review

There exists no unified theory of FDI. Instead, the theoretical literature is choked with an array of hypotheses drawing heavily on theories of imperfect competition and market failure to explain the FDI phenomenon. These hypotheses find their roots in Hymer's (1960) seminal work, refined and publicized by Kindleberger (1969), but they emerged in a more consistent manner from Dunning's (1977, 1979) "eclectic approach." Essentially, this approach seeks to explain the motives for international production, and thus FDI, in terms of the ownership advantages of multinational firms, the desire to "internalize" these advantages, and the locational advantages of the host country. Ownership advantages are factors that enable the firm to overcome the handicaps of producing in an alien environment, such as differences in language and culture, legal systems, tax regimes and access to inputs. These "firm-specific" advantages include superior technology, management and marketing skills, which help the multinational differentiate its product successfully. This competitive advantage is usually created through substantial investments in advertising and in research and development.

But ownership advantages do not, of and by themselves, justify foreign production. They only suggest that the firm commands a competitive edge in a foreign market, which can be exploited in several ways other than through the establishment of foreign subsidiaries. For instance, the firm can simply sell part of its domestic output to the foreign market. Indeed, exports would be a more attractive avenue to the extent that they avoid the difficulties of operating a plant in an unfamiliar territory. Thus, a firm's decision to set up production facilities abroad can only be explained by the locational advantages offered by the host country that significantly offset the usual handicaps of offshore production. These advantages typically derive from lower costs of production, which reinforce the multinational's initial competitive advantage. The availability of a pool of cheap labor is an important factor, especially for labor-intensive operations, but the generous tax holidays and duty concessions typically offered by developing country governments as part of an incentive package to attract FDI cannot be ignored. Locational advantages may also result from trade barriers (including transport costs) that make it difficult to export to the country.

An alternative – and perhaps more practical – classification of the host-country determinants of FDI distinguishes between business facilitation measures, the policy framework for FDI and economic determinants. Business facilitation measures include investment incentives, measures directed at reducing the hassle costs related to corruption and administrative inefficiency, and social amenities. Policy determinants of FDI comprise policy and political stability, rules relating to FDI, international agreements on FDI, and privatization, trade and tax policies. The economic determinants are further categorized into market-seeking (market size and growth, market structure, access to regional markets), resource-seeking (availability of raw materials, labor, physical infrastructure) and efficiency-seeking (cost of resources, labor productivity).

3.2 Empirical Review

The increase in multinational activity since the 1990s has spawned renewed interest in research into the drivers of FDI, both because of its sheer volume and its rather different character. The world inward FDI stock has increased over 7-fold between 1990 and 2008, growing at an accelerated pace in recent years. A significant part of these FDI flows is of the vertical type, and has been driven by the need to strengthen the multinational firm's core competencies by allowing it to shift areas of declining comparative advantages to offshore locations.

China figures prominently in the global FDI trends since "Chinese enterprises are at the forefront of becoming major foreign direct investors in Asia and beyond".[7] The Chinese FDI impetus is due to a combination of government support and openness along with locational advantages such as cheap labor and raw materials. China is also an attractive destination for market-seeking FDI due to its large and growing economy and rising purchasing power. These determinants – featuring both push and pull factors – have been investigated extensively. Here, we focus on the empirical evidence on drivers of Chinese outward FDI. Our review of the literature identified three such studies, all of which are recent and use panel data estimation. However, the results are rather mixed.

Using panel data on Chinese FDI to 41 countries over the period 1984-2001, Buckley *et al* (2007) examine variables such as institutional quality, natural resource abundance, market size, trade intensity, geographical distance and cultural proximity to China, among others, as potential determinants of Chinese investment abroad. The results are generally sensitive to the period under consideration. For example, poor institutions (proxied by an index of political risk) and natural resources (measured by the share of minerals in merchandise exports) are both statistically significant in the sub-sample period 1992-2001 but not in the full sample. The authors conclude that the flow of Chinese FDI to countries with poor institutions but abundant natural resources is a recent phenomenon. The evidence also suggests that host countries with larger domestic markets (measured by the size of GDP), higher inflation, greater openness and closer cultural ties with China tend to attract more substantial flows from China. Fung and Garcia-Herrero (2008) provide further evidence in support of the market-seeking motive. Additionally, and controversially, they find that China's investments tend to flow to destinations with poor labor quality.

The finding that Chinese FDI has flowed to countries with high rates of inflation is rather surprising since inflation – both because it signals macroeconomic instability and poor cost competitiveness – is likely to deter, not attract, inward FDI. However, this particular result could be the incidental outcome of Chinese FDI in some of the oil-rich countries of Africa, such as Angola, which are notorious for high and persistent inflation. This confirms that Chinese resource-seeking FDI conforms little to the behavior of FDI generally – a hypothesis that is also supported by the finding that poor institutions have mattered little in Chinese FDI decisions.

[7] Karl Sauvant, Director of UNCTAD's Investment Division. Quoted from Matt Pottinger and Owen Brown, "Shares in Chinese Companies May Not Gain a Major Push", *Wall Street Journal*, March 11, 2010.

The study by Habib and Zurawicki (2002) sheds some light on the perverse association between Chinese FDI and host-country institutional quality. The authors claim that greater absolute differences in corruption have a negative impact on bilateral FDI from China, implying that China is more likely to invest in equally corrupt countries as itself. A further implication is that the institutional setting in China may be an important determinant of the sectors and countries it invests in. Several studies argue that the organization of Chinese companies and the economic and political backing they receive from the government have led them to take excessive risks, in utter disregard of the quality of institutions in target countries (Yeung and Liu, 2008; Morck et al., 2008; Buckley et al., 2007).

However, the study by Cheung and Qian (2008) rejects some of the above findings. While they find that Chinese FDI has generally flowed to countries with abundant natural resources and large domestic markets (measured by absolute GDP levels), there is no evidence that countries with weaker institutions have attracted larger amounts of Chinese investment. One rather unsettling result is that GDP per capita, a measure of effective market size, seems to have repelled, rather than attracted, FDI. The authors provide no explanation for this puzzling result. Our hypothesis is that Chinese FDI, especially in Africa, is negatively correlated with the host country's level of development, which GDP per capita may actually be proxying for. This is evident in the fact that the Chinese have invested more in countries like Angola, Sudan, and Zambia than in countries like Botswana, Gabon, and Mauritius, Africa's middle-income economies.

In a panel study on 90 host countries, Cheng and Ma (2008) investigate a rather different set of determinants of Chinese outward FDI, focusing on such variables as cultural proximity and various geographical characteristics of host economies, including domestic market size. They exclude natural resources and institutions. Their panel regression estimates suggest that large markets, cultural proximity to China and congruency (that is, sharing a common border) tend to attract FDI whereas physical distance and landlockedness deter Chinese investment.

To summarize, the above empirical studies do not provide a clear picture of host country determinants of Chinese FDI. This ambiguity seems to have pervaded other, survey-based studies, as well. For example, according to a poll of Chinese enterprises in 2000, cheap labor in other developing countries was found to be the singular most important determinant of Chinese foreign investment.[8] However, the Asia Pacific Foundation of Canada reports that, in a 2005 survey, Chinese enterprises assigned a relatively low score to "access to low cost labor" as a driving factor in their FDI decisions.

4. Theoretical Framework and Methodology

Our prime objective is to assess the impact of Chinese investment on the Mauritian economy. To our knowledge, no formal methodology exists to guide us in this exercise.

[8] MOFTEC Offshore Plant Project (2000)

However, in keeping with the general spirit of the Jenkins-Edwards (2005) methodology, one can argue that any assessment of the economic effects of FDI should at least consider the impact on such variables of interest as employment, value-added, exports and growth. These effects can be direct or indirect, complementary or competitive, and they may be quantifiable to various degrees.

The most direct effects are likely to be on employment and income. Exports will also be affected to the extent that FDI is destined to serve foreign markets, as in the case of export-processing zones. Hamada (1974), in his pioneering analysis of the welfare effects of EPZs on the host economy, concluded that FDI into a duty-free zone in an economy with neoclassical features will lead to a loss of national welfare. However, this result rests critically on the assumption of full employment, which is unrealistic of developing countries.

In practice, most countries will benefit from FDI whether it flows into an EPZ or a non-zone sector. The net effects of FDI (Chinese or otherwise) will depend on the size and type of investment, the sector to which it is directed, the level of technological sophistication of the investment project and its capacity to create linkages with the domestic economy. Larger investment projects do not always have proportionately bigger impacts in terms of job creation, contribution to GDP and exports. For example, investment in the banking sector may create few jobs and may not bring much to an economy that already boasts advanced financial development, such as is the case in Mauritius. Similarly, investments in property development, which tend to come in rather large spurts, contribute little to the economic uplifting of a country in the short term.

FDI is likely to be most beneficial when it is Greenfield and export-oriented. If it is meant to serve the local market, then the investment should preferably be in sectors that the country is actively seeking to promote and should avoid direct competition with local producers. Moreover, FDI projects that generate knowledge spillovers and foster the development of backward and forward linkages with the domestic economy are particularly beneficial to the host country.

The indirect effects relate to long-term growth. Such effects are hard to detect, isolate and measure since they occur with unknown lags, are spread over several years, are buffeted by various other factors thereby reducing their significance in any given year, and are generated by spillovers that are inherently difficult to capture. Similar effects occur when FDI contributes to the emergence of industrial clusters, i.e., the agglomeration of certain industrial activities in a given area. Clustering may improve the supply of key inputs to firms in the cluster, entail better infrastructure and services, and strengthen external linkages through networking and technology sharing. All of these effects may contribute to economic growth over the long term.

FDI may also generate negative effects. Perhaps the one effect that has received the most attention in the literature is the risk of a Dutch disease induced by massive spurts of FDI in an otherwise foreign exchange-constrained economy. The resulting currency appreciation can erode the country's export competitiveness, leading to a loss of exports, while stimulating import demand, on the other. This combination of declining exports and rising imports can aggravate payments difficulties. Another adverse effect could arise if switching modes of supplying a local market from directly exporting to the country to setting up production units within its territory results in a greater competitive challenge to indigenous firms.

With Chinese investment, additional concerns are likely to arise since Chinese multinationals are known to use Chinese, rather than local, labor and inputs, which reduces the multiplier effect of any FDI project on the local economy. Similarly, since the Chinese favor wholly-owned enterprises and tend to be secretive about their processes and ways of doing business, the potential for knowledge or technology spillovers is greatly reduced. This hurts an important challenge through which FDI impacts on domestic economic growth.

In this study, however, we are unable to present an in-depth analysis of Chinese FDI in Mauritius both because investments from China have been historically small and irregular, and because we could not obtain detailed, firm-level data to gauge the real effects of Chinese investments in terms of job creation, value added and contribution to exports.[9] We managed to obtain some data on Chinese firms in operation in Mauritius from the local Chinese Embassy but these were not up to date. Hence, in what follows, we offer a rather descriptive analysis of data purged from various sources, and present a couple of case studies featuring major Chinese investment projects.

5. Empirical Analysis

Chinese FDI to Mauritius is mainly Greenfield, thus leading to the creation of new production capacities. Moreover, the Chinese subsidiaries are wholly foreign-owned and spawn a variety of sectors. There were nine Chinese-owned enterprises in operation in 2004 in such sectors as textiles, services, and construction (Table 6). The Chinese have invested in a small, inland hotel, in cotton spinning, garment-making and services, including financial and building services. However, most of these companies were defunct by 2008; only two firms are still in business, namely Hong Kong – Shanghai (Mauritius) Co. Ltd. and Tianli Spinning (Mauritius) Co. Ltd.

Table 6: Chinese Firms in Mauritius (2004)

Name of Firm	Sector
Yunnan International Economic and Technical Cooperation, Mauritius Chang Cheng Esquares Co. Ltd	Services
Beijing Zhuzong Group Co. Ltd, Mauritius Branch	Services

[9] It appears that the Board of Investment does not maintain a database of foreign investments in Mauritius, being more focused on marketing Mauritius as an investment destination rather than interested in research as such. Our attempts to elicit information on Chinese investments in Mauritius from the BOI were unsuccessful.

Mandarin Hotel Mauritius Ltd MCFI-SFB Co. Ltd	Tourism
Tianli Spinning (Mauritius) Co. Ltd	Textile
Hong Kong – Shanghai Knitting Factory Ltd	Textile
China National Overseas Engineering Cooperation Mauritius Office	Construction
Shanghai Foreign Service & Economic Cooperation Co. Ltd	Services
China International Water and Electric Cooperation	Energy
Zhongjiang International 1,500 Housing Project Office	Construction

Source: *Chinese Embassy in Mauritius*

Impact of Chinese FDI in Mauritius

It is difficult to assess the impact of Chinese investments in Mauritius in the absence of detailed data on the value of initial investment by each company, and subsequent investments (if any), the number of workers employed, turnover, and exports (if any). However, the Chinese firms of Hong Kong origin that relocated to Mauritius during the period 1984-1990 made significant contributions to the economy. Their activities are often credited for ushering in a period of sustained export-led growth in Mauritius, lasting at least a decade. Employment in the textile-dominated EPZ increased sharply from 27,428 in 1984 to 87,358 in 1990. During this period, exports increased more than five-fold and real GDP growth averaged about 7 percent annually. When the non-renewal of the third-country fabric derogation under AGOA in September 2003 and the specter of fiercer competition from China following the end of apparel quotas in December 2004 forced the firms to exit the Mauritian EPZ, massive job losses – over 25,000 between 2001 and 2005 – were recorded, along with a significant decline in exports. However, exports rebounded in 2006, reaching a new peak in 2007 before financial crisis bore down on the clothing industry. Figure 7 summarizes the evolution of the clothing industry in the light of changes in the trade regimes governing it.

The above discussion illustrates the footloose nature of Chinese FDI, which was premised on Mauritius' preferential access to the US and EU markets and other trade preferences, such as the derogation from AGOA's yarn forward rule. While several other local firms – and, indeed, the entire clothing industry – also confronted the same problems, they restructured to stay in business and survived the onslaught of China. The Hong Kong-based firms' decision to leave should therefore be seen as an attempt by multinationals to reorganize their global supply chains to maximize value. Significantly, no new Chinese investment in the textile industry has occurred since 2005.

Figure 7: Evolution of clothing-related trade regimes

	MFA	AGOA 1	AGOA 2	AGOA 3	AGOA 4	3rd country Fabric	Companies from Hong Kong started Delocalising	Hong Kong Retrocession to China	Closures of Enterprises from Hong Kong, China					
1974														
1984														
1990														
1997														
1998														
1999														
2000														
2001									Tajima Embroidery & garments	Lord Jym Ltd	Olympic Knitting Ltd			
2002									Afes Textiles Ltd	International Fashions Ltd				
2003									Hong Kong Textile Ltd	Maurihai Ltd	Stylish Knits Ltd	Winbright (Pty) Ltd	Summit Knitwear Ltd	Leisure Garments Ltd
2004									Summit Industries Ltd	Goodlands Knitters Ltd	United Knitters	Novel Textiles Ltd	Summit Textile Ltd	Novel Garments Ltd
2005									Grove Industries	Kentex Garments	Sinotex Ltd			
2006														
2007														
2008														
2009														
2010														
2011														
2012														
2015														

Source: Enterprise Mauritius; updated by authors.

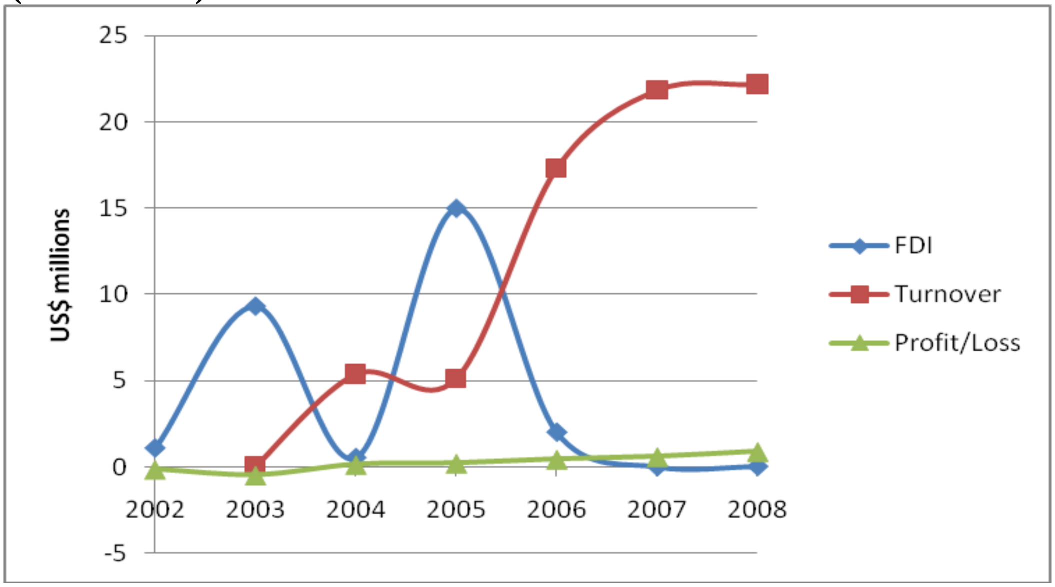
The rest of our empirical analysis focuses on two case studies involving major Chinese FDI.

Case Study 2: Tianli Spinning

Tianli Spinning (Mauritius) Ltd. is one of the rare significant and successful cases of Chinese investment in Mauritius. Established in 2002 with an initial investment of US$ 1.3 million, the firm has made sizeable additional investments, notably in 2003 and 2005 (Figure8). Cumulative investments to the end of 2008 amounted to US$28.2 million. These investments have allowed Tianli to increase its spinning capacity to 2,200 tons of cotton yarn annually.

The spinning sector in Mauritius comprises three categories of activity: (1) spinning of woven fabrics for the manufacture of shirts, trousers and denim jeans; (2) spinning of woolen products such as pullovers and cardigans; and (3) spinning for knitwear, including T-shirts and Polo shirts. Most of the firms producing knitwear are vertically integrated and generate their own yarn. Tianli is the only independent producer of cotton yarn, which it supplies to local firms, including some of those that have in-house spinning operations.

Figure8: Tianli Spinning Ltd: Investments, turnover and profit, 2002-2008 (US$ millions)



Official statistics on the clothing industry's installed and utilized capacities are not available. However, it is clear that Tianli contributes a non-negligible share to the local production of cotton yarn, allowing Mauritius to reduce its imports of this intermediate product, hence saving on foreign exchange. Table 7 shows that, between 2000 and 2007, the volume of imported cotton has increased over three-fold while imports of cotton yarn have decreased by a significant 37 percent over the same period. This confirms the trend towards building spinning capacity as part of the national strategy of promoting greater vertical integration in the textile industry. Indeed, while incentives were harmonized across the manufacturing sector in 2006, specific incentives to promote and protect investment in spinning were retained until 2016.

Tianli employed some 450 workers at the end of 2008, of which only 58 of are local. Such heavy dependence on Chinese labor is typical of Chinese firms operating in Mauritius (and elsewhere), more particularly in the construction sector. Its effect is to further reduce the economic impact of Chinese FDI on the host economy. It is difficult to assess the extent of knowledge spillovers that Tianli has generated. These are likely to be small and limited to knowledge acquired by local workers through training and experience, which are transferable and so can benefit other firms.

Table 7: Imports of raw material and intermediates (cotton and cotton yarn), 2000 and 2007

Commodity Code	Commodity Description	2000 Value (US$ mn)	2000 Volume (kg)	2007 Value (US$ mn)	2007 Volume (kg)
Cotton					
S3-2634	Cotton, carded or combed	1.29	393,567	2.15	1,347,056
Cotton yarn					
S3-65112	Yarn of carded wool	6.88	746,197	2.28	61,953
S3-65113	Yarn of combed wool	1.18	117,329	0.32	22,605
S3-65114	Yarn of fine animal hair (carded or combed)	4.61	45,638	9.05	81,356
S3-65133/34	Cotton yarn	129.94	42,549,921	92.98	26,550,667

Source: UN COMTRADE

Tianli Spinning faces an uncertain future. On the one hand, Tianli has recorded small profits, less than US$ 1 million in 2008, which leaves one wondering whether the firm is obtaining a decent return on its investments. On the other hand, some recent developments can have the effect of further reducing Tianli's contribution in the textile industry. First, after much diplomatic haggling, Mauritius was successful in obtaining, in 2008, renewal of the third-country fabric derogation that had lapsed in 2003, and this until 2011. This derogation allows local firms to source their yarn and fabrics from cheaper Asian suppliers. Moreover, with the coming into effect of the Economic Partnership Agreement, Mauritius will 'benefit' from a softening of the rules of origin governing its exports of wearing apparel to the EU. A shift from the current double-transformation requirement to the proposed single-transformation rule under the EPA will make it easier for Mauritian clothing firms to comply with the rules of origin by importing yarn and fabrics, rather than sourcing them locally. However, Tianli Spinning can bet on some key advantages, including reliability of supply, proximity to clients, and hence lower transportation costs, shorter delivery times, and greater flexibility in responding to clients' needs, as well as continued government support to the spinning sector, to stay in business – in the short term at least.

Case Study 3: The Jin Fei Project

The Jin Fei project has necessitated an initial investment of US$ 1 billion. It covers 362 hectares of land in the region of Riche Terre, close to the port. The project will be implemented in two phases. The first phase, which started in September 2009, is expected to be completed by 2012. This phase consists of physically setting up the industrial zone. It concentrates on the development of infrastructure, water and electricity supply, and the construction of residential and industrial buildings. The second phase (expected to finish in 2015) will be devoted to the development of new industries such as light processing, pharmaceuticals and stainless steel. Box 2 describes the various steps leading to the realization of the Jin Fei project.

Box 2: Chronology of the Jin Fei Project

October 2006: The Tianli Group proposes to set up an integrated industrial zone featuring some 40 Chinese companies named the Mauritius Tianli Economic and Trade Corporation Zone. The industrial zone will feature some 40 Chinese companies across a range of high-end, value-added industries, including light engineering, agro-processing, manufacturing and IT; a School of Technology, which will provide training and solutions to manpower problems, is also proposed.

April 2007: The Tianli project is finalized. To make space for the project, it is proposed to relocate some 103 farmers presently occupying the plot of land earmarked for the industrial zone. However, the farmers strongly protest against relocation to the two sites identified by the government.

June 2007: The government agrees to compensate farmers for relocation. Based on the value of the land, the government offers compensation at the rate of Rs. 50,000 per hectare. Moreover, the Development Bank of Mauritius re-adjusts the payment schedules of loans made to the farmers; the Central Electricity Board writes off some Rs 1.5 million of electricity bills owed by the farmers.

July 2007: During an official visit to China, the Prime Minister signs an accord with the Tianli Group for the setting up of the ECZ in Mauritius.

January 2008: Launch of the project is postponed to the start of 2009. The government of Mauritius asks for more details on some components of the project, in particular those pertaining to the construction of two hotels on the coast of Tombeau Bay, close to the site of the industrial zone. The government opposed the project because of its purported adverse environmental effects.

May 2008: Differences between Mauritian and Chinese architects further delay the project.

January 2009: Two additional groups, namely the Taiyuan Iron and Steel Group and the Shanxi Coking Coal Group, join the project. As a result, major modifications are made to the initial project. The three Groups create a company incorporated in China under the name of Jin Fei Investment Co. Ltd and as new partner the China-Africa Development Fund. The four partners create another company registered in Mauritius under the name of JFET.

September 2009: The Jin Fei project officially starts.

Source: Board of Investment and various press articles

Information collected from the Board of Investment suggests that over one-half of the activities of the Jin Fei zone will be in services, including education, logistics and information technology. The idea is to position Mauritius as the headquarters for Chinese investments in Africa. For example, Chinese operators in Madagascar wish to have the administrative offices in Mauritius because of the distinct advantages that Mauritius provides as a regional business hub. It is for this reason that the Jin Fei project includes important investments in property development, including apartments and hotels.

Potential impact of the Jin Fei Project

As opposed to a similar zone to be set up in Zambia, the terms of the Framework Agreement for Jin Fei Project in Mauritius contain a clause of confidentiality, as required by the Chinese investors. Consequently, little information is available on the specifics of the project, which has fueled rumors and wild guesswork by the local press. The Minister of Finance refused to give information on the project in reply to a question raised in the Parliament by the Leader of the Opposition, citing the project's confidentiality clause.

However, it appears that the Mauritian government is finding a convenient escape goat in the confidentiality clause: it has little information on what the project will precisely entail since the Chinese themselves do not know yet which companies will be set up. One observer aptly remarks: '*Chinese projects are not normally based on any feasibility study. They have their own way of doing business. They invest money, take over space and wait for enterprises to be set up*.'

It is clear that the government has made a number of concessions to the Chinese to get them to invest in Mauritius. Indeed, it comes as a surprise that the Chinese chose Mauritius, a country with no natural resources, acute labor shortages and high wages, and geographically far from mainland Africa and from its traditional export markets, as one of the coveted locations to host a SEZ. The Mauritian government claims that the Chinese wish to use Mauritius as a gateway to Africa and beyond. If this were truly the main reason for the Chinese to invest in Mauritius, one wonders if they would not have done better by choosing, say, Madagascar, which has become a privileged destination even for Mauritian investors. Madagascar, like several other African countries, offers what Mauritius claims to offer in terms of export market access plus important cost advantages due to abundant labor, low wages and access to raw materials and inputs.

The main concession made by the government in the context of the Jin Fei project is its obligations to provide offsite infrastructure. It is estimated that some US$ 25 million needs to be invested to build roads and extend water, telephone, sewerage and electricity networks to the site of the industrial zone. The authorities claim that the central government itself would incur only US$ 3.2 million; Jin Fei would contribute US$ 3.3 million, the Central Electricity Board would invest US$ 8.3 million, and the Central Water Authority and the Waste Water Authority would share the rest of the cost. However, the last three corporations are agencies of the government, and their debt is part of the national debt. Thus, by advertising its share of the cost as a meager US$ 3.2 million, the government has deliberately tried to play down the real value of the concessions made to the Chinese.

In addition, the Jin Fei industrial zone will benefit from incentives generally available to local firms. In addition to a flat 15% corporate tax rate, and duty exemptions on imports of materials and capital equipment, the Chinese enterprises will not pay customs duty or VAT on construction materials and their exports will not be subject to any VAT. Further, for every US$ 500,000 of investment, the Mauritian government will grant the Chinese investors one Mauritian passport. Another concession made to Jin Fei that has raised some controversy is the lease conditions of the 362 hectares of land put to the disposal of the SEZ. The land is leased at a token rate of US$ 3 per hectare, which, as per the terms of the agreement, will increase by 50% after 10 years and by a further 50% after every 10 years subsequently.

Do the potential benefits of the SEZ justify the generous concessions made?

In presenting the Jin Fei project, the government claimed that it would lead to the creation of some 43,000 jobs, of which 34,000 directly. However, pressed by the opposition and the press, it finally conceded that only 10 to 15 percent of the jobs would accrue to Mauritians. This means that the employment impact will be much smaller than expected. Moreover, the construction of the industrial zone, currently under way, is utilizing a large number of Chinese expatriate workers. Construction materials are mainly being imported from China. This reduces the multiplier effect of the initial FDI while accentuating the already heavy bilateral trade deficit vis-à-vis China. Finally, the SEZ will produce primarily for the export market. Since the enterprises will be wholly Chinese-owned, the bulk of the export proceeds will likely be remitted to the home country. Consequently, the impact on foreign exchange earnings will be minimal.

Our analysis suggests that the Chinese industrial zone will have little impact, if any, on the Mauritian economy through the traditional channels of jobs, contribution to GDP and export earnings. There are two remaining ways in which the SEZ can benefit the local economy: through knowledge spillovers and through the development of linkages with the economy. In our case study of Tianli Spinning, we argued that technology spillovers are very unlikely from Chinese investments because of the way the Chinese protect propriety knowledge and other trade secrets. This scenario is likely to recur with the Jin Fei project, more so since the majority of the companies will be Chinese-owned. This will be really unfortunate since Mauritius hopes that the technological superiority of the Chinese firms will 'brush off' on local firms and help the country gravitate to a higher technological plane with innovative, high value-added products.

On the positive side, there does exist some potential for the SEZ to build linkages with the local economy. However, just as with the EPZ, the linkages will be mainly forward, involving logistics, forwarding, and insurance and financial services. Backward linkages will be fostered to the extent that the Chinese firms contract out transportation and catering services for their employees and subcontract with local firms. In any case, the economic value of these linkages is likely to pale in comparison with the value of output generated by the firms in the industrial zone.

To conclude, we believe that the economic benefits arising from the Chinese SEZ will be too small relative to the costs incurred by government in terms of road infrastructure and utility and telecommunication networks. Environmental concerns aside, there are also fears that providing water to the industrial zone will deprive already-vulnerable areas of the island of this precious commodity, especially in the dry season when water supply runs low and cuts are more frequent. Moreover, the SEZ will consume a tremendous amount of electricity, putting pressure on existing capacity, and inflating the imported oil bill. Given these considerations, one wonders whether the government conducted a proper feasibility study or an environmental impact assessment before it allowed the project to go ahead. We are inclined to believe that the lure of a billion-dollar FDI project was powerful enough to override any other concerns. The government has brandished the potential economic benefits of the project, and has claimed credit for attracting FDI on such a massive scale. However, our analysis suggests that the SEZ will bring little in terms of jobs, incomes, export earnings or technology spillovers. On the other hand, the government will certainly lose in terms of tax revenue foregone due to the many fiscal concessions granted to the Chinese operators and face heavier debt service charges as a result of borrowing to finance infrastructure and services.

6. Conclusion

This report sets out to examine the impact of Chinese investments on the Mauritian economy. We do this by describing the nature, trends and sectoral composition of FDI flows from China to Mauritius and vice versa; discuss the FDI-aid nexus; review the FDI regimes in the two countries and then turn to an in-depth analysis of Chinese FDI in Mauritius. Our empirical methodology is constrained by data availability and data consistency. Consequently, we rely mainly on descriptive analysis, case studies and primary information obtained from interviews.

6.1 Key Findings

The key findings of this study can be summarized as follows:

1. Mauritius offers an attractive investment climate. The Business Facilitation Act and the Finance Acts of 2006 have brought about major reforms to the investment regime. Incentives have been rationalized and harmonized and a reduced, uniform corporate tax rate of 15 percent applies across economic sectors. These reforms have helped place Mauritius 17th on the World Bank's Doing Business rankings in 2010.
2. Until 2004, FDI flows to Mauritius were small, irregular and unevenly distributed across sectors. A clear upward trend is noted in recent years. However, much of the FDI flows have been directed to services, especially property development, tourism and financial services.
3. FDI inflows are concentrated in a narrow range of sectors and originate in a few, traditional partner countries – EU, USA, India and South Africa.
4. The real sectors – agriculture and manufacturing – have failed to attract significant FDI on a sustainable basis. This may be due to the overall low cost competitiveness

of the Mauritian economy and systemic factors, including the lack of natural resources and the policy emphasis on services.

5. Chinese investments have been small and erratic through the years. However, the launch of the Jin Fei project in 2009 has resulted in a massive spurt of FDI from China into the special economic zone. Such flows are likely to continue over the next 5 years or so.
6. China has implemented significant corporate tax reforms and rationalized incentives so that its FDI regime complies increasingly with WTO rules. However, a number of weaknesses persist. FDI procedures are complex, bureaucratic, often inconsistent, and non-transparent. Investment is encouraged selectively in certain specific sectors, but deterred in others. China ranked 89th on the World Bank (2010) list, and obtained very poor scores on several indicators.
7. Agreements between Mauritius and China in the domain of double tax avoidance and investment protection seem to have been a catalyst for Mauritius' outward FDI to China, which has broken new ground in recent years thanks to the activities of one textile company, the Compagnie Mauricienne de Textile Ltee. Although, in absolute terms, such investment has been small, accounting for a mere 1.6 percent of China's total inward FDI in 2008, Mauritius is nevertheless the biggest investor from the African continent.
8. Contrary to the documented practice in much of Africa, there is no evidence that Chinese FDI in Mauritius has been bundled with aid nor has such aid been given on the same terms as to other African countries (where aid has often been exchanged for rights to Chinese firms to exploit natural resources).
9. China has provided loans on concessional terms with generous grace periods, flexible repayment schedules and with no conditionality attached. On the downside, however, exclusive bidding by Chinese firms for some infrastructure projects financed by the EXIM Bank has resulted in collusive practices to the detriment of the recipient country, as was the case in Mauritius recently.
10. Our review of the determinants of Chinese outward investments yields a mixed bag of evidence. While the evidence points quite conclusively that natural resources and large markets have been significant pull factors, there is some controversy about the role of institutions, with some studies suggesting that China favors investing in countries with weak institutions and high levels of corruption.
11. None of the above factors is relevant in the case of Mauritius, which has no natural resources, is small (in absolute terms) and boasts a solid democratic tradition, the rule of law and strong institutions. Yet Mauritius has attracted large flows of FDI from China in recent years into the special economic zone, one of the few that China is setting up across the African continent.
12. The SEZ will house various high-value, cutting-edge technology industries that Mauritius has actively sought to promote but had not been successful so far. Thus, the SEZ could help Mauritius graduate to a higher technology plane.
13. However, our analysis suggests that the SEZ, even when it becomes fully operational, will have little positive effects on the economy.

6.2 Policy implications

China's engagement with Mauritius through the investment channel raises a number of policy issues and implications. Before the launch of the Jin Fei project, Chinese FDI in Mauritius has been small and irregular through the years. The wave of FDI from Hong Kong-based companies into the nascent clothing industry in the mid-1980s helped Mauritius create thousands of jobs and generate a high rate of export-led growth over a long period, especially as local investors also joined in. However, the exodus of these firms in the years preceding the expiry of the MFA, which signaled the end of Mauritius' preferential access to the US market on which the foreign investors had concentrated their exports, led to a drastic decline in employment and exports. But the fact that the clothing industry recovered after 2005 means that Mauritius had not depended on the foreign firms to the extent that it appeared. Therefore, their true contribution to the Mauritian economy is likely to have been small.

Can this conclusion be generalized to Chinese investment in Mauritius? A clear answer could emerge if we did a careful project-by-project analysis of Chinese FDI. We could afford to do this since such investment has been small and concentrated in a few sectors. Our case study of Tianli Spinning suggests that the firm has indeed contributed to filling the fabric gap in Mauritius, thus helping to build a vertically integrated clothing industry capable of meeting stringent rules of origin. However, its installed capacity is rather small relative to the industry's total requirement in cotton yarn and the firm has been further marginalized by local investments in spinning and weaving operations. Moreover, the softening of the rules of origin in the proposed Economic Partnership Agreement with the EU as well as the renewal of the third-country fabric derogation under AGOA, both of which will make it possible for local clothing exporters to source their yarn and fabrics from cheaper Asian suppliers, means that independent spinners like Tianli will see their role diminish.

Our analysis of the Jin Fei project further supports our claim that Chinese investments are unlikely to have a significant impact on the local economy. The true motives for setting up such a massive industrial zone in a resource-poor, geographically isolated and high-cost country are unclear since the project is conveniently protected by a confidentiality clause, atypical and unprecedented in Mauritius' history of doing business with foreigners. The thesis that the Chinese see in Mauritius a gateway to the African market and beyond sounds dubious since any other African country can offer the same market access privileges plus other attractions, such as the availability of local inputs and cheap labor. Can Mauritius' experience and maturity make a difference? Perhaps. But then why would business-minded Chinese operators want to invest in Mauritius when local investors themselves are fleeing to nearby Madagascar? Or do the generous concessions offered by the Mauritian government to its Chinese counterpart override any other considerations? While a definite answer to these questions is not possible in the absence of further information on the Jin Fei project, our analysis puts together several compelling arguments that suggest that the economic benefits to Mauritius will be small relative to the start-up costs borne by the government and its agencies.

The SEZ will utilize predominantly Chinese labor and only a small fraction of the 40,000-plus jobs that will be created will actually go to Mauritians. Moreover, based on casual evidence on staffing patterns in Chinese-owned enterprises, we can expect jobs at the technical and management levels to be reserved for Chinese expatriates, with local workers crammed into low-paying jobs. The construction of the industrial zone is under way: the workers are predominantly Chinese, the contractor is Chinese and so also are most of the inputs and materials being used. This suggests that the investment, notwithstanding its scale, will have only a marginal multiplier effect on income in Mauritius. We also argued that both because of the low potential for technology spillovers from Chinese enterprises in the SEZ and for the development of linkages with the local economy, the Jin Fei project will yield small benefits to Mauritius even over the long term. While the government has justified the project citing the technological sophistication of the enterprises that it would comprise, local firms, and the economy, are unlikely to benefit from it if the zone operates as an enclave.

Several points emerge from the above discussion about what should be done to maximize the benefits on the local economy from Mauritius' investment relations with China or to minimize any negative impacts. A priori, the following prescriptions merit consideration:

1. Balanced negotiations

The government should be aware that dealing with Chinese investors will not be business as usual. China is a developing country notorious for its high level of corruption and poor respect of human rights. Being Communist, the Chinese government is significantly present in all investment projects and often negotiates directly with the government of the country it wishes to invest in. The balance of power in such negotiations is skewed in favor of the Chinese given their economic might, their authoritarian methods, and their hunger for economic prosperity. The Chinese firms are thus able to impose their terms on their weaker partners, who are often impotent in the face of the ever-present threat that the Chinese investors might simply turn to other countries, in a global race to the bottom, if they do not get a favorable deal. Mauritius, as a small economy, is particularly vulnerable to China's influence. But the government should ask whether compromising the country's democratic principles is a good price to pay for investment projects that may bring little in terms of direct economic benefits to the country. While Mauritius is small, it is also a mature economy and boasts a long tradition of industry and exports. Moreover, Mauritius offers economic and political stability to prospective investors; a permissive, hassle-free investment environment; a shrinking but skilled workforce; and good and reliable logistics that can compensate for the country's geographical isolation. Few African countries can match these benefits. Hence, Mauritius should find strength in the unique package of incentives that it can tender to potential investors, including China, and use its diplomatic experience to negotiate for mutual benefits.

2. Seeking investment projects that are in tune with the country's economic orientation

Mauritius, which is well set on the path of a services-oriented economy, should refrain from seeking investments in sectors in which it does not have a comparative advantage.

This is particularly true of low-skill, labor-intensive activities, in which a combination of high wages and low productivity has eroded Mauritius' export competitiveness. Worker motivation in these sectors is also generally low as could be evidenced by the prevailing high rates of absenteeism. Even in the seafood industry, which the government is actively seeking to promote, operators are being forced to seek expatriate labor since Mauritians are reluctant to work odd hours and tend to be absent from work more frequently than foreign workers. Even if the government could secure more jobs for the locals, it is debatable whether Mauritians would want to work in an industry that does not offer better working conditions than the traditional sectors – clothing and seafood. The expatriate labor phenomenon, which has taken proportions atypical of a developing country like Mauritius, is being driven not by local labor shortages but rather by a shift of workers away from low-wage manufacturing towards the burgeoning services sector. Consequently, the national FDI policy should be geared towards higher value-added services in the ITES-BPO sector, and in education, health and tourism, consistent with government's policy of developing Mauritius as a hub in these sectors.

3. *Requiring Chinese investment and construction projects to use more local labor and inputs*

Agreements on loans from the Chinese government to finance construction (including the building of the SEZ) and infrastructure development often include clauses that require the projects to be carried out by a Chinese contractor, using labor, materials and other inputs from China. These agreements leave little room for Mauritian workers and building companies to be involved in major construction projects, which minimize the multiplier impact on the economy. Thus, while the government may gain through favorable terms of credit, the country loses out on the opportunity to generate higher value added. In future negotiations for funding with the Chinese, it is important that the Mauritian government demand that a given proportion (say 10 to 20 percent). Such local content requirements are common in FDI projects elsewhere, including in China. We are suggesting that the use of local inputs be negotiated rather than be imposed.

4. *Promoting joint ventures and sub-contracting*

While Chinese investors may bring superior technology and knowhow to Mauritius, we have argued above that the local economy is unlikely to benefit from spillovers due to the mode of operation of Chinese firms. This would be a pity in the context of the Jin Fei project, which proposes to set up firms in high-technology sectors such as light engineering and pharmaceuticals, since Mauritius would miss a real opportunity for technological leap-frogging. The fact that the project will utilize little local labor, which, moreover will likely be limited to the factory level, and will be closed to Mauritian investors, means that the industrial zone will be operating as an enclave, sealing off any potential spillovers to Mauritius. If the government wishes to nurture any hope for the country to reap the benefits of technology and knowledge transfers from the Chinese companies to the benefit of local firms, it is imperative that the government negotiates with its Chinese counterpart to allow some space for Mauritian companies in the SEZ. In addition, or alternatively, the Mauritian side can push for joint ventures in select high-technology industries. We believe that there is scope for such negotiations since the Jin Fei project is not yet finalized.

5. Avoiding the prisoners' dilemma trap

There is an important policy lesson for the whole of Africa in the way it deals with Chinese investors. What gives the Chinese the power to impose their terms on the countries they deal with is not so much their economic might than the absence of collaboration, and in some cases, sheer dividedness, among African host countries. All of Africa is engaged in a relentless race to the bottom to attract the biggest FDI projects. This competition entails a kind of prisoners' dilemma predicament where all countries clamor to offer the most generous incentives to woo the Chinese and are ready to make the most sacrificial concessions. If the same countries cooperated to adopt a common stance in their engagements with China, and agreed to limit incentives and concessions, on the one hand, while exacting more from the Chinese side, on the other, the entire continent would gain. Such cooperation is not difficult to achieve. The various regional economic communities already provide a forum for this kind of cooperation to emerge and to be solidified into a common line of action with the blessing of a Pan-African initiative such as the NEPAD.

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Table A.1: Aid from China

Year	Type of Assistance	Loan amount	Terms of Assistance	Project Details
09/08/1972	Loan	GBP 13,540,961	Interest-free with repayment in 10 years within 25 years grace period	Terminal Building at Plaisance Airport. Technical Assistance for agricultural projects.
01/07/1985	Loan	RMB 35,000,000	Interest-free with repayment in 10 years and 10 years grace period	Sports complex - Anjalay Stadium. Barkly Bridge (Moka) Pointe Monier Bridge (Rodrigues) Police Workshop
15/12/1990	Loan	RMB 20,000,00 Plus: Commodity Loan of RMB 5m dated 01/07/85 Converted into Project Loan Total RMB 25m	Interest-free with repayment in 10 years and 10 years grace period	Upgrading of Flacq Hospital
20/07/1991	Loan	RMB33,000,000	Interest-free withrepayment in 10 years and 10 years grace period	Beau-Vallon Housing Project
13/04/1993	Change in repayment terms		Interest-free with repayment in 20 years and 10 years grace period	On-lent to NHDC
14/06/1993	Loan	RMB 20,000,000 RMB 4.7m under loan of RMB 33m will be used to supplement the RMB 20m loan	Interest Free with repayment in 10 years and 10 years grace period	Atlee Housing Project Recreation Centre for Senior Citizens
03/05/1997	Loan	RMB Yuan 50m	Interest Rate 4%. Duration of credit12 years with grace period to be determined by banks on both sides	Efficient Joint-venture projects.

03/05/1997 25/02/1999	Loan Loan	RMB Yuan 60m RMB Yuan 35m	Interest rate 4% with repayment of 9 years and grace period of 3 years	Ship for Mauritius Shipping Corporation (Mauritius Trochetia) – a 3500-ton Passenger-Cum -Cargo Vessel
30/11/2000	Loan	RMB 20M	10G + 10P	New Market at Quatre- Bornes.
05/07/2001	Loan	RMB Yuan 20m	Interest Free in 10 years with a moratorium of 10years	Construction Project
01/07/2002	Loan	RMB Yuan 20m	Interest free; Repayment in 10 years with a moratorium of 10 years	Economic Assistance Loan
06/2002	Loan	RMB Yuan 100 m	Interest Rate of 4% with repayment of 8 years and grace period of 4 years	Low-cost housing
07/2002 01/2003		20m Yuan 20m Yuan	Equipment for the Customs at the Port and Airport Project completed and handed over to the Customs in February 2006	X-ray scanning equipment and Pallet-sized X-ray machine
16/01/2003	Loan	RMB Yuan 20m	Interest free; Repayment in 10 years with a moratorium of 10 years	Economic Assistance Loan
10/06/2003		RMB 260M Yuan (RMB 150m signed on 30 Nov. 2000 and RMB 110m signed on 10 June 2003)	The framework agreements for the two loans has been extended until December 2007.	Plaines-Wilhems Sewerage Project - lot 2 of P-Wilhems Reticulations Network and House Connection.
01/2005	Grant	RMB 3m Yuan	Part of this has been used to finance TA in Mauritius and a seminar on Textiles in China (private sector participants)	Human Resource Training and Office Equipment
12/07/2006	Grant	RMB 5 Yuan	To be utilised for project relating to human resource development cooperation and for other projects to be mutually agreed upon	Human Resources Development

08/2006 07/2001 07/2004 01/2005 01/2006	Loans	RMB 100m Yuan Loan of RMB20m Loan of RMB20m Loan of RMB40m Loan of RMB20m Surplus of RMB 16m to be used to partially fund procurement of radio and TV broadcast equipment.	Interest-free loans Chinese side responsible for design, provision of construction, equipment and materials, dispatch of engineering and technical personnel	Construction of new MBC headquarters
07/2007	Loan	RMB 800 million	Line of credit at subsidized interest rate to be spent over 3 years	Expansion of the waste water network, construction of a water treatment plant, modernization of the port, construction of the Bagatelle Dam, conversion of Highlands into an urban zone.
02/2009	Grant	RMB 10 million	Interest rate free Subsidised rate of 2% interest-free	Infrastructure development Extension of the Airport Terminal Building
	Loan	RMB 30 million		
	Loan	$260 million		
	Loan	RMB 40 million		
	Grant	RMB 30 Million		
04/2009	Loan	Rs 25 billion		East-West Corridor, the Ring Road at Port Louis, a Bus Way and the Harbour Bridge.

Source: Ministry of Finance