

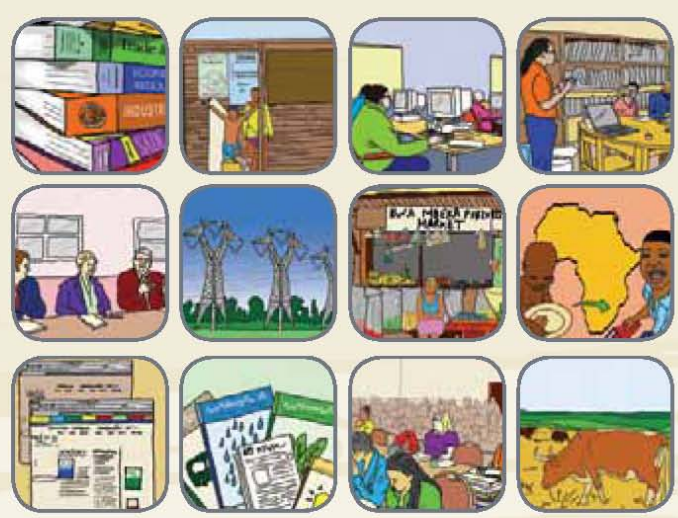
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TRADE & INDUSTRIAL POLICY STRATEGIES



TIPS Small Grant Scheme Research **Paper Series 2008**

Assessing the Overall Trade, Business
and Investment Climate in the Island
States of the Western Indian Ocean

Graham Sherbut

December 2008



indigenous **growth**

Assessing the Overall Trade, Business and Investment Climate in the Island States of the Western Indian Ocean

**By
Graham Sherbut**

**Report Composed for Trade and Industrial Policy
Strategies (TIPS)
December 2008**

Abstract

This paper evaluates the trade, business and investment climate currently in place within the island states of the Western Indian Ocean. Operating on the premise that trade-based globalization poses a considerable challenge to island states' economic stability and prospects for equitable development, this report argues that both state institutions and exporting firms in the Comoros, Madagascar, Mauritius and the Seychelles must aggressively seek to put in place policies and practices that are conducive to attracting foreign investment, encouraging private sector growth and expanding export capabilities. As part of this analysis, this paper provides a politico-economic overview of the Western Indian Ocean island states as well as a theoretical outline of academic perspectives relating to island states' prospects for growth in a globalizing world economy. This is followed by an examination of trade and investment-related trends in these four countries (informed by primary interview research) and the presentation of potential policy options these countries can pursue to improve their competitiveness and overall trade performances.

Keywords: Development Finance, Economy, Globalization, Investment, Island States, Trade, Western Indian Ocean

Acknowledgments

First, my thanks go to Trade and Industrial Policy Strategies (TIPS) in Pretoria for their willingness to encourage this research. In particular, I am grateful to Myriam Velia, Ximena Gonzalez-Nuñez and Stephen Hannival for considering the merits of this project in its early stages and for providing the financial support necessary for this project to come to fruition. I also acknowledge the efforts of Professor Imraan Valodia at the School of Development Studies (University of KwaZulu-Natal) for his management of project finances and for his enthusiastic assistance. I would also like to note that financial contributions for this work were also forthcoming from the School of Development Studies itself and I am appreciative of this support.

I also extend my gratitude to Alain Pierre-Bernard of APB Consulting in Madagascar and to Fanja Ravoavy of the International Finance Corporation (IFC) in Antananarivo for assisting me in the data collection for this report. Finally, a sincere thank you is extended to those individuals in Madagascar, Mauritius and the Seychelles who participated in this study by way of providing relevant insights into this study's topics of concern.

List of Acronyms

AfDB	African Development Bank
AGOA	African Growth and Opportunity Act
ASEAN	Association of Southeast Asian Nations
ATPC	African Trade Policy Centre
BMOI	Banque Malgache de l'Océan Indien
CARICOM	Caribbean Community
CBS	Central Bank of the Seychelles
CNMF	Malagasy National Microfinance Coordination Unit
COMESA	Common Market for Eastern and Southern Africa
CSO	Central Statistics Office, Mauritius
DFI	Development Finance Institution
EDBM	Economic Development Board of Madagascar
EEZ	Economic Exclusion Zone
EPA	Economic Partnership Agreement
EPZ	Export Processing Zone
EU	European Union
FDI	Foreign Direct Investment
FES	Full Employment Scheme
GDP	Gross Domestic Product
IMF	International Monetary Fund
IOC	Indian Ocean Commission
IOMAC	Indian Ocean Marine Affairs Corporation
IOR-ARC	Indian Ocean Rim Association for Regional Cooperation
IOT	Indian Ocean Tuna Ltd.
IT	Information Technology
MCFI	Mauritius Chemical & Fertilizer Group
MFA	Multi-Fibre Agreement
MMM	Mouvement Militant Mauricien
MPRD	Ministry of Planning and Regional Development, Comoros
NGO	Non-Governmental Organization
OCADIJ	Overseas Coastal Area Development Institute of Japan
OECD	Organization for Economic Cooperation and Development
PMSD	Parti Mauricien Social Démocrate
PPP	Purchasing Power Parity
PRSP	Poverty Reduction Strategy Paper
SADC	Southern African Development Community
SAP	Structural Adjustment Program
SIBA	Seychelles International Business Authority
SIDEC	Seychelles Industrial Development Corporation
SPS	Sanitary and Phytosanitary Standards
SPUP	Seychelles People's United Party
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Program
UNECA	United Nations Economic Commission for Africa
UNEP	United Nations Environment Program
WEP	Work Experience Program
WFP	World Food Program
WIDER	World Institute for Development Economics Research
WIO	Western Indian Ocean
WTO	World Trade Organization

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Introduction

Background to the Research

As the first decade of the twenty-first century gradually comes to a close, it is apparent that trade-based economic globalization continues to present both opportunities and challenges to low and middle-income nations seeking to enhance their prospects for sustainable growth and development. On one hand, the expansion of global free trade agreements at both the bilateral and multilateral levels has increased the inter-connectedness between national economies. This, in turn, has encouraged many countries to produce goods and services more efficiently along their comparative as well as competitive advantages. At the same time, the World Trade Organization (WTO) has insisted on establishing a level playing field vis-à-vis global trade and it has made resultant efforts to encourage the “phasing out” of preferential trading regimes. Consequently, even as developing countries shift their productive activities in such a way that allows them to be more active participants in the global economy, these states are also facing the loss of the privileged access to developed markets which have economically sustained them for much of their post-independence history.

For the island states of the Caribbean, South Pacific and Western Indian Ocean, it is contestable as to whether or not full entry into the realm of global free (or freer) trade can ever make up for a loss of preferential access to such markets as the European Union (EU). After all, countries such as Fiji, Mauritius and St. Lucia (amongst others) have long benefited from knowing that their key commodities (i.e. bananas, copra, fish, sugar, etc.) were guaranteed profitable returns on the basis of these advantageous agreements with the metropolitan economies of the north. Moreover, the governments of these islands tended to view the stable levels of foreign exchange brought in by the trade of these products as being imperative in helping them pursue their respective development strategies. If island states are unable to reinvent and acquire equally privileged terms of trade through new bilateral agreements or by boosting their shared leverage via the formation of regional associations such as the Caribbean Community (CARICOM), the logic goes, then their economies will be exposed to extensive vulnerability when it comes to securing export markets in a more competitive globalized world.

The majority of island states, according to the World Institute for Development Economics Research (WIDER), are geographically small, have tiny populations, are physically remote from metropolitan markets and have a scarce natural resource base. Related to these characteristics, WIDER asserts, are a number of factors which act to hinder the development of these states’ economic potential. For example, a small population means that these countries have limited reserves of human capital to draw upon to promote a diverse range of productive activities. Their limited array of exploitable resources, on the other

hand, means that economic activity as a whole tends to be limited in scale and this then leads to low levels of domestic savings due to the presence of a diminutive corporate tax base (WIDER 1995, ix). For its part, the United Nations Environment Program (UNEP) argues that the majority of island nations are simply too small (both geographically and in terms of population sizes) to benefit from economies of scale, thus ensuring that their prospects for economic success remain ever precarious (UNEP 2005, 5). While exceptions to some of these characteristics exist in the form of larger island republics such as Cuba, Madagascar and Papua New Guinea, organizations like UNEP assert that factors such as geographical isolation and the presence of limited natural resources are still defining features of these states as well.

Amongst the implications of what these organizations are saying is that perhaps more than most other polities, island states lack the natural endowments, labour reserves and general “economic might” to be forceful players in the sphere of competitive international trade. Indeed, while large emerging economies such as Brazil, China, India and Malaysia are each capable of attaining a high degree of export diversification and can devise industrial policies to “target” the growth of particular economic sectors on the basis of shifting global patterns of demand, the island nations of the Caribbean, South Pacific and Western Indian Ocean cannot follow suit. According to UNEP, this leads to an inevitable scenario in which island states in these three regions are permanently relegated to the periphery of the global economy except in those sectors such as tourism and the export of primary commodities, both of which are heavily subject to external shocks and detrimental price fluctuations (UNEP 2005, 5-6). Island states, to put it bluntly, look to be potential losers in a world system which frowns upon preferential trade agreements and which is dominated by larger and much more powerful political and corporate interests.

However, for those who are concerned about the economic, political and social future (and even survival) of island states, these pessimistic assertions demand a forceful reply. Should it simply be accepted that a lack of obvious economic strengths will lead these countries into a life of permanent dependency, stagnation and even poverty? After all, while limitations of natural and human resources are a fact of life in most islands, current trends suggest that these states are capable of much more creative policy efforts than might be initially imagined. Mauritius, for example, has embarked on ambitious plans to move fully beyond its historical dependence on the export of sugar and is now attempting to position itself as a major player in the production of high-value textiles and as a centre for information technology (IT) services. In the South Pacific, meanwhile, both Samoa and Niue (the latter a dependency of New Zealand) are also attempting to establish themselves as regional IT centres serving the Australasian and Southeast Asian markets. Island states, it may be said, are making attempts (whether entirely successful or not) to expand beyond the limitations ascribed to them by organizations such as UNEP and WIDER.

What these above examples do suggest, however, is that if island states are to be successful in expanding their economic possibilities, then they must be particularly adept at encouraging investment (both domestic and foreign) into industries and sectors whose likelihood for success may not be especially obvious (i.e. IT networks in the remote South Pacific, textile exports in an isolated Indian Ocean island). For this investment to be forthcoming, it is prudent to argue that the private and public sectors of island countries must be cognizant of the need to put in place a trade, business and investment climate that encourages entrepreneurialism, ensures the availability of capital, guarantees necessary fiscal outlays in infrastructure (i.e. communications, roads, ports, etc.) and assures that competent regulations for trade facilitation (i.e. customs procedures) have been implemented.

By doing this, island nations (like other developing states) can offer vital support and attractive incentives to encourage local business people to take risks and search for more profitable export-based initiatives as opposed to maintaining a focus solely on “traditional” productive activities. Similarly, a sound business environment is also apt to encourage foreign investors from a host of nations to look upon island states as locations upon which to base offshore services in the fields of finance, IT and export-oriented manufacturing. Even more important for the long-term development of island states, however, is that through the creation of an attractive climate for trade, business and investment, investors of many stripes are more likely to assist national governments pursue improvements in the quality of their education, health care and even social security systems. This will have a pronounced effect on improving the quality (if perhaps not the quantity) of human capital that island states have at their disposal.

At first glance, the benefits described above would appear to accrue to island states in the same way as they would to other developing countries. While this may be true, it is the position of this research that the unique vulnerability faced by island states after the loss of preferential trade agreements makes the need for them to pursue aggressive business-friendly policies all the more urgent. While the creation of these policies must be engaged in an environmentally and socially responsible manner, it is contended in this paper that a failure to follow this pro-private sector course of action will likely lead to what UNEP and WIDER call the “economic marginalization” of island nations within the new world order currently being forged.

Project Focus and Objectives

The objective of this research paper is to evaluate, on the basis of both primary fieldwork carried out by the researcher as well as the use of selected secondary research sources, the trade, business and investment climate in the island states of the Western Indian Ocean (WIO). In particular, this research seeks to highlight those areas in which regional islands are succeeding in developing pro-trade, business and investment policies while also noting those fields for which

effective policies have not yet been put into place. In undertaking this survey, this study will ideally be in a position to comment upon the extent to which the WIO islands are likely to be able to take advantage of the types of investments, production opportunities and other economic benefits identified in the previous section. At a broader level, this overview should also be capable of putting forward an argument as to the likelihood of the WIO islands being able to avoid the fate of economic marginalization. Finally, this research will endeavour to advance a number of suggestions as to how island governments in the WIO region can build upon current successes and reverse apparent mistakes in order to ensure that their countries can position themselves to compete effectively in a global economy lacking the security of preferential trade arrangements.

Because this paper is focused on business and investment from an explicitly trade-based perspective, the key idea that this study aims to explore is that of “trade capacity”. Specifically, the focus is placed on those business and investment-oriented factors which influence how countries (and their firms) can strengthen themselves either as exporters of goods (i.e. primary commodities, textiles, etc.) or exporters of services (i.e. tourism, financial and IT services, etc.). This paper does not delve into how building a strong business and investment climate can improve forms of economic production that serve only an island’s domestic market.

For the purposes of this paper, the countries deemed to be grouped as part of the WIO are the Comoros, Madagascar, Mauritius and the Seychelles. The overseas French territory of Mayotte and the French Department of Réunion are also located in the WIO but as they are not independent countries, a decision has been made to exclude them from this study’s central analysis. The Maldives and Sri Lanka, while sometimes considered part of the WIO, have also not been included in this study due to the fact that neither country (currently) envisions itself as playing an active role in this region – namely, neither island has *formally* joined the WIO’s main regional politico-economic body, the Indian Ocean Commission (IOC) (although the Maldives does enjoy the status of a limited overseer within the IOC).

As an island region, the WIO is unique when compared to the Caribbean and the South Pacific due to the widely differing natures of regional island economies as well as the substantial chasm that exists in regards to the different islands’ respective levels of development. Mauritius and the Seychelles, for example, both enjoy relatively diversified economies focused around the production of textiles, the provisioning of offshore IT services, high-class tourism and various forms of light manufacturing. The Comoros and Madagascar, by contrast, remain extremely poor commodity-oriented economies. In these island states, the export of such products as cloves, coffee, vanilla and ylang-ylang remains the economic mainstay and the prospects for any trade-based developments beyond basic low-value manufacturing remain clouded by poor physical infrastructures and human capital deficiencies.

While similar disparities exist in the Caribbean (i.e. between the Bahamas and Haiti) and the South Pacific (i.e. between Fiji and the Solomon Islands), they are especially notable in the WIO due to the sheer *scale* of these developmental differences – UNEP, for instance, notes that the per capita Gross Domestic Products (GDPs) of Mauritius and the Seychelles are both above US\$8,000 while those of the Comoros and Madagascar are both below US\$2,000 (UNEP 2005, 13). Consequently, the region's different islands will have unquestionably different priorities and goals when it comes to encouraging the growth of pro-trade, business and investment climates. Attempting to understand the nature of these differences adds a degree of interest to a study of the WIO that from the perspective of this researcher would not have been as forthcoming in a study of one of the two other major island regions.

Structure of the Report

This research paper is divided into seven key sections. The first section offers an overview of the research methodology used to collect the qualitative data employed in this study. The second section then goes on to provide a broad overview of the political and economic trends which currently define the island states of the WIO. In particular, this section uses a comparative approach to establish how different influences and processes (i.e. democratization, economic ideology) have come to shape the islands of the WIO and what these factors may mean when it comes to these states' prospects for future trade, business and investment growth. Section three operates on a more theoretical basis and surveys scholarly literature as to how island states (and those of the WIO in particular) can best operate in a globalizing world oriented towards economic inter-dependence.

The fourth section expands on these theoretical underpinnings and uses this study's own research findings (as well as selected secondary research sources) to comment upon the strengths and weaknesses of the trade, business and investment climate in the WIO from a macro-level (i.e. institutional) perspective. As such, this section explores how (or if) such entities as regional organizations (i.e. the IOC), government ministries, judiciaries, commercial/developmental banks and port authorities are playing an active role in improving the trade and investment performance of regional islands. Section five follows a similar path but explores issues from a micro-level (i.e. firm-based) point of view. Consequently, the focus in this section is placed on the performance of exporting firms themselves as well as small business support organizations and chambers of commerce.

A sixth section synthesizes this report's research findings and puts forward a number of policy suggestions which may be of some use in helping regional governments (and relevant donor agencies seeking to assist the WIO island states) improve overall trade, business and investment performances. Finally,

section seven concludes with a summary of notable project findings and offers suggestions for future research.

1. Research Methodology

The research carried out for this project is qualitative in nature. As a result, the aim of the fieldwork conducted by the researcher was to collect *descriptive* data that could be used to shed light on how individuals in a number of different professional capacities view the prospects for pro-trade and business development in the WIO islands. Because qualitative research accepts that each research participant possesses subjective and unique views on relevant issues, it was determined that following an idiographic approach to research would be an ideal way to give voice to a diverse group of individuals whose experiences, opinions and preferences are strikingly different. By comparing and contrasting these differences, this research should be in a position to arrive at an equally distinctive set of conclusions surrounding the strengths and weaknesses of the trade, business and investment climate in the WIO region.

The gathering of descriptive data for this project was accomplished via a series of semi-structured interviews with research participants. These participants were approached for their input as an outcome of either purposive or snowball sampling procedures. In the case of the former, potential participants were identified based on the use of two primary sampling frames: 1) formal lists of enterprises and banking institutions provided by national chambers of commerce in Madagascar, Mauritius and the Seychelles and 2) faculty lists provided by tertiary education institutions in these three countries. Using these lists, the researcher made the decision to contact particular individuals for their insights into the topics of this study's concern. Those participants approached through purposive sampling included two academic economists from the University of Mauritius, a representative from the export-based Mauritius Chemical & Fertilizer Group (MCFI) in Port Louis, the General Secretary of Textile Madagascar and a representative from the *Banque Malgache de l'Océan Indien* (BMOI) in Antananarivo.

At the same time, two of this study's participants were contacted after their names were suggested to the researcher by other participants. As such, snowball sampling was used as a means to approach a member of the Malagasy government's *Ministère de l'Economie, du Commerce et de l'Industrie* and a representative from the Development Bank of the Seychelles.

The interview process occurred in a semi-structured format with all research participants (with each interview lasting an average of between sixty and ninety minutes). Consequently, while a set of pre-determined questions was provided by the researcher in order to encourage participants to address pertinent issues, the researcher was also careful to make note of the responses that these

questions elicited and to make use of these responses in order to devise new questions and to open new lines of enquiry. These responses form the core of the primary research that is utilized in the later sections of this paper. In particular, the qualitative data collected from these interviews is designed to complement the secondary literature analysis which makes up a considerable component of this study's synthesized research findings. Further details regarding the interview process (i.e. the questionnaires) can be found in the appendix of this report.

At the request of research participants, the names of those individuals contacted for contributions to this study are not provided in the later sections of this report. Instead, each participant is identified by their professional title and their institutional affiliation. Given the sensitivity associated with discussing certain economic and (especially) political matters, ensuring respondent confidentiality was deemed by the researcher to constitute an important ethical concern that had to be addressed in a satisfactory manner.

2. The Political Economy of the Western Indian Ocean Island States

The aim of this section is to provide a broad overview of the economic conditions currently prevailing in the Comoros, Madagascar, Mauritius and the Seychelles. In particular, a focus is placed here on how these countries' histories and political situations impact upon their present-day economies and how different processes such as democratization and civil conflict are likely to affect these states' prospects for long-term trade and private sector development. The main importance of this section, however, should be seen in its attempt to provide a comparative "big picture" context upon which this study's later (and more detailed) discussion of fostering a strong regional trade, business and investment climate can be localized.

Comoros

The Comoros is, without question, the poorest of the WIO island states in economic terms. According to UNEP, a severely limited natural resource base combined with a weak export sector burdened by the country's detachment from major international trade routes, has contributed to the Comoros being one of the most economically disadvantaged states in the world (UNEP 2005, 15). UNEP also notes that the Comoros is dealing with a remarkably high external debt which (including arrears) constitutes 80% of national GDP and 319% of the country's total export value (UNEP 2005, 15). For its part, the Comoran government's Ministry of Planning and Regional Development (MPRD) states that the country's primary economic problems lie with a failure to stimulate a sustained growth in GDP. This, combined with strong population growth (around

2.5% a year), has led GDP per capita to fall considerably since the beginning of the century (MPRD 2005, 8).

Other macroeconomic indicators are equally dismal. While inflation has been controlled by disciplined monetary policies and low overall growth rates, the country's trade balance has been severely affected by declining commodity prices for cloves, vanilla and ylang-ylang, combined with a rise in the import of consumer products and foodstuffs (MPRD 2005, 9). In the 2005 fiscal year, the nation's capital and financial operations account surplus fell by 85.2% (from US\$9.5 million to US\$1.4 million). Meanwhile, the consolidated balance of payments deficit actually improved by the middle of this decade, decreasing from US\$6.3 million in 2003 to US\$4.3 million in 2005. However, the financing of this deficit was primarily accomplished via the accumulation of further arrears (MPRD 2005, 10). This acts to reinforce the fact that the Comoran government's spending patterns tend to rely (often by necessity) on deficit spending and an acceptance that without substantial amounts of foreign aid and/or remittances from Comorans working in other countries, a balanced budget is not a feasible economic objective.

At the microeconomic level, household poverty remains a defining feature of the Comoros. The World Food Program (WFP) notes that 60% of the national population earns income from the agricultural sector while the remainder is engaged primarily in petty trading or operate their own micro-enterprises within the informal economy (WFP 2006, 22). The wages provided by these types of employment are rarely enough to cover more than a household's subsistence needs and recent surveys carried out by both the WFP and the Comoran government suggests that 45% of the population lives below a dollar per day. Outside of the main island of Grande Comore, however, this figure increases to almost 50% (see **Table 1**) (WFP 2006, 22). Recent examinations of the national GINI coefficient, on the other hand, indicate that it is not only overall poverty levels that are high but also levels of income inequality. For instance, the Comoros registered a GINI coefficient of 0.443 in 1995 and a coefficient of 0.557 in 2004 (which is equivalent to an increase in national income inequality of 26% over this period) (WFP 2006, 22).

TABLE 1: Inter-Island Poverty in the Union of the Comoros

<u>Island</u>	<u>Households Living Below US\$1/Day</u>	<u>Individuals Living Below US\$1/Day</u>
Anjouan	38%	46%
Grande Comore	35%	43%
Mohéli	38%	49%
National	37%	45%

Source: World Food Program (WFP), 2006.

Based on the above economic indicators, it would not be a mistake to suggest that the Comoros is (and will remain) at the margins of the global economy.

Oppressive poverty, a lack of income-generating activities, downward shifting commodity prices and indebtedness have come together to form a state that is severely underdeveloped and has often been described as being on the verge of complete structural collapse.

To understand why the Comoros possesses such a fragile economy, especially when compared to the relative economic success stories of nearby Kenya, Mauritius and Mozambique, a brief examination of the country's political history is of some value. Since its independence in 1975, the Comoros has struggled to remain a unified state. Centrifugal forces representing the interests of each of the Comoran islands (Anjouan, Grande Comore, Mayotte – which has a specific French political status – and Mohéli) have frequently struggled for influence, with the smaller islands often attempting to rebel against what they perceive to be the inordinate power of political elites in the more populous Grande Comore. These rebellions have tended to take the form of attempted military coups or small-scale wars aimed at securing political independence for the smaller islands.

Comoros' close relationship with its former colonial ruler, France, has also played a role in stoking inter-island conflict. In particular, Anjouan, Mayotte and Mohéli have periodically sought political union with France and have sought Paris' support in justifying a desire to break away from Grande Comore. The fact that Mayotte succeeded in separating from the Comoros to become a French overseas collectivity in 1997 likely played some role in encouraging Anjouan and Mohéli to maintain demands for a similar political arrangement. For its part, the French government under Jacques Chirac chose not to abide by these demands and in 2001, took a leading role in supporting the Fomboni agreements that led to a devolved power-sharing deal between the three remaining Comoran islands.

Under the terms of the Fomboni agreements, the Comoros now survives as a highly decentralized federation consisting of Anjouan, Grande Comore and Mohéli. The agreements (via a nationwide referendum) instituted a new political system that allowed each of these three islands to draft their own separate constitutions while remaining loosely united within the newly named Union of the Comoros (MPRD 2005, 4). At the national level, executive power is wielded by the President of the Union. The Union presidency is rotated between the three islands every four years as part of a plan to establish a balance of political power between the islands. In turn, however, each of the three islands also elects its own "island president" to a five-year term and the presidents of the two islands not currently holding the Union presidency will also serve as vice-presidents at the national level.

It is apparent that this devolved political structure has brought some measure of political stability to the Comoros. Indeed, with the exception of an outbreak of violence in Anjouan in 2007, the Comoros has remained largely peaceful since 2001. In addition, political decentralization has spurred a high degree of

democratization and political participation amongst the Comoran populace (MPRD 2005, 5-6).

From an economic point of view, however, the significance of this shift in political structure is not so positive. While the establishment of more stable politics has undoubtedly created conditions whereby Comoran policymakers can begin directing their efforts towards economic development rather than just maintaining inter-island unity, confusion still exists as to which level of government (national or island) has the legal authority to set out economic goals. This is particularly the case when it comes to the setting of fiscal policy, with leaders in each of the islands often going against the wishes of the national government in Moroni when it comes to determining budget priorities, devising anti-poverty-based social programs or even when it comes to designing initiatives geared towards attracting foreign direct investment (FDI) (MPRD 2005, 4).

Given the policy confusion that has arisen out of the Comoros' political system, it seems prudent to suggest that the country's chances of successfully addressing its myriad economic problems are not very strong. It is difficult to envision, for example, how governments unsure of their powers and responsibilities in relation to one another (i.e. at the national level versus the individual island level) can really agree on a common front when designing plans capable of reducing the overall budget deficit. Similarly, if divisions continue to persist between leaders at the national and sub-national levels over who should control fiscal and social policy design and implementation, then enacting coordinated anti-poverty measures that are backed by the full efforts of the state will not be easy. The Comoran political system, while bringing peace and mild stability to the country, may (without a clearer distribution of powers) have a strongly negative impact on poverty reduction and the overall economy.

For the purposes of this study, it is also true that if the Comoros persists in having a lack of clarity in decision-making within government, the nation will struggle to take even initial steps to improve its trade competitiveness, promote growth within the private sector or encourage inflows of FDI. To be sure, investors are unlikely to direct their resources towards a country whose political situation remains precarious enough to suggest the possibility of a return to violent conflict. Also, the Comoros' opportunity to engage in increased international trade through the signing of economic partnership agreements (EPAs) or through the pursuit of further regional integration into a nearby common market such as the Southern African Development Community (SADC), will be compromised by a political system that lacks clarity and which presents an unstable face to the outside world.

Madagascar

Madagascar's economic situation, while not as dire as that of the Comoros, is still extremely fragile. Export industries are mainly confined to the primary

commodity sector, with cloves, coffee, fish products and vanilla remaining the main generators of foreign exchange. The establishment of an export processing zone (EPZ) in the early 1990s did act, for a time, as a means for Madagascar to branch into the production and trade of low-value manufactured goods (namely textiles). At its peak, the EPZ acted as a boon for Madagascar's economy, using the appeal of low wages and generous tax exemptions to attract over 300 Malagasy and non-Malagasy firms to set up operations and providing direct employment to over 100,000 people (especially women) (Cling *et al.* 2007, 3). Unfortunately, the EPZ's success was always dependent on the continuation of textile-based preferential trade agreements such as the African Growth and Opportunity Act (AGOA) and the Multi-Fibre Agreements (MFAs). With the discontinuation of the MFAs, however, countries such as Madagascar are no longer protected from competition with lower-cost mass textile producers such as China and India when seeking to access markets such as the United States. This, in turn, brings into question the viability of Madagascar's textile industry and with it, the importance of the EPZ as a generator of economic growth and employment over the long-term (Cling *et al.* 2007, 1).

To be fair, the EPZ has undoubtedly played a role in encouraging a healthy growth in Madagascar's GDP over the last eight years. Indeed, with the exception of 2001-2002, when Madagascar was negatively impacted by political instability, GDP growth has averaged over 5% per year (Madagascar PRSP 2006, 6). The Malagasy government's own economic forecasts predict a growth rate of 7.5% for 2009 based on rising returns on mining and tourism. However, according to the Malagasy government's own Poverty Reduction Strategy Paper (PRSP), growth remains confined to a narrow range of industries and to sectors of the economy that do not generate large-scale employment (Madagascar PRSP 2006, 4). Moreover, this growth remains heavily exposed to exogenous shocks such as a fall in commodity prices and increases in global oil prices. Like the Comoros, a high population growth rate (3% per year) has prevented gains in GDP growth from being translated into higher per capita GDP figures.

In contrast to the Comoros, however, most of Madagascar's macroeconomic indicators are fairly stable. Inflation has held steady due to tight monetary policies and the overall budget deficit declined steadily from 2000 to 2006. Reform of the country's tax system has allowed revenue mobilization to be drastically improved and this has had some impact in making up for those revenues which have been lost as the result of declining prices for Madagascar's key export commodities (Madagascar PRSP 2006, 3-4).

However, in spite of the EPZ, Madagascar's need to import most of its consumer products has ensured that its trade balance remains heavily in deficit at more than US\$-850 million (Madagascar PRSP 2006, 7). Stated differently, the current accounts deficit has increased from 8.8% of GDP in 2006 to 12.6% of GDP in 2007 mostly as the result of lower commodity prices (particularly for vanilla) (OECD 2007, 391). Fortunately, a high degree of debt restructuring

negotiated between the Malagasy government and the International Monetary Fund (IMF) earlier this decade means that the country's debt-to-GDP ratio fell to 12% by 2007 (down from 36% in 2005) (OECD 2007, 393). This stands in sharp contrast to the Comoros (where this ratio is 80%) and gives hope to the possibility that Madagascar can use more of its revenues for developmental purposes as opposed to debt servicing.

Poverty rates in Madagascar are exceptionally high. Per capita income is often identified as being below US\$800 per person per year and over 60% of the population lives on less than US\$2 per day according to the African Development Bank (AfDB). In rural areas, low levels of farm output caused by a dearth of mechanized agricultural inputs (i.e. tractors) means that most farmers are only able to provide enough food to meet the subsistence needs of their households (AfDB 2006, vii). In any case, poor roads often hinder the ability of farmers to transport their produce to nearby markets, thus making local agriculture an industry in which consistent income-generating opportunities are difficult to find (AfDB 2006, 2-3). Even in urban areas, poverty levels have been increasing steadily from 44% in 2001 to 52% by 2005 (they have remained steady since 2005) (Madagascar PRSP 2006, 2). Employment in Madagascar's main cities tends to take place within the informal sector, with an extremely poor education system acting to prevent individuals from developing the skills (i.e. literacy or basic accountancy) they need to enter the formal workforce (Madagascar PRSP 2006, 6).

As is the case in the Comoros, the national GINI coefficient signifies a considerable degree of income inequality, with a figure of 0.435 prevailing in 2006 according to the United Nations Economic Commission for Africa (UNECA). While not as high a figure as the Comoros' GINI coefficient or that of other nearby countries such as South Africa (whose GINI coefficient is a remarkable 0.611), Madagascar is clearly a state in which the wealth generated by both the trade in key commodities as well as the activities of the EPZ disproportionately benefits a select few elites (UNECA 2006, 10).

In the Comoros, economic instability was identified as being at least partly the result of political disunity and violent conflict. Madagascar, by contrast, has remained a strong centralized state. However, in the opinion of this researcher, a different politico-historical factor acts to at least partly explain why Madagascar remains economically underdeveloped. Specifically, a number of the country's post-independence governments (especially those led by President Didier Ratsiraka) chose to adopt the tenets of an inefficient command economy system. Starting in the early 1970s, the Malagasy government began pursuing policies that encouraged the nationalization of key industries, the imposition of price controls on agricultural products and the taxation of exports (Maretniel 2006, 8). Meanwhile, parastatal organizations such as agricultural marketing boards took control of the collection and marketing of crops and fixed prices at depressed

levels at each stage of the production chain in order to make food products less expensive for urban dwellers (Maret Niel 2006, 9).

As would be expected, these measures quickly acted to undercut agricultural productivity. It is estimated that from 1974 to 1987, Malagasy coffee producers only earned 40% of the value of their product based on global prices while vanilla producers earned only 25% (Maret Niel 2006, 9). At the same time, Ratsiraka's pursuit of "scientific socialism" (outlined in his own *Charter of the Malagasy Socialist Revolution*) also saw his governments devolve administrative functions away from the central government in favour of local-level functionaries (Marcus 2004, 2). One implication of this decision was that newly-nationalized industries (i.e. mining) came to be controlled by inexperienced and often corrupt local officials with little sense as to how to pursue industrial growth and little willingness to use industrial activity as a way to grow opportunities for employment in their localities. Instead, managerial positions within key economic sectors were used primarily as ways in which to exploit patronage networks and accumulate personal wealth (Marcus 2004, 2-3).

The dismantling of Madagascar's socialist system began in the late 1980s and this process arguably culminated in the election of the country's current president, Marc Ravalomanana, in 2001. Ravalomanana is unique in that he is one of the few African leaders to become well-established in the private sector (he became wealthy as owner of a dairy retailer called *TIKO*) prior to seeking public office. As president, Ravalomanana has taken a number of steps towards promoting the growth of the Malagasy private sector and has remained a committed supporter of the EPZ (Marcus 2004, 6). His government has also sought to put in place incentives to grow national agriculture and reduce rural poverty (to very mixed results).

Despite these efforts, however, Madagascar's socialist legacy appears to continue to impede possibilities for current economic success. Agricultural productivity remains extremely low as the result of an inefficient distribution of land and a lack of clarity surrounding land ownership (Jacoby and Minten 2005, 4). In particular, the state's attempts to collectivize select parcels of agricultural land in the 1970s and 1980s has been haphazardly reversed, with the national government often providing overlapping deeds to farmers for the same piece of land. Also, because decisions surrounding land ownership were removed from village commons under Ratsiraka's collectivization plans and handed over to parastatal bodies, the demise of collectivization and the state's role in land titling has left no other authority with the power to settle ownership disputes (Jacoby and Minten 2005, 6). Confusion surrounding land ownership also appears, in turn, to negatively affect agricultural productivity, including in the country's export sector (with such crops as coffee and vanilla).

At the same time, the state's past insistence on nationalizing key industries and service sectors (including banks and insurance companies) has also proven

detrimental to Madagascar's economy. Under state control, for instance, national banks were encouraged to extend capital mainly to large-scale government-backed endeavours (i.e. infrastructure projects) rather than to businesses. Today, this situation continues to play itself out with many Malagasy banks demonstrating a lack of awareness when it comes to setting loan criteria for private sector firms to access finance (IMF 2006, 4-5). A lack of experience in lending to interests other than the state can also be seen by the failure of Malagasy banks to develop meaningful lending and insurance products for individuals and families. Indeed, it was estimated in 2006 that only 35% of Malagasy households had access to savings accounts and 2% had access to regular credit (IMF 2006, 5).

The aforementioned problems cannot solely be blamed on the economic choices of past Malagasy governments. However, Madagascar's inability to significantly boost its agricultural growth or make its national banks more "friendly" to non-state actors should be seen as having some basis in the nation's past pursuit of socialist economic ideology. Issues of land titling and agricultural growth would not be as problematic today had Ratsiraka's government not pursued poorly-planned policies of collectivization. The banking system would be more open to the private sector and to individuals if it had not been encouraged for so many years to prioritize the vast majority of its lending to the state. The socialist policies of previous political regimes, in other words, have created specific realities that harm the performance of the present day economy.

When it comes to fostering a strong trade, business and investment climate, these negative outcomes of socialist economic policy also have an important impact. In particular, they suggest that in Madagascar's case, a continual process of institutional reform may have to be pursued by the Ravalomanana government if it hopes to accomplish such goals as ensuring the availability of credit to export firms or fostering a productive export-oriented agricultural sector. While the Comoros' ability to develop a strong private sector and attract investment is dependent upon the country's ability to display political stability and clarify policymaking powers between national and sub-national elites, Madagascar's likelihood of accomplishing these goals appears to depend on a different set of factors. Namely, the country must capitalize on the political and economic stability it seems to have found under Ravalomanana and expend the political capital necessary to create improved institutions (i.e. banks, agricultural cooperatives, etc.) that are explicitly geared to aiding private sector development rather than the directives of state officials.

Mauritius

It has been established that both the Comoros and Madagascar remain economically disadvantaged due to their continued reliance on the primary commodity sector to generate the bulk of their foreign exchange. Mauritius, by contrast, has developed an increasingly diversified economy in which primary,

secondary and tertiary industries are all important catalysts of growth and export-led development.

In the immediate period after the country achieved its independence in 1968, Mauritius possessed a monocrop economy centred on the production and export of sugar. In 1970, however, Mauritius launched its own EPZ and like Madagascar two decades later, a dynamic textile industry was born in the country (Subramanian and Roy 2001, 8). Unlike Madagascar, however, Mauritius' small population meant that labour shortages were always a prime concern for the national government when planning the future of the textile sector. Indeed, a large number of EPZ clothing producers shut down in the early 1990s due to a shortage of workers; a problem which became more acute once the Mauritian textile industry was forced to compete with those other African and Asian producers whose greater labour supply provided them with larger productive capacities (Subramanian and Roy 2001, 9). To cope with this challenge, a number of Mauritian governments (in conjunction with EPZ firms) took steps to promote increased labour productivity (i.e. introducing incentive-based payment and improved labour standards) and a shift towards the production of *higher-value* (and less labour-intensive) textiles.

Today, Mauritius remains a strong producer of high-value clothing products and its EPZ remains a cornerstone of the national export sector (Subramanian and Roy 2001, 9). Considered from a comparative perspective, it may be said that while Madagascar struggles to remain competitive in a world of low-cost textile production, Mauritius has managed to carve out a productive niche for itself in creating the types of higher-value (i.e. more sophisticated in design) clothing products that potential competitors such as China and India have yet to produce on a large-scale. This should allow Mauritius to remain an active contributor to the global textile manufacturing industry for the foreseeable future and this, in turn, should ensure that Mauritius remains in possession of an export industry (textiles) capable of generating reasonable amounts of foreign exchange.

At the same time, Mauritius has made concerted efforts to establish itself as a centre for IT services such as data processing and the hosting of technical support programs for Internet-based businesses (Chan-Meetoo 2007, 9). The creation of "Cyber City", an IT-based business park outside of Port Louis, is designed to facilitate the establishment of a strong "technical infrastructure" in Mauritius by encouraging the country's citizens to pursue "e-learning" and for national (and foreign) firms to establish businesses geared around the provision of electronically-based offshore financial services (Chan-Meetoo 2007, 10-11). Along with tourism, which remains a bedrock of the Mauritian economy, the national government's pursuit of IT development is likely designed to provide the country with a strong services sector capable of absorbing large numbers of Mauritius' well-educated workforce.

From a macroeconomic point of view, the strength of this economic diversity would appear to be overstated. GDP growth, while averaging over 6% in the early 1990s, fell to a more modest 3% to 4% per year between 2000 and 2006 (OECD 2006, 357). These lower than expected growth rates largely occurred as the result of declining sugar production and small-scale contractions in EPZ textile manufacturing (though the latter has begun to slowly recover since 2005) (OECD 2006, 358). At the same time, this growth has proven adequate in providing Mauritius with increasing GDP per capita figures, which now stand at roughly US\$12,000 according to UNEP. When compared to the Comoros and Madagascar (where this figure is usually listed at a level below US\$2,000), it is clear that crippling poverty is not as widespread in Mauritius as it is in these other two WIO island states.

Mauritius' inflation rate is moderately high as a consequence of the national government's decision to relax certain price controls at the end of 2006 and because of rising global prices for food imports (IMF 2008, 23-24). In 2007, inflation stood at 8.8% and given the need for Mauritius to import so much of its food and fuel, this figure is unlikely to fall significantly in the near future (OECD 2008, 432). The fiscal deficit, however, declined from 5.3% of GDP in 2006 to 4.3% in 2007, though much of this occurred due to the state's efforts to curb public sector salaries combined with an influx of grant money from the country's development partners seeking to finance such projects as "Cyber City" (OECD 2008, 435). Meanwhile, the trade deficit has increased as sugar exports have declined and imports of consumer goods have increased. The growth of the tourism sector has had particularly negative effects on Mauritius' current accounts balance as new developments (i.e. hotel building) frequently require further imports of food, construction materials, etc. (OECD 2008, 437).

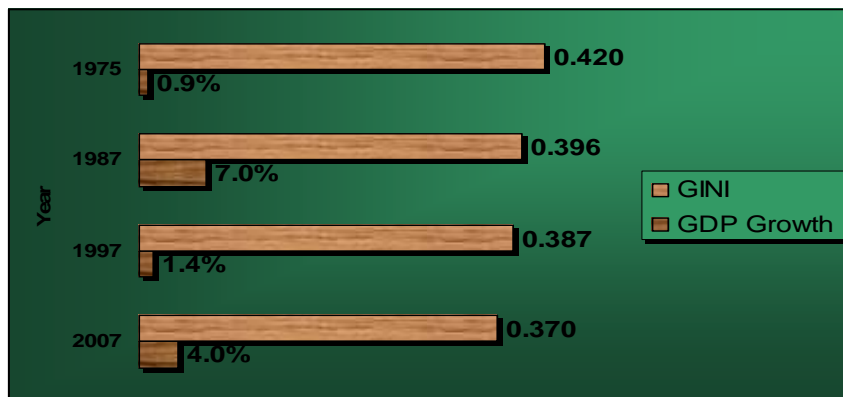
The most positive characteristics of the Mauritian economy, however, lie at the microeconomic level and the drastic improvements made by the state in reducing poverty levels. While the number of households living on less than US\$1 per day in the Comoros stands at around 37% and the number of individuals living below this threshold stands at 45%, these numbers are 7.7% and 7.8% in Mauritius according to the country's Central Statistics Office (CSO) (Mauritian CSO 2007, 7). These figures are particularly notable given the fact that in 1968, 75% of the national population lived on less than US\$1 per day (Sacerdoti *et al.* 2005, 11).

Mauritius' success in addressing its once high levels of poverty can be credited largely to the previously noted efforts of various national governments to encourage economic diversification. Additionally, the revenues generated by such sectors as the EPZ and tourism have been continually re-invested by the state into constructing a strong social welfare system that has prioritized the establishment of quality education and healthcare programs (Sacerdoti *et al.* 2005, 17-18). To be sure, poverty levels remain higher amongst rural Mauritians and on the island of Rodrigues, where exhausted fisheries are no longer able to provide a consistent income to many residents. However, even rural poverty

figures have declined considerably over the last three decades from around 40% in 1980 to a little over 10% in 2007 (Mauritian CSO 2007, 12).

As of 2007, Mauritius' GINI coefficient stands at 0.370 (Mauritian CSO 2007, 16). This is down from a high of 0.420 in 1975. In fact, contrary to the experiences of the Comoros and Madagascar, income inequality has steadily declined in Mauritius. Combined with (fluctuating) increases in GDP growth over this same time period, Mauritius is one of the few countries which has managed to generally grow its economy while simultaneously ensuring that wealth is spread relatively equally amongst the population. **Figure 1** offers a graphic representation of this point by showing that fluid (but generally upward shifting) GDP growth rates have been constantly accompanied by GINI coefficient decreases from the period 1975 to 2007.

FIGURE 1: Trends in Mauritius' GDP Growth and GINI Coefficient Figures, 1975-2007



Source: Mauritian Central Statistics Office, 2007.

Politically, the relative economic success achieved by Mauritius should be attributed to the unique process of democratization the country underwent in its immediate post-independence period. The lead-up to national independence was characterized by divisive cleavages between Mauritius' Hindu majority and its French, Creole and Muslim minorities (Subramanian and Roy 2001, 5). However, the decision of the country's first Prime Minister, Sir Seewoosagur Ramgoolam, to usher in a parliamentary system in which minority groups would be guaranteed a fair degree of proportional representation, managed to create a balance of power system that has kept the country politically stable for most of its recent history (Subramanian and Roy 2001, 6). Moreover, in spite of the wide-ranging political spectrum that has traditionally existed in Mauritius – ranging between far-left parties such as the *Mouvement Militant Mauricien* (MMM) to more pragmatic groupings such as the *Parti Mauricien Social Démocrate* (PMSD) – there has existed a broad commitment to maintaining a democratic system that upholds the rule of law.

This stands in pointed contrast to the Comoros, where the failure (prior to the Fomboni agreements) of the state to create a fair political system that

incorporated the perspectives of different interests (i.e. the various islands) led to sustained violence and instability. Mauritian politics also differs from those of Madagascar. Indeed, a lack of a well-established and financed political party system in Madagascar helped to create the conditions that allowed the country's military (under the leadership of Ratsiraka) to take power and introduce misguided socialist economic policies. By creating a balanced political system that fostered a relative degree of ethnic unity and party acceptance, Mauritius has been able to escape the problems faced by the other WIO islands and has been able to instead expend its efforts on issues related to development and economic growth.

Perhaps most important, these efforts have been greatly boosted by the fact that in spite of their differences, Mauritius' political parties have largely developed a consensus on the types of economic development programs the country should pursue (Subramanian and Roy 2001, 7). While some differences emerged over the degree to which the state should attempt to preserve the strength of the national sugar industry, political actors reached widespread agreements when it came to supporting the EPZ, developing tourism and investing in the creation of an IT infrastructure and such projects as "Cyber City". If nothing else, this consensus has undoubtedly acted to allow different Mauritian governments to act quickly in adopting specific pro-growth policies and to target investments towards particular sectors. Had Mauritius' political climate been more unstable, it is prudent to suggest that conflict between parties (and between the different ethnicities they represent) could have made such decision-making more difficult and development may have proceeded more slowly.

For trade, business and investment purposes, Mauritius' political stability and diversified economy clearly makes the nation a more attractive destination for FDI and a preferred partner for trade associations such as SADC. While a number of shortcomings still exist that constrain Mauritius' potential to enhance its "trade capacity" (which will be dealt with later in this report), the country finds itself in a position where it does not have to undertake the same types of institutional reforms that appear necessary to boost private sector performance in Madagascar. Instead, the challenges facing the Mauritian economy seem to lie with guaranteeing a sustained enthusiasm for innovative projects such as IT. Given Mauritius' physical isolation and small population, it is these unique initiatives capable of absorbing skilled labour that are necessary to pursue if the country is to maintain its economic good fortune.

Seychelles

As the least populated of the WIO island states, issues related to human capital are particularly important in the Seychelles. Like Mauritius, the Seychelles' post-independence economy revolved around the export of primary products, namely cinnamon and copra (Rosalie 2004, 8). As the prices for these products fell during the 1980s, the government of France Albert René chose to pursue

policies that promoted economic diversification and a move towards alternative industries capable of generating employment for the country's small but well-educated population. However, whereas Mauritius (and later Madagascar) created large-scale EPZs to generate manufacturing growth, the Seychelles did not follow suit (though it did put in place a much smaller EPZ). Instead, the country focused on establishing itself as an exclusive destination for tourists and it also sought to take advantage of a large maritime Economic Exclusion Zone (EEZ) to grow its commercial fisheries sector (Rosalie 2004, 8-9).

In the development of these two industries, the Seychelles has been largely successful. The national tourism sector, while considerably smaller in scale than that of Mauritius, is geared largely towards serving wealthier visitors and "eco-tourists", both of whom have helped to create employment in hospitality services, construction, handicrafts and transport. Moreover, by marketing itself as an exclusive holiday destination to affluent tourists rather than as a destination for mass market tourism, the Seychelles has, until now, been able to generally limit the environmental impact of the sector (i.e. by providing services – i.e. hotels – that are superior in quality but less numerous). Ideally, this should mean that the tourist industry will be sustainable over the long-term as the country will be able to continue capitalizing on its "paradise" image by avoiding environmental degradation caused by over-development.

The fisheries sector, on the other hand, remains a somewhat more volatile part of the Seychelles economy. With the assistance of the U.S.-based HJ Heinz Company, the Seychelles established the world's second largest tuna canning factory under the ownership of Indian Ocean Tuna Ltd. (IOT) in 1995. By 2000, the factory supplied the EU with around 14% of its canned tuna imports and this brought the Seychelles economy an estimated US\$20 million per year (Rosalie 2004, 8). Combined with a sizable domestic industrial fishing fleet and the willingness of the state to sell fishing licenses and service other nation's vessels, the fishing industry as a whole contributed almost US\$70 million per year to the country's economy based on 2003 figures (Rosalie 2004, 9). Unfortunately, overexploitation is beginning to negatively affect the sustainability of the fisheries sector and its ability to generate similar revenues (and provide employment) in the future may be put into doubt unless greater conservation efforts are made.

In common with Mauritius, the Seychelles has taken some steps to encourage the establishment of an IT infrastructure, specifically relating to the offshore financial sector. The Seychelles International Business Authority (SIBA) has been particularly active in this regard and has sought to market the Seychelles as an investment location for the EU and for large developing countries such as India and Pakistan (Rosalie 2004, 8). However, these efforts are in their formative stages and their success cannot yet be judged. Finally, the Seychelles also engages in limited EPZ textile production, though this industry has never become the export-based mainstay that it has in Madagascar and Mauritius.

The Seychelles' rate of GDP growth has averaged around 5% per year since 2006 according to the AfDB. This figure has been strengthened by increasing revenues within the tourism and offshore finance sectors (AfDB 2008, 122). Growth rates in the Seychelles have, in recent years, followed a similar trajectory to those found in Mauritius and like the latter, growth in the Seychelles is likely being somewhat constrained by production losses in the primary commodity sector (namely fisheries). However, given that the Seychelles population currently stands at fewer than 100,000 people, this growth has proven capable of delivering a per capita GDP figure of around \$US15,000 when purchasing power parity (PPP) is taken into consideration (AfDB 2008, 122). This figure is considerably higher than the per capita figures noted in the other WIO islands and demonstrates the successes achieved by the Seychellois state in creating a high degree of prosperity in spite of the country's physical remoteness, limited resource base and human capital shortages.

Because of its almost complete dependence on imports for fuel, consumer goods and certain food products, the Seychelles has struggled more than the other three WIO island states to contain inflation. Based on data provided by the Central Bank of the Seychelles (CBS), inflation stood at 27.2% as of September 2008 (though this figure is considerably lower according to other sources). This is up from more modest rates of 7% to 8% recorded by the CBS in 2003-2004. Admittedly, non-food and non-fuel based inflation remains lower than 27.2% and many of the price rises being experienced in the Seychelles are a product of global price increases that the Seychelles government cannot hope to control. However, this rise in inflation is also the result of foreign exchange liberalization policies adopted at the end of 2006 and the government's decision to keep interest rates well-below the regional average (CBS 2007, 1-2). At present, little evidence exists to suggest that high inflation rates are impacting negatively on standards of living. Nevertheless, it is apparent that curbing inflation should remain a priority for Seychellois policymakers.

According to the African Trade Policy Centre (ATPC), the Seychelles has consistently operated with a large budget deficit as the result of the state's need to pursue public investment programs to maintain the national infrastructure (ATPC 2004, 12). Also, the introduction of trade liberalization in the mid-1990s saw the Seychelles eliminate most forms of trade taxes on imports and exports and this has considerably reduced the size of the country's tax base (ATPC 2004, 19). Consequently, deficit spending is used to finance key budget priorities. The trade deficit, meanwhile, is inevitably high due to the Seychelles' dependence on imports combined with declines in export-based fisheries production. Given these types of deficits, it is not surprising that the Seychelles has also chosen to achieve its financing goals through borrowing and the nation possesses a high external debt that stands at around 90% of GDP (CBS 2007, 3).

When it comes to addressing poverty, the Seychelles appears to be the most successful of the WIO island states. Whereas a large amount of the workforce in the Comoros and Madagascar is employed within the informal economy, most Seychellois workers are engaged in formal employment (Rosalie 2004, 10). The fact that the state has developed comprehensive employment generation programs such as the Full Employment Scheme (FES) and the national Work Experience Program (WEP) has certainly played a role in ensuring that the majority of the Seychelles' citizens are able to access employment opportunities. At the same time, the governments of France Albert René and (currently) James Michel have introduced innovative social policy endeavours such as a cash transfer scheme to assist poorer households access education and healthcare (Rosalie 2004, 10-11). One of the end results of these types of initiatives is that less than 1% of the population is believed to subsist on less than US\$1 per day (CBS 2007, 2).

Unfortunately, neither the Seychellois government nor international development organizations appear to have conducted a recent analysis of the country's GINI coefficient. In fact, the most recent figure identified by this researcher is from 1984 – a figure of 0.470 (Hussein 2008, 5). However, given the state's successful efforts to curb overall poverty levels, it is fair to suggest that the Seychelles' GINI coefficient likely stands today at a rate similar to Mauritius (around 0.370) if not lower. In any case, the Seychelles has been remarkably successful in ensuring that the benefits of growth in such industries as tourism have been spread relatively equitably throughout the population.

To some extent, Seychellois politics has taken on characteristics similar to those found in Madagascar. The military-backed overthrow of the government of James Mancham in 1977 saw France Albert René's Seychelles People's United Party (SPUP) come to power on a promise to introduce socialist economic policies. These included pledges to transfer private property to state ownership and to nationalize key industries such as tourism (i.e. by placing all hotels under government control). According to scholars such as Deryck Scarr, René's new regime was inherently undemocratic and even "totalitarian" in its attempts to suppress the nation's independent media and revoke progressive elements of the "liberal" constitution bequeathed to the country by the British at the time of national independence in 1976 (Scarr 2001, 196).

While this is not necessarily an incorrect perspective, it should be noted that whereas Madagascar under Didier Ratsiraka pursued "scientific socialism" modeled after the Soviet Union, René's SPUP undertook what it described as an independent type of "Indian Ocean socialism" which placed a greater emphasis on "social" rather than "structural" change. In other words, while Ratsiraka emphasized wholesale economic changes such as agricultural collectivization and the formation of state-run rural co-operatives, René chose to focus on establishing fair access to health and education as well as putting in place the framework for the aforementioned cash transfer program (Rosalie 2004, 11).

Because of this difference in approach, the outcome of socialist policy implementation in the two countries was dramatically different. While Madagascar struggled to cope with the inefficiency of state-run agriculture and fell into deepening poverty, the Seychelles emerged from René's rule with a state that while not particularly democratic, did possess a well-established social security system (i.e. including the FES and WEP) that has since been strengthened to help reduce poverty. If the Seychelles is to maintain its relative prosperity in the future, then the current government under the leadership of James Michel must prioritize further economic diversification into such fields as IT and other tertiary industries. By doing so, the state can ensure that the revenues needed to maintain this social system remain available even in the face of declining returns in the once lucrative fisheries sector. Given the Seychelles' extremely small population, the need to continue operating an externally-oriented economy is clear and the country should persist in utilizing agencies such as SIBA in an attempt to attract investment and locate market opportunities in nearby emerging economies such as India and the Gulf states.

This section has identified the economic trends currently prevailing in the WIO island states and has commented upon the impact that historical and political forces have had in shaping these economic realities. In the sections that follow, attention will turn to the trade, business and investment climates presently in place in the Comoros, Madagascar, Mauritius and the Seychelles. However, these climates are inevitably the direct products of the broader economic conditions in which they are fostered. As such, reference will be made throughout the remainder of this report to many of the issues discussed above.

3. Island States in a Globalizing World – Opportunities and Challenges as Identified in the Academic Literature

The study of island states has become an important part of such academic disciplines as comparative political science, cultural anthropology and development economics. The literature produced in each of these fields has provided those concerned with the sustainable future of island states with the opportunity to gain valuable insights into the particular challenges these countries will face in a globalizing world based increasingly on economic inter-dependence between nations. The purpose of this report's third section is to provide an overview of the major arguments and ideas found within this literature (especially in relation to the WIO). In doing so, this section aims to provide a theoretical grounding that can be used to inform the remainder of this paper's discussion on trade, business and investment development.

The Challenges of Globalization for Island States

It is aggressively argued within much of the literature that regardless of the difficulties that economic globalization poses for island states, it is necessary for these countries to “enthusiastically engage” with the globalization process in order to overcome developmental deficiencies (i.e. small domestic markets) and become internationally competitive. Read (2004) identifies some of the more basic opportunities that globalization provides to island countries. First, he notes that these states are dependent upon imports when it comes to acquiring many consumer goods as well as oil and certain food products. As such, Read argues that it is necessary for island states to adopt an outward trade-based economic orientation simply so that their exports can be used to acquire the foreign exchange necessary to finance their imports (Read 2004, 368). At the same time, Read suggests that island states should actively *promote* free trade and global economic integration as they stand to strongly benefit from comparative advantages vis-à-vis their productive specializations. In particular, Read asserts that the types of unique primary commodities exported by island states as well as their “prowess” in such sectors as offshore finance, give these countries an advantage when it comes to finding lucrative niche opportunities for production and trade within the global economy (Read 2004, 370).

In making this argument, Read is certainly understating the vulnerability that these sectors actually face in a globalizing world (i.e. in relation to the potential for commodity price downturns or the enactment of new international laws constraining offshore financial transactions). However, this writer is correct to note that globalization does provide opportunities that island states can exploit to their advantage. Moreover, given their dependence on imports and the small size of their domestic markets, island states have no choice but to engage with the rest of the world and pursue trading relationships where they can be found. However, the challenges that globalization presents island states should not be underestimated and they play a considerable role in influencing the extent to which these types of nations can pursue the development of a strong trade, business and investment climate.

The first of these challenges can be seen as relating simply to the “smallness” of most island states. Bernal (2001), writing about industrial development in the WIO and South Pacific islands, argues that with such small domestic markets, there is little opportunity or rationale for a large number of firms to be created to serve similar industries. In other words, instead of each industry being driven by a number of competing businesses, the majority of economic sectors in island nations tend to be dominated by single “large” firms. In Mauritius, for example, MCFI is an exclusive player in the country’s chemical and fertilizer production industry. Bernal suggests that because of this single-firm dominance, the private sectors of island states tend to have little exposure to the “dynamics of competition” and are resultantly timid in undertaking reforms needed to improve

productive efficiency – i.e. generating increased labour productivity (Bernal 2001, 41).

Bernal then goes on to argue that if such firms chose to adopt an export orientation and produce products for which they will face a large amount of foreign competition (i.e. textiles), these firms will struggle to compete due to the fact that they have not been “disciplined” by exposure to intense competition within their domestic markets to the same extent as their competitors (Bernal 2001, 42-43). If this argument is to be believed, then globalization presents island states and their firms with the challenge of being forced to compete under conditions for which they may not yet be ready. Bernal also states that manufacturing firms within small island states are ill-prepared to compete in a global economy due to their inability to attain “internal economies of scale”. Specifically, even larger firms remain too small in manpower and capitalization for firm size to have any positive effect on reducing unit production costs. In addition, because of these firms’ relative “smallness”, they are equally unable to take advantage of “economies of scope”. Namely, these firms cannot easily exploit their existing resources, technologies or human capital to shift production to new and innovative products (Bernal 2001, 43). Considering that competition within a world economy often necessitates that firms be capable of altering their focuses of production (i.e. to entirely new products) on the basis of shifting patterns of global demand, an inability to quickly adjust firm priorities, retrain workers, etc. all pose a considerable threat to island state businesses seeking to prosper under globalization.

Even if firms operating in island states are able to produce goods efficiently, Bernal as well as Redding and Venables (2007) contend that high transport costs act to severely impede the export potential of these states. Redding and Venables make a particularly notable argument surrounding the elasticity of transport costs. These writers claim that the elasticities of these costs when measured on the basis of geographic distance are between -0.9 and -1.5 (Redding and Venables 2007, 113). Stated in a less technical manner, as an island state’s distance from a metropolitan market increases, growing transport costs will mean that the volume of trade that these states engage in will dramatically decrease. **Table 2** illustrates this point, using an assumed price elasticity of -1.25 (see Redding and Venables for calculation details). This table represents trade volumes relative to their value at 1000 km.

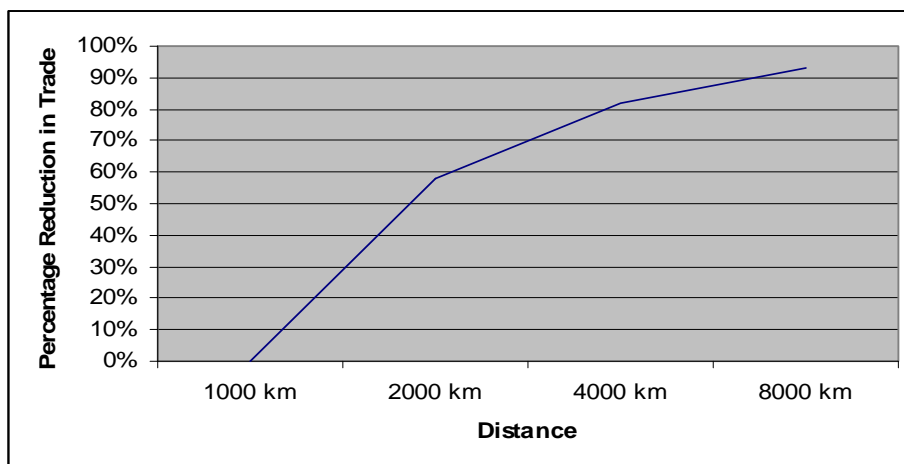
TABLE 2: Price Elasticity of Transport Costs and Corresponding Reductions in Trade Volumes

<u>Distance Travelled</u>	<u>Decrease in Trade (%)</u>
1000 km	0%
2000 km	58%
4000 km	82%
8000 km	93%

Source: Redding and Venables (2007).

Figure 2, meanwhile, offers a graphic representation of these figures. What is important to note about these numbers is that for the island states of the WIO, the distance between themselves and metropolitan markets (i.e. the EU) is well over 7,000 km, meaning that trade flows are massively reduced from what they might otherwise be if transport costs did not have to be factored in. For the WIO islands, even nearby African markets are commonly 1,500 km to 2,500 km away, thus considerably reducing trade flows between these islands and their partners in an association like SADC. Indeed, the estimated distance between Port Louis and the South African port of Durban is at least 2,500 km, suggesting a decrease in trade of over 60% simply based on the costs associated with transport and distance. Redding and Venables do suggest that maritime transport costs remain lower than the costs of transporting goods for long distances overland (i.e. freight costs are cheaper for the WIO island states than for landlocked countries such as Chad) (Redding and Venables 2007, 113). However, for island states seeking to be successful exporters, transport costs clearly pose a formidable challenge and they suggest that for island nations to be successful in a globalizing economy, it may be better for them to focus on furthering developments in such industries as finance, IT and tourism as these sectors incur fewer (if any) freight charges.

FIGURE 2: Price Elasticity of Transport Costs and Corresponding Reductions in Trade Volumes



Source: Redding and Venables (2007).

The importance of geographic distance is not limited to its negative impact on transport costs and the shipping of exports. This factor also makes it very difficult for firms operating in island states to source intermediate and capital goods such as machinery (Redding and Venables 2007, 110). On one hand, this is a consequence of transport costs as the import of capital equipment will inevitably be more expensive for island states incurring significant freight charges than it would be for other countries. At the same time, for firms operating in such regions as the WIO, there exists a substantial time-based cost in acquiring needed equipment. For instance, if a large piece of machinery breaks down, it will take a great deal of time for a firm located on an isolated island state to

acquire a replacement via maritime transport. The loss of productivity experienced by the firm while waiting for this new machinery may be extremely damaging to the firm's ability to remain viable and globally competitive.

As noted in the previous section, many island states (i.e. Mauritius) are gearing their manufacturing sectors around the production of high-value products like certain textiles as a way to cope with their relatively high labour, transport and other costs. This is in comparison to nations like China and India, where low-cost and low-value manufacturing is the norm. Unfortunately, the production of higher-value goods typically demands the use of superior capital equipment. As argued by Horscroft (2007), if this equipment is difficult or expensive to acquire (or to repair), then island states are in a particularly difficult situation as they must be capable of dealing with the *amplified* financial and time-based costs of sourcing this equipment and regularly upgrading it should improved technologies come onto the market (Horscroft 2007, 61). While non-island countries must also be able to cope with sourcing difficulties and transport issues, Horscroft suggests that many larger states will choose to develop a "domestic stock" of capital equipment through either bulk purchasing or domestic production. For island states with smaller economies and smaller levels of overall savings, these options are not viable, meaning that sourcing difficulties, transport delays, etc. are especially damaging to the productivity of island states (Horscroft 2007, 63).

From a political point of view, Read highlights another potential challenge posed to island states (and smaller countries in general) by globalization. Specifically, he argues that because the international economy is dominated by the interests of global capital and the policy plans of international financial institutions like the World Bank and IMF, island states integrating themselves into this economy stand to lose their "economic sovereignty" when it comes to setting taxation policies, determining expenditure priorities and designing their own independent regulatory environments (Read 2004, 370).

According to Read, the onset of globalization means the inevitable loss of state power to the growing influence of larger corporate and political interests. This is something this writer deems to be a dangerous development given the fact that small states in general are more at risk from exogenous market shocks (i.e. global financial downturns) than their larger counterparts. Read concludes pessimistically that while it is necessary for island states to assume an outward looking economic orientation, these states should know that they will have to sacrifice a great deal of their policy-setting freedom in the process.

The above issues are by no means the only challenges that globalization poses to island states. However, firms' lack of exposure to (and experience with) competition, firms' difficulties in generating economies of scale or scope, high transport costs, the challenges of sourcing capital equipment and the potential loss of national economic sovereignty are each identified within the literature as having the potential to constrain the "trade capacity" of island states within a

globalized world economy. Some of these challenges may be overstated in their importance. Mauritius, for example, has successfully begun to focus its textile industry around the production of higher-value products without having any apparent difficulties in sourcing equipment. Also, the existence of EPZs in countries like Madagascar and Mauritius *has* encouraged some competition between export-based firms in these states. Consequently, it should not be assumed (as Bernal would argue) that island state exporters will necessarily be unable to operate if exposed to greater international competition.

Nevertheless, these challenges are evident and effectively responding to them is necessary if island states are to exploit globalization for their own benefit. In what follows, three “coping strategies” (ways that island states can actively seek to improve their economic circumstances and address these challenges) are laid out. These strategies relate to: 1) how island states can alter their domestic policymaking decisions to overcome these aforementioned challenges, 2) how island states can establish upward and downward linkages with metropolitan markets to strengthen their positions within an emerging world economy and 3) how regional and sub-regional integration can be used to boost the leverage of island states and assist them to enhance their shared productivity and competitiveness.

Coping with Globalization – Strategy #1: Re-Evaluating Domestic Policy

While scholars such as Read may assert that island states lack the capacity to undertake independent policymaking in a globalized world system, other writers dispute this notion. Bernal, for instance, is keen to argue that rather than losing their political independence and policy setting sovereignty, globalization provides island states with the opportunity (and the need) to undertake more aggressive steps to re-evaluate and improve domestic policy efforts geared towards boosting trade competitiveness. Stating once again that island state manufacturing firms are too often unused to competition and are incapable of generating economies of scale or scope, Bernal makes the case that these countries must be willing to put in place “temporary” protectionist measures to foster the growth of those industries they want to turn into export-oriented economic pillars (Bernal 2001, 49).

To be more specific, Bernal asserts that island states must be given some flexibility and time to oversee the development of national firms prior to exposing them to international competition. Through the creation of detailed industrial policies, Bernal believes that island state governments can work with firms to put in place reforms in areas like labour productivity and corporate governance to bring their businesses in line with the “best practices” of firms in other nations. Also, Bernal notes that island state governments can use industrial policy formulation as a means to foster competition within their domestic markets, even if this means mandating the division of larger firms into a number of smaller

competitors (Bernal 2001, 49-50). Finally, industrial policy can be used as a way for governments to review and selectively “target” the growth of particular industries that they believe could eventually be made globally competitive.

Bernal is clear in suggesting that for these types of policies to be put in place, international bodies such as global financial institutions and the WTO must be more incremental in phasing out preferential trading agreements. As was noted in the introduction to this report, these agreements have traditionally allowed island states to gain exclusive export access to lucrative markets and Bernal stresses that this access must be allowed to continue until island nations are in a position where they deem themselves capable of competing without these agreements acting as a “safety net” (Bernal 2001, 48). Also, Bernal argues that island states should be given the exclusive opportunity to pursue an “asymmetrically phased implementation of rules and disciplines” in areas such as market liberalization (Bernal 2001, 49).

In other words, rather than pursuing quick reforms akin to structural adjustment programs (SAPs), island states should be given the leeway to pursue reforms slowly and in such a way that ensures that once they do expose themselves and their firms to the global market, island states will be capable of competing fairly and can exploit their comparative productive advantages to their full potential. If this flexibility is offered to island states, Bernal believes that these countries can then pursue the types of domestic industrial policy options that will allow these states to enhance their “trade capacity”.

Bernal’s focus on industrial policy is intriguing because it suggests that island states themselves have the power to develop their own competitiveness under globalization. The examples of the “Asian tiger” economies as well as China and India act to reinforce the possible benefits of industrial “targeting”, protectionism and corporate governance reform, all of which are incorporated within industrial policy plans. However, Bernal’s arguments rest on a number of assumptions which are unlikely to work in favour of the interests of island states to the extent that he appears to believe. First, with the creation of the EPZs, island states like Mauritius and even Madagascar have already developed firms with an explicitly export-based focus. Consequently, what opportunities remain for these states to pursue a statist approach to *fostering* the growth of industries like textile manufacturing if these industries have already developed under the auspices of the EPZs? While it is possible that island states could devise industrial policies geared towards the development of entirely *new* types of manufacturing, the aforementioned problem these states have in sourcing capital equipment makes this an unlikely proposition.

Second, even assuming a relative decline in influence for institutions such as the World Bank, IMF and even WTO, there is little reason to believe that island states are going to be given special treatment to pursue protectionist policies (even on a temporary basis). On the contrary, the potential growth of regional

associations such as SADC and the Common Market for Eastern and Southern Africa (COMESA) may make arguments in favour of dropping tariffs and pursuing quick market liberalization more forceful. Finally, considering the limited manpower available to many island state bureaucracies, it is highly contestable whether governments in these countries can really create, implement and effectively monitor the success of wide-ranging industrial growth strategies.

Moreover, even if this were possible, the small domestic markets found in these states make protectionism unworkable. If they are not allowed to export on a consistent basis (likely without the benefit of preferential trade agreements), who will island state manufacturers sell their goods to? This is particularly the case if island state governments follow Bernal's advice and foster the creation of a number of small firms to encourage domestic competition. Unlike larger emerging economies, there is simply not enough of an internal market within these states to make production for domestic consumption a worthwhile endeavour. As argued by Read, island state firms must always undertake an outward-oriented perspective and aggressively seek export markets. This makes the pursuit of protectionist policy reforms (and the introduction of domestic industrial policies in particular) a rather poor strategy for coping with globalization.

Coping with Globalization – Strategy #2: Creating Upward and Downward Linkages with Metropolitan Economies

A second strategy that could be utilized by island states to deal with the effects of globalization involves these countries forming what Read calls “upward or downward linkages” with metropolitan economies (Read 2004, 371). Specifically, island states should seek to link themselves to nearby (larger) countries and enter into strong bilateral relationships whereby they can benefit as joint partners in the production of particular products or profit from shared investments in industrial zones, factories, etc. These linkages may also be used to foster strong political relationships and their primary objective is to provide island states with the opportunity to gain economic opportunities (i.e. the chance to contribute to different supply chains) that they might not be able to realize by themselves.

Jain and Ghauri (1996) argue persuasively that nations such as Mauritius and the Seychelles are in a very strong position to pursue linkages with nearby emerging economies like India, Pakistan and South Africa. In particular, these writers suggest that the governments of these island states should seek to market their countries as regional “intermediaries” capable of taking on downstream production (i.e. value-added manufacturing) for export firms based in these larger nations (Jain and Ghauri 1996, 587). As an example, Jain and Ghauri claim that Mauritius should utilize its reputation for skilled labour and market itself to Indian textile firms as a location in which value-added work (i.e. more sophisticated designs) can be performed on the types of textile products manufactured cheaply in India itself (Jain and Ghauri 1996, 590). The island

states of the WIO can even be used as “logistics centres” from which these value-added products can be distributed to nearby African countries, thus allowing nations like India to reap the benefits of partnering with these island states to gain advantageous access to markets like COMESA and SADC (Jain and Ghauri 1996, 592).

The service sectors of island states can also benefit from the formation of linkages with larger countries. Jain and Ghauri identify the growing middle classes in nations like India and Pakistan as a justification for nearby WIO islands to pursue the marketing of offshore finance to these emerging economies (Jain and Ghauri 1996, 592). After all, with more wealth being generated within Indian Ocean rim countries, more individuals from these states will seek to locate a “stable” location in which to keep their finances (especially if political violence prevents this stability from emerging at home). WIO island states are already niche players within the financial sector but have tended to market their financial services primarily to regions like the EU (Jain and Ghauri 1996, 592-593). Jain and Ghauri argue that this approach is misguided and that Mauritius and the Seychelles in particular should be able to capitalize on their reputations in the financial sector to make themselves valuable actors in helping to secure the monetary well-being of firms and individuals in nearby emerging states.

For academics like Jain and Ghauri, island states’ ability to form manufacturing or service-based linkages with larger economies is important to the extent that it allows island nations to “piggyback” on the success of emerging economic powers like India (Jain and Ghauri 1996, 589). To be more specific, these linkages allow island states to carve a role for themselves as reliable partners that these larger states can depend on to help further the development of their key export industries – i.e. textile manufacturing, IT services, etc. If island states can sustain this image of “reliability”, then they may benefit not only by way of entering into prolonged economic partnerships with these larger economies but they may also be rewarded with investments in infrastructure (i.e. port facilities), technology transfers and worker training. Clearly, these types of investments would be beneficial to island states vis-à-vis improving their competitiveness on the global stage.

In relation to the globalization-based challenges that were identified earlier, the value of country-to-country linkages is also readily apparent. If manufactured products (i.e. value-added textiles) are produced by WIO island states on behalf of firms in a country like India, then the transport costs borne by these states when exporting finished goods should be reduced as Indian producers choose to share some of these costs on the basis of their own self-interest. Also, if island states undertake production on behalf of firms from larger countries, it may be easier for island state producers to source capital equipment via these firms at below market prices. In terms of broader economic benefits, on the other hand, partnering with other states as a downstream producer within a particular supply chain (such as within the textile industry) will likely allow island states to branch

into the types of high return value-added production that they would be less likely to pursue independently simply due to high costs.

Not surprisingly, however, these linkages do not act as a perfect “coping strategy” when it comes to island states’ attempts to deal with globalization. Many island nations could run the risk of not adequately diversifying their linkage partnerships while instead remaining reliant on a single partner state when undertaking joint investment plans and shared production regimes. Should an economic downturn negatively impact this larger state, then these island partners will clearly suffer as well. Nevertheless, writers such as Jain and Ghauri are correct to note that globalization is being increasingly driven by the power of emerging economies, many of which are situated within close proximity to island states like those of the WIO. The formation of productive alliances at least allows island nations to position themselves to take advantage of the power of these economies (not least in terms of fostering trade and investment growth) and it is the opinion of this research paper that this particular “coping strategy” should remain a topic worthy of further research.

Coping with Globalization – Strategy #3: Pursuing Regional and Sub-Regional Integration

It is cautiously argued within much of the literature that the pursuit of regional or sub-regional integration may be an effective way for island states to cope with globalization. The rationale behind this argument lies with the assumption that if island states can pool their resources (either amongst themselves or by connecting to larger trading blocs like SADC), they will be more successful in reducing their trade-related costs, developing economies of scale, promoting sound corporate and political governance, building sophisticated financial markets and sharing human talent and expertise.

For writers like Breytenbach (1999), regional or sub-regional integration is an inevitable geo-political requirement of globalization and the only dilemma to be faced by island states is whether it is better for them to pursue this integration via a loose form of “functional cooperation” or through a more systematic “neo-functional integration” (Breytenbach 1999, 71). In the case of the former, integration occurs on an issue-by-issue basis and without any legal requirements for states to harmonize tariff requirements or other standards. By contrast “neo-functional integration” necessitates that countries enter into a more formalized integrative agreement in which market liberalization, standards harmonization, etc. are pursued across the board (Breytenbach 1999, 71-72).

Writing about the prospects for regional and sub-regional integration for the island states of the WIO, Breytenbach suggests that a number of organizations have already formed in this region to present island state governments with the challenge of choosing how to integrate their national economies into a larger grouping of states without sacrificing their political sovereignty and “economic

flexibility". Both COMESA and SADC are identified by Breytenbach as *regional* groupings whose membership requirements incorporate elements of both of the aforementioned types of integration (though Breytenbach expects these organizations to become increasingly "neo-functionalist" in the future). In addition, this author points to the Indian Ocean Rim Association for Regional Cooperation (IOR-ARC) as an even larger example of a regional body, driven mainly on the basis of issue-by-issue cooperation that incorporates the WIO island states. The IOC, meanwhile, is portrayed by Breytenbach as the sole *sub-regional* integrative body in which the WIO island states take part (i.e. the IOC is "sub-regional" in that integration is designed to take place solely amongst the WIO island states without these countries linking themselves to a larger bloc) (Breytenbach 1999, 71).

Breytenbach writes positively about the potential benefits that can be achieved by the WIO island states (and island states in general) in choosing to integrate with organizations like those mentioned above. In a globalizing world that is increasingly defined by nation states choosing to transfer elements of their economic (if not political) independence to regional associations such as the EU or the Association of Southeast Asian Nations (ASEAN), Breytenbach suggests that island states stand to benefit from integrative processes that allow them to "pool their comparative advantages" with other countries. After all, integration allows these island nations to avoid having to compete on the international stage as individual small countries plagued by the challenges discussed earlier (i.e. an inability to generate economies of scope) (Breytenbach 1999, 72). Instead, Breytenbach argues that through regional or sub-regional integration, island states will be able to become members of larger politico-economic polities whose global competitiveness is enhanced by the expression of "aggregates of combined complementary comparative advantages" (Breytenbach 1999, 72). Stated differently, integration allows island states to compete with the committed support of an economically diversified group of countries rather than forcing them to compete solely on the basis of their own (limited) productive capabilities.

However, Breytenbach also cautions that for integration to be beneficial over the long-term, there has to exist a strong sense of "complementarity" between members of an integrative bloc. In other words, a division of labour and production between regional states has to be in place to prevent countries from simply focusing on the same productive tasks and by extension, to prevent them from simply competing with each other (Breytenbach 1999, 72). Breytenbach raises queries as to whether or not the small size of island states and the similar nature of their economies (i.e. a reliance on primary commodities, tourism, textile manufacturing, etc.) may make these complementarities difficult to achieve.

This is a view echoed by Kelegama (2000), who asserts that the "informality" of trading blocs like the IOR-ARC (i.e. their lack of binding requirements) makes it impossible for these types of associations to mandate an effective division of labour and production between their member states. Instead, these types of

blocs can achieve complementarities only to the extent that members (i.e. island states) work together to prevent an overlapping of productive activities (Kelegama 2000, 258). Given the fact that island states like Madagascar, Mauritius and the Seychelles pursue similar economic activities (textile manufacturing, offshore finance, etc.), Kelegama believes that preventing this overlap will be exceedingly difficult, thus negating the rationale for these countries to pursue the benefits of regionalization in the first place (Kelegama 2000, 258-259).

Indeed, if the point of regional integration is to allow countries (especially small ones) to pool their comparative advantages and compete on an explicitly “regional” basis, then having these nations compete with each other within key economic areas surely undermines the potential for a regional grouping (i.e. the IOC) to put forward a “united front” when competing with other global blocs. For writers like Kelegama, however, the informality associated with “functional cooperation” (which he also terms “open regionalism”) creates problems that extend beyond an inability to promote the formation of complementarities between island states. According to Kelegama, “functional cooperation” is also flawed because its integrative framework assumes that members of a regional bloc will undertake cooperation on a voluntary and unilateral basis. Therefore, the extent to which an island state will be able to partner with a larger member of a regional bloc to pursue economic and technical cooperation or trade and investment dialogue, will depend on the willingness of these larger states to cooperate in these endeavours. For Kelegama, it is better for regional organizations to possess some sort of bureaucratic mechanism that *mandates* this type of cooperation and puts in place rules which compel nations to share technology, expertise, intellectual capital, etc. (Kelegama 2000, 259). With cooperation in such organizations as the IOR-ARC (and to some extent COMESA and SADC) resting largely on voluntarism, however, Kelegama is skeptical that island states will be able to make their voices heard and they may even be disadvantaged if they abide by the wishes of their larger partners to pursue market liberalization but are unable to gain any benefits (i.e. technology transfers) in return.

In contrast to Breytenbach and Kelegama’s skepticism towards the potential benefits that regionalization can bring to island states, Dabee and Reddy (2000) offer a slightly more encouraging argument. Both of these writers acknowledge that small levels of intra-regional trade amongst the WIO island states make the prospects of a “neo-functionalist” trading bloc emerging out of an organization like the IOC highly unlikely (Dabee and Reddy 2000, 1153). In addition, they note that because so many island states (in the WIO and elsewhere) are dependent upon tariffs for a large part of their tax revenue (especially the Comoros, where around 65% of the country’s tax base is centred around trade-related duties according to 2000 figures), it will be difficult for island states to see a great deal of value in pursuing the types of trade liberalization that membership in regional organizations may demand (Dabee and Reddy 2000, 1151).

However, Dabee and Reddy put forward the belief that if regionalization is pursued *gradually* (i.e. if the WIO island states take concerted action to eliminate tariffs amongst themselves before extending that benefit to a wider group like the IOR-ARC), then these countries will have time to put in place policies that allow for a shifting of the tax burden away from the trade sector. Also, gradualism may allow for greater efforts to be made by governments in the WIO island nations to pursue further negotiations with potential partners in organizations like the IOR-ARC to see what willingness exists amongst larger countries to share technology and assist island states to undertake joint investment plans, shared marketing ventures, etc. If island states can use these negotiations to establish a “fair deal” for themselves, then it is more likely that some of the challenges identified by Kelegama (i.e. a lack of guarantee that island states will gain the benefits they seek from regionalization) can be resolved in advance of full integration. Additionally, negotiation may provide island states with the opportunity to use mechanisms like the IOC as a body within which they can negotiate issues of complementarities and produce a sub-regional division of labour that will prevent unnecessary competition from forming amongst the WIO island states once more advanced/deeper regionalization takes place (Dabee and Reddy 2000, 1154).

In other words, Dabee and Reddy are suggesting that while speedy regional integration will likely do little to help island states address issues that may be relevant to their economic success, a more gradual (and thoroughly negotiated) pursuit of regionalization may allow obstacles to be overcome in a more effective manner. Should these negotiations convince island states of the benefits of regional integration, then Dabee and Reddy seem to believe that associations like the IOC, IOR-ARC or even SADC will be seen as likely to offer advantages that the WIO island states deem worthy of pursuing. There is little reason to doubt Dabee and Reddy’s arguments and it is the case, regardless of the concerns raised by Breytenbach and Kelegama, that island states stand to gain significantly within a *well-planned* regional integrative framework. The opportunity to acquire technology and share ideas (at the governmental and firm-based levels) are only two of the advantages that could be gained by island states to a much greater degree within a regional body like the IOR-ARC or SADC.

Breytenbach is prudent in raising issues related to complementarities and the possibility that overlapping forms of production may negate the benefits of regionalization for many island states. However, as the previous section of this report established, even industries that are shared in common between nations like Madagascar, Mauritius and the Seychelles are not identical. Madagascar’s textile manufacturing industry, for instance, is based around low-value production while that of Mauritius is centred in higher-value goods. All of the WIO island states export fish and fish products but the Seychelles enjoys a particular comparative advantage when it comes to the export of canned tuna (due to the presence of a large canning factory). The WIO islands do enjoy economies that, while similar, are different enough to suggest the potential for developing

complementarities. The challenge, however, is to forge a greater sense of intra-island participation within the WIO (likely through the IOC) to identify how these complementarities can be best cultivated. Dabee and Reddy's emphasis on gradual negotiated regionalism may be an effective tool by which to pursue this goal.

This section has identified the key challenges faced by island states within a globalizing world economy. It has also detailed three possible "coping strategies" (each considered within the prevailing literature) that could be used to help these countries maximize their potential to succeed in this economy. The discussion of the following sections turns towards the WIO island states and their ability to foster a strong trade, business and investment climate. As was the case for the economic overview portion of this paper, the issues discussed in this section will be referenced in the sections that follow as a means to highlight important concerns and identify the key challenges that the WIO island states continue to face in developing their "trade capacities".

4. The Western Indian Ocean Island States: Assessing the Overall Trade, Business and Investment Climate from a Macro-Level Perspective

In this report's fourth section, attention is turned directly to evaluating the trade, business and investment climate currently in place within the WIO island states. More specifically, this section is interested in trying to understand the quality of this climate from a macro-level (i.e. institutional) point of view. When speaking of "trade capacity", various institutions play a vital role in promoting trade facilitation, putting in place investment-friendly policies, guaranteeing the availability of start-up and investment capital and ensuring the development of a trade-enhancing physical infrastructure. This report has chosen to focus on the following institutions that fulfill these functions in the WIO island states: 1) commercial and developmental banks, 2) judicial systems, 3) port authorities, 4) assorted government ministries and 5) integrative regional organizations. By commenting on the extent to which these institutions are succeeding in performing their allotted functions, an analysis can be provided as to the strengths and weaknesses of the trade, business and investment climate they are intended to foster.

This section's analysis is based largely on the primary research carried out by the researcher (as detailed in section one). However, a review of select secondary sources has also been used to reinforce some of the ideas found within this research and to offer more detailed rationales for why the research participants contacted for this study may hold certain beliefs, ideas and perspectives vis-à-vis private sector development in the WIO.

Commercial and Developmental Banks

If export-based firms in the WIO island states are to grow their businesses, acquire productive inputs, purchase quality capital equipment, invest in human capital and pursue sophisticated marketing strategies targeting overseas consumers, then they must be able to access finance in a timely and cost-effective manner. Indeed, for firms to even make the initial transition away from inward-oriented production towards an export-led business strategy, finance must be made available in the form of grants and/or loans that are offered to entrepreneurs at non-predatory interest rates. Banking institutions, whether commercial or developmental in focus, are the bodies responsible for ensuring that this finance is made accessible to private sector interests. In South Pacific locations like Samoa and Niue (mentioned at the beginning of this report), the willingness of (primarily) Australian and New Zealand banking institutions to make finance readily available to burgeoning IT enterprises (and to work with entrepreneurs in these islands to develop thorough business plans) can be credited with much of the success these locations have had in developing a strong IT services industry. For the WIO island states to be successful exporters in the future, they must be able to depend on their national banks being equally enthusiastic in offering their assistance.

Sadly, an interview with the General Secretary of Textile Madagascar (*interview: November 15, 2008*) suggests that this assistance is not forthcoming for Malagasy entrepreneurs. On the contrary, this research participant claims that the relationship between entrepreneurs and commercial banking institutions in Madagascar is “difficult”. In particular, the General Secretary notes that for her firm (which is a medium-sized exporting establishment employing around 120 people) to access a bank loan, she must be willing to accept an interest rate set by all of the country’s major banks at around 18%. While this figure may not be considered exceptionally high compared to the rates charged within many mainland African states, the General Secretary notes that for her firm, even an interest rate at this level acts as a major disincentive for her to even approach banks in search of loans in the first place. Instead, this participant states that if her firm wishes to expand, improve staff training or purchase superior machinery, it will have to do so by mobilizing “internal funds” (namely the firm’s savings).

The General Secretary asserts that using internal funds allows her firm to avoid indebtedness. However, she also says that by relying on small levels of savings to pursue firm improvements, her organization has little capital to fall back on (i.e. to pay salaries) should an economic downturn harm exports. Also, any improvements made through the investment of savings tend to be piecemeal as savings levels tend to be modest to begin with (at least compared to what would be available through a bank loan). Without a more “fair” lending strategy, in other words, the General Secretary believes that her firm will be unable to undertake the *scale* of improvements necessary to remain competitive, especially if the continued “phase out” of AGOA and the MFAs leaves her firm in a position where

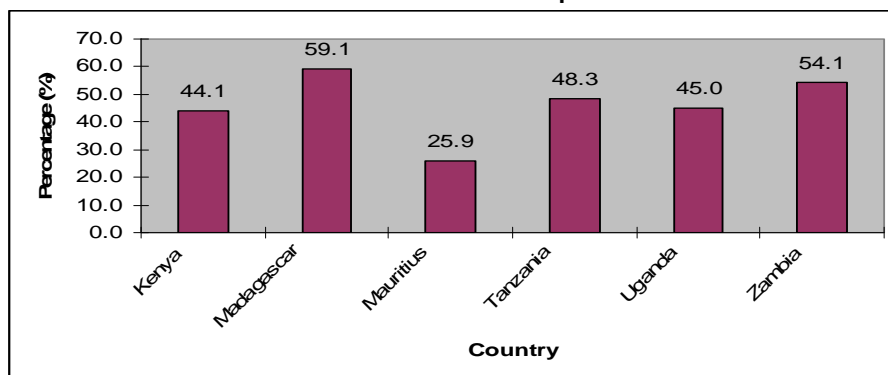
it has to compete more directly with Chinese and Indian producers whose access to capital is typically guaranteed by state financial bodies.

Not surprisingly, a representative from BMOI, one of Madagascar's major commercial banks (*interview: November 24, 2008*) takes a different perspective from that of the General Secretary of Textile Madagascar. While acknowledging that his bank receives a number of complaints from national firms in regards to interest rate levels and collateral requirements, this respondent argues that given the poor quality of most firms' business plans and the lack of trained staff available to banks to help entrepreneurs develop better plans, it should be expected that banks would show some hesitancy in their lending. Notably, this BMOI representative then goes on to acknowledge that lending to the private sector remains less of a priority for his institution than lending to the government. In fact, this participant claims that the majority of the loans he oversees are provided to government-owned firms or to private sector firms (i.e. construction companies) undertaking activities on behalf of the state. Private sector export firms (except within the EPZ) are not given priority when it comes to lending.

The responses given by the General Secretary of Textile Madagascar are not startling and issues related to Malagasy firms' inability to acquire loans due to high interest rates and demanding collateral requirements are well acknowledged. Indeed, Madagascar's own 2007 PRSP comments that Malagasy banks "never" lend to small firms (export-based or not) and that even when firms are able to access finance, this tends to come in the form of short-term loans rather than the types of long-term financing that firms require when attempting to project their future business opportunities (Madagascar PRSP 2007, 115). Reinforcing the BMOI representative's comments about private vs. public sector lending, Madagascar's PRSP states that the amounts of capital given to private firms via loans is around only 9% of GDP, a figure that is lower than similar numbers calculated for war-torn Burundi and Ethiopia (Madagascar PRSP 2007, 114). Meanwhile, the World Bank, in a 2005 study of Madagascar's investment climate, notes that the collateral requirements of Malagasy banks like BMOI are typically 137% higher than the average for sub-Saharan Africa (World Bank 2005, 3).

What these participant responses and supporting data indicate is that Madagascar's banking system is simply not helping to enhance the "trade capacity" of national export firms. If the collateral requirements mandated by Malagasy banks are as high as the World Bank suggests, then it is hardly unexpected that the General Secretary of Textile Madagascar would not be eager to approach a bank like BMOI for a loan. Similarly, if lending to the private sector is as low in Madagascar as the PRSP states, then why would firms even consider undertaking the costs (mainly time-based) of processing the paperwork necessary to apply for a loan in the first place? **Figure 3** offers a graphic illustration of the extent to which "access to finance" is a greater concern for Malagasy exporters when compared to their counterparts in other African states.

FIGURE 3: Percentage of Exporters Listing Inadequate “Access to Finance” as a Constraint on their Operations



Source: World Bank (2005).

In Mauritius, access to finance is not such a troubling issue (as the graph above makes clear). However, according to an economist at the University of Mauritius (*interview: June 12, 2008*), the Mauritian banking sector is constrained in its lending by the fact that the ownership structure of national banks tends to be dominated by a select few “privileged” families. In many cases, these families also control many of the country’s key large-scale export firms and this leads to a situation in which bank lending is largely funneled into “preferred” family corporations rather than capital being made available to the private sector as a whole. The project manager for MCFI in Port Louis (*interview: June 14, 2008*) also notes problems associated with bank ownership and argues that the ability of firms to access finance depends largely on the “connections” they enjoy with prominent bank owners and managers. Going further, this respondent suggests that loans to the Mauritian private sector are distributed more on the basis of bank managers’ “preferred interests” rather than as an outcome of their accepting a strong business plan from a potential client.

At a more technical level, the MCFI project manager states that equity requirements for the average small-scale business loan in Mauritius are often around 50%, a figure comparable to the rest of Africa but much higher than that for firms in East and Southeast Asia. At the same time, this respondent acknowledges that for EPZ firms, this requirement is less strenuous and the fact that the EPZ continues to be heavily supported by the state means that pressure is often applied on national banks to make finance more easily available to EPZ firms than for their non-EPZ counterparts.

A second economist at the University of Mauritius (*interview: June 12, 2008*) argues a position somewhat at odds with those of his academic colleague and the respondent from the MCFI. While recognizing that “vested interests” and equity requirements can make it difficult for some Mauritian firms to access start-up or investment capital, this respondent also argues that the Mauritian banking sector is well-developed and that any caution expressed by Mauritian banks in extending finance should be seen in the context of these banks being more

vulnerable to distress (due to smaller levels of capitalization) when clients default on their loan repayments. At the same time, this economist remarks that any shortcomings in accessing finance through commercial banking institutions is remedied by the presence, in Mauritius, of strong state-backed development finance institutions (DFIs) like the Development Bank of Mauritius. Because these types of bodies have the risk associated with their lending activities underwritten by the state, they are much more willing to extend finance in generous amounts than more “risk-averse” commercial banks.

These DFIs, this economist believes, have a key role to play in helping small-scale non-EPZ firms access capital. Additionally, the fact that DFIs tend to offer below market interest rates on their loans means that firms attempting to “find their feet” in the export sector (and which may be coping with high costs in sourcing equipment, training staff, etc.) have more leeway to take advantage of the finance available to them as opposed to having to concern themselves with keeping their debts from spiraling out of control. This is a perspective echoed by the loans manager at the Development Bank of the Seychelles (*interview: June 17, 2008*) who contends that her institution plays a vital role in providing finance to firms that may have difficulty accessing loans from commercial banks. To be specific, this respondent makes the case that many of the Seychelles’ commercial banks are unwilling to provide finance to small export firms until they can meet loan equity requirements in excess of 40%. Given the small size of most Seychellois firms, this tends to be a difficult requirement to meet and the national development bank offers a sound financing alternative until firms are in a position whereby their fiscal position allows them to interact with commercial banks on a more “equitable” basis.

The MCFI project manager does offer a note of caution when discussing the value of DFIs like the Mauritian and Seychellois development banks. With the inevitable shift towards further market liberalization demanded by globalization and the entry of these island states into regional bodies like COMESA and SADC, this respondent argues that governments (and the firms they support) will be counted upon to increasingly pursue their financing by way of exploiting capital markets. According to this project manager, this may eventually lead to a situation in which parastatal DFIs come to be seen as “politically unacceptable” financing mechanisms.

A dearth of literature produced on the health of the Comoran banking industry makes it difficult to comment on finance accessibility in this country with the same level of detail as was possible for the other three WIO island states. However, the Comoran MPRD states that the country’s banking sector remains heavily underdeveloped and that the focus of its lending activities is oriented towards supporting “already established” firms in sectors like ylang-ylang and clove production (MPRD 2005, 7). Emerging firms in need of finance, the MPRD makes clear, struggle to meet even the more modest collateral requirements set out by Comoran banks. In addition, the significant influence of French interests

in the Comoran financial sector (and to a lesser extent in Madagascar) means that lending is often prioritized for foreign-owned firms rather than for those firms run by “indigenous” entrepreneurs (MPRD 2005, 8-9).

In sum, what the above interviews and secondary sources are suggesting is that firms’ access to finance (and thus the performance of banking institutions in providing it) is largely inadequate within the WIO sub-region. In Madagascar, high interest rates, exceptionally demanding collateral requirements and a failure to direct lending towards the private sector are preventing Malagasy export firms from being able to acquire the capital necessary to improve the functioning of their businesses. In Mauritius and the Seychelles, accessing capital is also a challenge for export firms but for different reasons. The prevalence of “vested interests” within the Mauritian banking sector combined with high equity demands put in place by both Mauritian and Seychellois banks have made acquiring loans challenging (though certainly not impossible) for firms in these states. The Comoros’ banking sector, meanwhile, remains at the mercy of that country’s overall lack of development. This structural weakness, in turn, has allowed the Comoran banking industry to be inordinately influenced by foreign interests and this has left Comoran-run firms at a disadvantage in making their voices heard in the country’s financial sphere. DFIs like the Mauritian and Seychellois development banks remain possible sources of alternative financing but their future may be clouded in a globalizing world economy.

In evaluating the trade, business and investment climate of the WIO island states, it is clear that the difficulties associated with obtaining finance act as a highly negative influence. It is extremely difficult, for example, to envision how countries like the Comoros and Madagascar can foster the growth of entrepreneurialism if the barriers to obtaining start-up finance remain so rigid. While the General Secretary of Textile Madagascar suggests a willingness to rely on firm savings in lieu of bank loans to invest in firm development, this option is only truly viable if firms have a relatively solid financial base to start with. For smaller firms and those entering the export market, operating without access to bank loans is simply not an option. It was mentioned in the introduction to this report that facilitating pro-private sector development is necessary if firms are to be encouraged to shift away from inward or even “traditional” forms of production in favour of an export bias. Without improved access to capital, this shift will not occur (at least outside of the EPZ context – where many operating firms are actually foreign-owned anyway). Without question, the “trade capacity” of these states will be severely undermined if entrepreneurs are experiencing financial barriers to becoming exporters.

From a business-oriented point of view, the difficulty of obtaining loans from commercial banks has a detrimental impact on the capacity of firms to source capital equipment and develop economies of scope. As previously noted, capital equipment is particularly costly for isolated island states to import due to high freight costs. In all likelihood, these transport costs alone would be beyond the

ability of most smaller-scale export firms to cover through their own savings. If these savings are not adequate and if loans are not forthcoming or are too difficult to obtain (due to interest rates, collateral or equity requirements), then firms may choose to forego the acquisition of improved machinery, equipment, etc. This may subsequently impede firms' ability to pursue enhanced economic returns via value-added manufacturing and may inhibit the formation of associated downstream production linkages with other countries.

On the other hand, if firms have difficulty accessing the capital needed to introduce worker training initiatives or put in place more advanced marketing techniques, then their ability to generate economies of scope will be put in jeopardy, particularly if doing so involves an attempt to shift production towards increased (or differently focused) forms of production. It is possible that these types of problems would be less notable in Mauritius and the Seychelles assuming that their respective development banks can fulfill the types of functions ascribed to them by the two respondents noted earlier. More research is required into the capacity of these DFIs, however, before such a claim can be authoritatively made.

For their part, foreign investors may look upon the difficulties associated with firms' acquiring capital as a reason to avoid investing in WIO island enterprises. If investors are given signs that the companies they intend to invest in will struggle to acquire the finance they need to grow their operations (and thus their profits), then investors may come to see these firms as offering little in the way of growing economic returns. In a country like Madagascar, the continuing Ratsiraka-era practice of prioritizing lending to the state rather than to the private sector may even be seen by investors as evidence that the country is not prioritizing business development. Equally possible, the unwillingness of the Malagasy banking sector to provide capital to national firms may encourage investors to gear the bulk of their investments towards EPZ firms that tend to be less constrained in their financing while leaving emerging non-EPZ firms with little opportunity to attract investment interest.

It is apparent that each of the banking-related problems identified above act as potential constraints on the ability of the WIO island states to foster a strong trade, business and investment climate. Returning to the assertions of groups like UNEP and WIDER identified at the beginning of this paper, it seems sensible to suggest that unless regional banks are reformed in such a way as to make them more sensitive to the needs of the private sector (particularly small export firms), then it will be extremely difficult for the four WIO island countries to grow their "trade capacity" and avoid becoming marginal players in the world economy.

Judicial Systems

The competence and trustworthiness of national judicial systems plays an important role in determining the extent to which firms and investors are willing to

enter into such arrangements as trade contracts, purchasing agreements and share trading. If deemed to be effective, well-functioning judiciaries act as a necessary form of security that can guarantee “consistency” and “predictability” in investor-firm and even supplier-firm relations. However, if judiciaries are seen to be ineffective or corrupt, then facilitating trade and investment becomes much more challenging as parties believe that they are taking on risk without the possibility of redressing any grievances that may arise in the process.

In the context of the WIO island states, interviews with research participants reveal a sharp difference between the perceived quality of the court systems in the Comoros and Madagascar on one hand and those in Mauritius and the Seychelles on the other. According to a representative from the Malagasy government’s *Ministère de l’Economie, du Commerce et de l’Industrie* (interview: November 3, 2008), there exists a clear lack of trust amongst both Malagasy firms as well as investors (both domestic and foreign) in the quality of the country’s judicial system. According to this respondent, Malagasy courts are often “lax” in enforcing contracts and may not always recognize deals made between Malagasy firms and foreign investors. The rights of foreign shareholders are identified by this government representative as being very poorly protected within the Malagasy court system and he suggests that in cases where firms are forced to declare bankruptcy, foreign creditors (i.e. machinery suppliers owed money by firms) stand little chance of recovering any of the capital (financial or equipment-based) they have provided. For these reasons, this respondent argues that Madagascar’s judiciary remains a barrier to the country’s ability to attract greater inflows of FDI and portfolio investment and it explains why some of Madagascar’s export firms experience challenges in finding suppliers willing to provide them with “high technology inputs” like tractors, construction machinery, etc.

Messick (2005) reinforces many of this respondent’s views when he states that because of the Malagasy judiciary’s weakness in enforcing contracts, national firms themselves are “nervous” about entering into partnerships with investors or suppliers that they are not already familiar with (Messick 2005, 11). According to Messick, this hesitancy has two important implications. First, by not eagerly entering into partnerships with new investors or suppliers, Malagasy firms will find it increasingly difficult to move into new markets such as the Gulf states or India, whose growing consumer purchasing power has the potential to be a boon for Malagasy exports like coffee and textiles. Second, many Malagasy firms will be hesitant to expand their operations if they feel uneasy about entering into contracts with new foreign suppliers, especially if they fear that these contracts will go unrecognized by national courts. According to Messick, this may discourage small firms from seeking improved technology and for domestically-oriented firms, it may even prevent them from wishing to enter the export sector in the first place (Messick 2005, 10-11).

The Comoran judicial system faces a similar lack of confidence from firms and investors as to its effectiveness. Like Madagascar's judiciary, Comoran courts are identified as being inconsistent in their rulings vis-à-vis penalties for breach of contract, non-payments of debt, etc. In addition, the IMF argues that a number of key business and investment laws that are commonly enforced in most countries are simply not found within the Comoran legal system. Bankruptcy laws, for example, are poorly defined and in some of the nation's lower courts, the legal precedents designed to deal with bankruptcy issues are non-existent (IMF 2005, 15-16). Additionally, the IMF notes that Comoran courts are typically hesitant to issue rulings that may impede on the authority of local-level Islamic jurists (who often issue rulings on finance-related matters). This, combined with the fact that the different Comoran islands tend to emphasize different components of the nation's legal code (i.e. the national government and some local officials call for legal interpretations based on French civil law while others emphasize interpretations based on Islamic *Sharia* law) makes the introduction of a uniform legal approach to business and investment matters difficult to put in place. Because of these divisions, the IMF states that the Comoran judicial system is likely to remain mired in uncertainty and this will play a role in scaring away foreign investors (IMF 2005, 18).

By contrast, the Mauritian and Seychellois legal systems are typically identified as being competent, effective and well-resourced. Sacerdoti (2005) makes clear that unlike the Comoros and Madagascar, the business and investment laws of these two countries are thorough and are regularly applied in a "fair" and consistent manner. Also, given the experience that both Mauritius and the Seychelles have in dealing with foreign investors, no legal hurdles exist in these two countries when it comes to recognizing foreign deals, protecting the rights of foreign shareholders, etc. (Sacerdoti 2005, 43). Moreover, the research participant from the Development Bank of the Seychelles argues that courts in Mauritius and the Seychelles are technologically advanced and have ready access to files, past records and copies of relevant contracts (most of which are electronically stored on databases created by the two countries' governments). Madagascar and the Comoros, by contrast, are identified by this respondent as having legal systems that are "antiquated" as an outcome of their lack of technological capacity.

As was the case with the banking sector, problems related to judicial shortcomings will undoubtedly act to hamper the development of a strong trade, business and investment climate amongst some of the WIO island states. If lax contract enforcement on the part of judicial systems in the Comoros and Madagascar dissuades exporters from seeking investors and suppliers from new markets, then the likelihood of these two countries forming meaningful trading relationships with countries beyond their usual export partners is slim. Given that the phasing out of preferential trade agreements is making these countries' continuing reliance on traditional export locations like the EU increasingly risky, a

failure to diversify markets and attract new types of investors is clearly a threat to the export potential of these two countries.

For Mauritius and the Seychelles, by contrast, well functioning judicial systems will provide confidence to both domestic firms and foreign investors. This should allow exporters in these two island states to more aggressively seek the types of trade and investment linkages to metropolitan markets that may be useful in helping these exporters shift to the production of higher value products. The strength of the Mauritian and Seychellois judiciaries should also reassure foreign investors that these countries are locations in which their rights will be protected and any grievances promptly resolved. This then encourages these investors to envision Mauritius and the Seychelles as locations where taking risks with their investment capital is truly worthwhile. Indeed, this sense of security would allow projects such as “Cyber City” and the creation of its associated technical infrastructure to draw increased investment despite the fact that IT may not automatically be seen by foreign interests as a “natural fit” for an island economy. On the other hand, if these judicial systems were weaker and if investor rights were clouded in ambiguity (as is the case in the Comoros and Madagascar), then it is prudent to argue that any forthcoming investment would be directed into industries that were deemed to be “safe” and which posed as little risk as possible to investors wanting to avoid any possibility of legal entanglements.

The politico-economic overviews of Mauritius and the Seychelles provided earlier in this report noted that economic success in these two countries would occur only if these nations aggressively pursued economic diversification and if they could sustain enthusiasm for those “unique” initiatives like “Cyber City” that could provide these smaller island states with opportunities for niche production. Maintaining sound judiciaries should ensure that for these WIO island states, both of these objectives will be easier to meet as firms and investors gain the security they need to pursue more innovative types of trade and business strategies.

In a country like the Comoros, however, a lack of judicial development combined with a shortage of clarity surrounding the power of different legal authorities (i.e. civil vs. Islamic) simply reinforces the notion that the country’s power divisions remain too momentous to allow for the establishment of the common political purpose necessary to pursue institutional upgrading. In this country (and to some extent in Madagascar), judicial shortcomings are hindering the development of a stable trade, business and investment climate. This, in turn, may further deepen the developmental duality that exists in the WIO between successful economies like Mauritius and the Seychelles and poverty-stricken Comoros and Madagascar.

Port Authorities

The willingness of national governments to put in place a trade-enhancing transport infrastructure goes a long way towards determining the extent to which their countries will be competitive in the export sphere. This infrastructure, which may refer to roads, railways, airports, seaports, etc. impacts a state's "trade capacity" because its quality affects the ease by which firms can move exportable goods from their sites of production to relevant transport and shipment points and then on to their final overseas destinations. If a country's secondary road system is poor, then agri-businesses may find transporting their products to nearby port facilities to be a long and expensive undertaking. If ports are badly managed or under-resourced, then firms may be faced with long loading delays or a lack of quality storage facilities (i.e. for food products).

Not surprisingly, given island states' dependence on maritime transport as the key method of shipping their goods, the quality of national ports (and the port authorities that manage them) is of particular importance to these states' export potential. According to this study's research participants, however, the importance of maintaining adequate port facilities can only be seen in the context of states' attempts to ensure that "complementary" infrastructure (i.e. roads, railways) is also of a high standard. In the case of the WIO island states, this is an important point to make as it could be argued that while the management of ports themselves is of a generally high quality in the region, sub-standard roads and rail connections are preventing these port facilities from realizing their full potential.

The respondent from the Malagasy *Ministère de l'Economie, du Commerce et de l'Industrie*, for instance, is adamant that the management of Madagascar's ports has improved drastically in recent years. The granting of a concession to a foreign operator to manage the port of Toamasina, for example, has allowed for a sustained "modernization drive" to be carried out at this location (i.e. the building of more berths), something this respondent says will significantly increase the amount of cargo that can be transported via this vital port facility. For her part, the General Secretary of Textile Madagascar claims to be "extremely pleased" at the progress being made to boost port efficiency, eliminate corrupt practices amongst port customs officials and to ensure the availability of quality packing containers and storage locations. This respondent also argues that the recent opening of a new port in the town of Ehoala near Fort Dauphin is proof that the Malagasy government understands the importance of maintaining an infrastructure that allows firms to more easily facilitate the export of their goods.

Admittedly, both of these respondents acknowledge that port developments outside of Toamasina and Ehoala/Fort Dauphin are less promising. Exporters operating out of the country's west coast, for instance, are deemed by the government representative to remain disadvantaged due to the under-development and poor capacity found at key ports like Mahajanga and Toliara.

In general, however, the improvement of national ports should be seen as a success for Malagasy development. Where problems remain, according to these two respondents, is in the quality of the country's road and rail systems, something which they passionately argue will hamper the ability of exporters to fully take advantage of improved port functioning. According to the General Secretary, poor road quality means that the transport of goods overland (i.e. from Antananarivo to Toamasina) is very time-consuming and because of the "logjam" of trucks attempting to navigate these roads, long loading delays are common once these goods finally arrive at port facilities themselves.

The government representative, on the other hand, suggests that without a developed rail transport system, the country's roads are inevitably overused by transport trucks, thus adding to the wear and tear placed on an already poorly developed road network. This, combined with the fact that port authorities in places like Toamasina are unable to afford the costs associated with hiring more customs officials (or providing improved training to those they already have), security personnel or traffic control workers, means that the delays associated with the transport of export goods by road are "enormous" and continue to impose a high cost on firms that export perishable products like fruits and vegetables (as long delays may result in product spoilage). The development of a strong high-capacity rail network, at least between Antananarivo and Toamasina, is seen by the government representative as being essential if products are to be shipped quickly between production sites and ports. If this efficiency can be put into place, then this respondent has little doubt that the benefits of improved port and port authority performance in the country can be fully realized.

Khalid (2005) agrees with these two research respondents and argues that while it is the responsibility of national governments to pursue large-scale road and rail improvements, port authorities also have a role to play in improving their surrounding infrastructure and in making sure that they can be efficient enough to mitigate the problems associated with traffic "logjams" and other delays. In the case of Madagascar, Khalid notes that Malagasy port authorities have not taken advantage of the expertise found in such organizations as the Association of Shipping and Port Authorities in the Indian Ocean or the Indian Ocean Marine Affairs Corporation (IOMAC) to gain the support of these bodies in resolving their outstanding infrastructure and performance-based issues (Khalid 2005, 6). For example, Khalid insists that an organization like IOMAC can work with the Malagasy government to help attract investment capital from countries like China or India to help a port like Toamasina build more berths, acquire more shipping containers and cranes and perhaps most important, to help improve roadways in the port vicinity. Also, this investment could be used to improve port logistics by way of helping port authorities hire more staff to speed up the unloading of trucks and the processing of cargo (Khalid 2005, 8).

Khalid makes clear that the purpose of this foreign investment would not be to upgrade Madagascar’s infrastructure as a whole. Rather, its objective would simply be to help port authorities better cope with the country’s infrastructural problems (i.e. by reducing unloading delays and thus traffic congestion) until the Malagasy government finds a way to overhaul and improve the national road infrastructure. For port authorities, which Khalid argues are well-managed throughout the WIO, a responsibility exists for them to act as interlocutors between foreign investors and the state and to plan and oversee any infrastructural improvements they may deem necessary to improve their export capacity. What should be clear from Khalid’s suggestions and from the two respondents noted earlier, is that a consensus seems to exist as to Malagasy port authorities being highly effective but also being simultaneously constrained by the wider infrastructure deficiencies they are forced to deal with.

Infrastructure complaints are also noted as being important in Mauritius and the Seychelles. According to the project manager for MCFI, Mauritius’ main port in Port Louis is served by a well-functioning road network. However, the small size of the port itself is identified by this respondent as a “constraint” on quick access, particularly for transport trucks that must remain idle for long periods of time while waiting for their cargo to be offloaded at a limited number of “unloading sites”. The MCFI respondent also expressed frustration at the inefficiencies he considers to be inherent in the functioning of a “small” port like Port Louis. For instance, this respondent claims that while cranes in the port of Singapore can move around 20 barrels onto a waiting ship at once, the cranes in Port Louis are equipped to move only 6 or 7 barrels at a time, thus considerably reducing the speed at which goods are loaded and offloaded onto cargo vessels. In the eyes of this respondent, this slowness is particularly problematic for the country’s food product exporters (i.e. in the fisheries sector) who must also cope with a shortage of on-site storage freezers and sanitary packaging materials. **Table 3** shows the size of the Port Louis container terminal in comparison to a number of other African ports.

TABLE 3: Comparing the Major African Indian Ocean Port Facilities by Terminal Area and Berth Size

Port	Terminal Area (ha)	Container Berth Size (m)	Container Berth Depth (m)
Beira	20.0	645.0	12.0
Dar es Salaam	12.0	550.0	11.5
Durban	105.5	2128.0	12.8
Maputo	8.0	300.0	10.3
Mombasa	20.0	610.0	10.4
Port Louis	13.6	560.0	13.0
Toamasina	7.5	360.0	10.5
Victoria	0.9	240.0	11.5

Source: Penfold, Andrew, 2006.

In reality, Mauritius' main port is by far the largest in the WIO (with a terminal area of 13.6 hectares versus 0.9 hectares in the Seychelles and 7.5 hectares in Toamasina). However, the volume of goods exported through this terminal is also larger, thus likely explaining why the MCFI project manager contends that the "smallness" of his country's port is a concern.

The MCFI respondent does argue that Mauritian port authorities are highly effective when it comes to trade facilitation – i.e. making sure customs inspection procedures are efficient, ensuring that required documentation is available electronically to firms, etc. In other words, like Madagascar, this respondent is making the case that Mauritian port authorities themselves are highly effective but infrastructure shortcomings act to prevent this "effectiveness" from benefiting the country's export sector to the extent that it should.

According to the representative from the Development Bank of the Seychelles, road access to that country's main port in Victoria is negatively impacted by the "narrowness" of local roads. As such, the number of trucks able to enter and exit the port at one time is very small, something that this respondent argues leads to a number of traffic backlogs and offloading delays. To be fair, however, this respondent also claims that the efficiency of the port authority at this location combined with the relatively small volume of goods actually being exported from the Seychelles, means that these delays are not constant and they are not significantly disrupting the overall effectiveness of the port. In the future, however, this respondent suggests that the country's government (perhaps with the support of the development bank) consider a project aimed at road widening. The Overseas Coastal Area Development Institute of Japan (OCADIJ), a donor partner working in both Toamasina and the Seychelles, concurs with this idea and notes that with efforts being made by many of the major WIO ports (including Victoria's) to widen their shipping berths to handle more cargo, the need to improve road capacity around port facilities is becoming more acute (OCADIJ 2008, 6).

It is only in the Comoros where the functioning of port authorities themselves appears to be problematic. In the opinion of Bell (2007), the main Comoran port at Moroni is hampered in its effectiveness by both a clear lack of infrastructural development (in the port and in the surrounding vicinity) as well as the excessive regulations imposed by Comoran port authorities and their customs officials on incoming and outgoing vessels. These regulations, which may include delays in carrying out inspections or the need for exporters to fill in an excessive amount of paperwork, are made worse by the Comoran port authority's lack of trained staff and dearth of adequate storage facilities (which again gives rise to the possibility of delays causing the spoilage of certain products) (Bell 2007, 3). Once again, road access is identified as an important issue that must be confronted by Comoran policymakers to make port facilities more easily accessible, especially at those locations outside of Grande Comore.

When assessing the WIO island states' trade, business and investment climate, the strength of port authority management (outside of the Comoros) should undoubtedly be seen in a positive light. As preferential trade agreements are phased out, then the demands of international competition for export market access make trade facilitation and the efficiency of the export process extremely important. If the WIO island states can export their goods in a timely manner when compared to their competitors, their chances of maintaining stature within their traditional markets (and ideally new markets as well) should be secured.

If the respondents identified above are correct in claiming that port management in the WIO island states is of a generally high quality (i.e. in terms of increasing volume capacity, introducing more efficient inspection processes, etc.) then this bodes well for the ability of these countries to remain competitive export players. Also, if a high level of port efficiency can be attained, then firms will face fewer costs vis-à-vis having to replace spoiled products (caused by delays), securing extra on-site storage containers (to keep products secure while waiting for loading) or paying transport workers for the prolonged periods of extra time they have to wait at ports before unloading their goods. Considering the small financial margins enjoyed by most exporting firms in the WIO and the fact that they are already facing high freight costs, even these relatively small savings are important and should help these firms stay cost-competitive as well as maintaining their engagement in the export sector.

At the same time, infrastructural deficiencies are a concern and if the WIO island states hope to grow their export capacity, then making road (and potentially rail) improvements will be necessary to facilitate the ease of transport between production sites and ports. This is especially the case for Madagascar. However, given that regional port facilities are deemed to be well-managed, convincing donors to provide the investment capital required to improve port infrastructure (i.e. berths or surrounding roads) may not be especially difficult. Indeed, from the standpoint of foreign investors, the soundness of regional port management should act as reassurance that these countries are committed to developing their "trade capacity" over the long-term.

Finally, regardless of the infrastructural challenges facing both governments and port authorities in the WIO, the competence of port management in the area should make it easier for regional island states to form the types of linkages with metropolitan economies discussed earlier. In particular, the quality of port management and the apparent success port authorities are having in introducing measures conducive to improved trade facilitation makes it more likely that these countries could exploit their proximity to key Asian economies like India and Pakistan to market themselves as effective distribution points for these countries to use in shipping their (value-added) products to African states. As noted earlier, this would allow these Asian countries to partner with the WIO island nations to gain advantageous access to markets like COMESA and SADC. All told, the general well-functioning of regional ports (with a note of caution

surrounding infrastructural issues) should thus be seen as a constructive factor in helping to build a strong trade, business and investment climate within the WIO.

Government Ministries

The effectiveness of government ministries in designing and implementing “pro-private sector” policies is arguably the most important factor in determining the extent to which a strong trade, business and investment climate will be fostered in a particular state. Establishing export promotion agencies, ensuring the availability of customs and market information, putting in place a consistent regime relating to product standards and guaranteeing the sound functioning of utilities like water and electricity services are all governmental responsibilities that have a direct impact on exporters’ ability to succeed and investors’ willingness to put forward their capital.

In Madagascar, the improved functioning of state agencies under the Ravalomanana government has been integral in allowing the country to begin moving away from the inefficient statism introduced under Ratsiraka. According to the respondent from the *Ministère de l’Economie, du Commerce et de l’Industrie*, the Malagasy government has become pro-active in terms of introducing measures designed to improve trade facilitation. This individual claims, for example, that his ministry holds monthly round-table discussions with the national customs service and with representatives from private sector bodies like chambers of commerce (as well as with firms themselves) to discuss matters related to improving the performance of the country’s customs officials. Also, this respondent notes that the government has introduced a new Internet data system called *GasyNet* to make relevant customs documentation, shipping schedules and information pertaining to the sanitary and phytosanitary standards (SPS) of overseas export markets available online.

According to this respondent, making sure that this type of information is available in a single (electronically-accessible) location rather than having it be spread across numerous government departments, has helped to make sure that firms are well-versed in knowing what their export options are and what is expected of them (i.e. in terms of domestic and foreign customs requirements) in the export process. This is especially true for firms operating outside of Antananarivo, whose physical isolation has in the past acted to “disconnect” them from the government’s efforts to disseminate trade-based information.

The Ministry representative also asserts that *GasyNet* has been a boon to investment by making sure that relevant information on taxation, legal issues, etc. is made available electronically to potential foreign investors. In the past, this respondent argues, investors were discouraged from investing in Malagasy industries by the difficulties associated with accessing information from assorted government representatives and by the dearth of investment information available in English. With the government’s introduction of *GasyNet*, however,

the Ministry representative strongly argues that these issues are being resolved and that potential investors now have at their disposal an improved and effective means of accessing the information they require to gain confidence in the Malagasy investment climate.

The Ministry official, along with the banking respondent from BMOI, both note that information-based shortcomings remain. The Ravalomanana government, for example, has yet to develop an effectual export promotion agency to act as a “contact point” for foreign investors. This, in turn, has made it difficult for Madagascar to source investment outside of its traditional trade and investment partners (namely France). Both of these research participants also note problems related to the Malagasy Board of Standards, whose reach remains limited outside of Antananarivo due to understaffing and budgetary problems. This is in spite of much the Board’s information being made available through *GasyNet*. As such, Malagasy firms still run the risk of falling short of the SPS and other product standards imposed by foreign markets. Both respondents do suggest, however, that firms operating within the EPZ are able to avoid some of these problems due to the fact that so much of the EPZ sector is dominated by foreign firm owners who tend to already possess a “greater awareness” of the product standards put in place by associations like the EU.

Where Madagascar’s national government is truly falling short when it comes to assisting the private sector, however, is in its efforts to guarantee the sound functioning of key utilities. The General Secretary of Textile Madagascar makes clear that the inconsistent power supply that plagues most of the country (including Antananarivo) is the most significant problem her firm faces in boosting its productive efficiency. For his part, the Ministry representative reluctantly acknowledges that the failure of the national power supply company, *Jirama*, to boost its capacity to meet growing energy demands, has scared off investors concerned about their returns should the country’s firms be forced to cut production to cope with regular power outages.

Considering the lack of private sector development experienced in Madagascar under the Ratsiraka government, it is highly notable that the Ravalomanana administration has begun to pursue initiatives like *GasyNet* and has scheduled regular government-private sector meetings to discuss relevant issues like the performance of national customs administrators. Moreover, the willingness of individuals like the Ministry representative interviewed in this report to acknowledge remaining areas of concern (i.e. inadequate electricity supply, the shortcomings of bodies like the Standards Board), bodes well for a government that is honest in appraising those fields in which its performance must be improved.

In Mauritius and the Seychelles, evaluations surrounding the performance of government ministries in promoting trade and investment are, by and large, very positive. In the opinion of one of the economists at the University of Mauritius,

both his country and the Seychelles have developed a “strong tradition” of pursuing “dialogue mechanisms” (i.e. seminars and workshops) between government ministers and private sector interests. In addition, this respondent notes that in both countries, information related to trade and investment is made widely available through government websites. Additionally, ministers in both nations are aggressive in launching overseas trade missions and in marketing their countries to potential investors at such locations as international trade fairs. This is a perspective reinforced by Vines and Oruitemeka (2008), who cite the recent creation of the Indo-Seychelles Commission and the development of the Indo-Mauritian Economic Cooperation and Partnership Agreement as examples of these two island countries seeking to market themselves to a nearby state (India) which has yet to discover the WIO as a trade and investment location (Vines and Oruitemeka 2008, 10).

Vines and Oruitemeka also argue that in both Mauritius and the Seychelles, government ministers are playing a central role in disseminating information on potential export markets to their national firms. These authors also declare that ministers connected to the Mauritian Ministry of Foreign Affairs, Regional Integration and International Trade have initiated a number of efforts geared around reforming taxation policy so that any “loopholes” that could be exploited for money laundering purposes are closed. Vines and Oruitemeka stress that these reforms were necessary in order to reassure investors in nations like India that their capital was being put into a country with a sound system of financial oversight. More to the point, these writers affirm that by competently addressing an issue that had the potential to deter needed investment, Mauritian policymakers can be credited with pro-actively seeking to enhance the quality of their country’s “investment” climate” (Vines and Oruitemeka 2008, 10). Seychellois government ministers, on the other hand, are identified by Vines and Oruitemeka as playing an essential role in using their presence at trade fairs in locations like the Gulf states, India and Pakistan to establish the connections necessary to help national firms (especially in the construction and fisheries sectors) source capital equipment at “reasonable costs” (Vines and Oruitemeka 2008, 8).

Praise for the actions of government representatives in these two countries is not uniform. The second University of Mauritius economist interviewed for this study, for example, alleges that the Mauritian government has often been guilty of directing investment into industries that are either “unproductive” (i.e. in attempts to revive a sagging sugar industry) or into sectors that do not provide large numbers of jobs (such as financial services). In general, however, government ministries in Mauritius and the Seychelles have performed remarkably well in guaranteeing the availability of needed information for exporters and investors and in promoting their countries as reliable business partners at overseas forums.

Once again, the Comoros remains an unfortunate exception when it comes to noting many of the positive trade, business and investment developments occurring in the WIO. Like Madagascar, the Comoros has experienced problems related to guaranteeing a consistent power supply and officials have even struggled to ensure the availability of water to national agri-businesses (MPRD 2005, 16). However, whereas Madagascar has somewhat atoned for utility-based shortcomings by aggressively pursuing information availability efforts like *GasyNet*, even the Comoran government acknowledges that its own efforts to promote state-private sector cooperation have been inadequate. This is in spite of the fact that the small geographic size of the Comoros should allow, as Treebhohun (2001) argues, for communication between parties to occur quickly and on an impromptu basis if necessary (Treebhohun 2001, 469).

This is not to say that such communication is entirely lacking. However, the country's export promotion agency is exceptionally weak, inadequately financed and understaffed and the country has yet to establish a regular consultative mechanism that brings the country's few export establishments into regular contact with officials responsible for promoting trade and investment (MPRD 2005, 19). According to the MPRD, the Comoros' aforementioned lack of political stability and the cleavages existing between elites in the country's three islands are hindering the development of a unified political program designed to remedy these problems (MPRD 2005, 20). In other words, while government ministries in Madagascar, Mauritius and the Seychelles are largely succeeding (not without setbacks) to be useful players in facilitating trade and investment, their Comoran counterparts remain seemingly incapable of doing the same.

It is readily apparent that the failure of national governments in the Comoros and Madagascar to guarantee the adequate provision of utilities like electricity and water will have a long-term negative impact on the trade, business and investment climate in these two states. For exporters, dealing with an inconsistent supply of electricity will require their firms to incur extra costs in the purchasing of generators. When this type of expense is added onto the freight and other transport costs these exporters already have to deal with, it seems realistic to argue that many Comoran and Malagasy business owners will see growing financial burdens as a constraint on their opportunities for growth. This may be less true for EPZ firms that tend to enjoy a higher level of capitalization. However, for entrepreneurs looking to transition their businesses away from a focus on smaller-scale domestic production towards the export sector, the possibility that inadequate power and/or water supplies will disrupt production and add to their overall costs will only act to dissuade firms from wishing to become export-oriented. When it comes to growing the "trade capacity" of the Comoros and Madagascar, this would clearly be an ominous development.

However, more positive outcomes can be identified in the attempts of government ministries in the WIO island states to pursue enhanced information availability campaigns and overseas marketing initiatives. With the demise of

preferential trade agreements, it is necessary for these four countries to establish a “brand” for themselves in new markets outside of their traditional export partners like the EU. The fact that ministers in both Mauritius and the Seychelles are seeking to establish a reputation for their countries in locations such as the Gulf states and the Indian subcontinent (i.e. at trade fairs) suggests that the governments of these two countries understand the need for export market diversification and are taking pro-active steps to ensure that their states do not become marginalized once preferential trading regimes are fully eliminated in favour of more competitive free trade. Unfortunately, the weakness of export promotion agencies in the Comoros and Madagascar may prevent these two WIO island states from achieving this same benefit. However, for Mauritius and the Seychelles, diversification towards new export markets and investment locations should allow their “small” export economies to remain viable and prosperous.

It is in the area of “information availability”, however, where the WIO island states appear to be achieving particularly notable successes. While the small geographic size of the Comoros, Mauritius and the Seychelles should make the distribution of information (and the holding of consultative meetings between the state and the private sector) easy to arrange, the ability of the Malagasy government to foster its own “dialogue mechanisms” and introduce *GasyNet* are both remarkable achievements considering Madagascar’s large size and poor infrastructure. For exporting firms, the introduction of improved communication linkages between themselves and the Malagasy state should reinforce the notion that under Ravalomanana, sincere efforts are being made by government officials to ensure that firms do not have their export potential undermined by a lack of information on customs requirements, shipping schedules or foreign product standards (though the latter could still be improved through an improved Standards Board). Ideally, knowing that they operate in a state that more fully supports exporter operations will also encourage entrepreneurs who are hesitant to enter the export sector to have the confidence necessary to adopt an outward-oriented production regime. If this happens, then Madagascar’s “trade capacity” will undoubtedly be improved under a more encouraging trade, business and investment climate.

Regional Organizations

The role that regional organizations like COMESA, the IOC or SADC can play in helping to promote greater trade and investment growth specifically in the WIO island states is a topic that has received comparatively little academic attention. For this study’s research respondents, the importance of regionalization tends to be identified on the basis of possible “future advantages” rather than as an outcome of analyzing “current benefits”. However, while it may be the case that the full implications of membership in regional organizations like those mentioned above is not yet readily apparent, it is clear that these supranational bodies can

have an important role to play in helping to cultivate a strong trade, business and investment climate in the WIO.

Regional organizations may play an active part in attempting to eliminate trade and investment barriers between their member states and between these states and other countries. These associations can also be important actors when it comes to promoting democratization and greater financial transparency within the public and private sectors of constituent states. Regional bodies also have the potential to develop integrated regional transport systems (i.e. by helping to improve the air and maritime transport links between countries) and they may put in place incentives to encourage greater cooperation between their member states' banking institutions. Finally, well-functioning regional organizations that are provided with tangible power can boost the shared leverage of individual member countries when it comes to helping them compete for export markets and source investment capital. In sum, regional organizations have the ability to become important agencies in generating development beneficial to the private sectors of developing nations.

When assessing the current performance of regional organizations in the WIO, the General Secretary of Textile Madagascar adopts a generally positive outlook. While this respondent notes that most of Madagascar's political efforts are geared towards more fully integrating the country into SADC, the General Secretary puts forward a personal belief that the IOC may become an increasingly important regional organization vis-à-vis assisting private sector development. For instance, this individual argues that the IOC has played an "intermediary" role in facilitating negotiations between Malagasy and Mauritian textile firms; negotiations which are designed to explore the possibility of Malagasy textile producers acting as low-cost "subsidiaries" for their Mauritian counterparts when it comes to producing goods for African markets like Mozambique, South Africa and Tanzania. This is an arrangement that the General Secretary sees as being very positive in helping to grow Madagascar's textile sector after the scaling-back of AGOA and the MFAs. Also, with an injection of Mauritian capital, this respondent argues that it will be much easier for Madagascar to realize opportunities to grow firm capacity and employment within the textile industry. The "consultative" role played by the IOC, in other words, is fostering greater communication and cooperation between two of the WIO island states with the aim of improving their *shared* economic performance.

The General Secretary also notes the issue of "complementarities" and argues that because Madagascar and Mauritius do not directly compete in the production of particular types of textiles and because they tend to export to different markets (i.e. Madagascar focuses on France and Germany while Mauritius primarily exports to the United Kingdom), it is relatively easy for the two countries to identify avenues of economic cooperation. What is more challenging, this respondent acknowledges, is turning "ideas of cooperation" into "tangible realities". Therefore, the importance of an association like the IOC, the

General Secretary believes, lies with its ability to put in place *consistent* dialogue forums between policymakers and firms in the hope that doing so allows for the building of trust amongst different regional actors. The development of textile-based partnerships between Madagascar and Mauritius is one example of how dialogue can lead to “real” benefits. The IOC, along with COMESA and SADC, this respondent urges, must be more aggressive in promoting inter-governmental (and inter-firm) contacts to make sure that similar positive outcomes can be achieved in the future.

The representative from the Malagasy *Ministère de l’Economie, du Commerce et de l’Industrie* is not as effusive in his praise for regional organizations as is the General Secretary of Textile Madagascar. For this respondent, cooperation should be pursued with neighbouring countries on an issue-by-issue basis. More aggressive attempts at regionalization, this respondent asserts, may threaten local industries if the wholesale elimination of trade barriers allows for cheaper imports from mainland African COMESA or SADC states to flood the Malagasy market. The Ministry representative also states that as a French-speaking country, Madagascar (along with the Comoros) is at a disadvantage when trying to negotiate beneficial agreements for itself within the primarily English-speaking COMESA and SADC. This respondent argues, for instance, that trade information (i.e. contract forms, SPS certification papers, etc.) is often not made available (or at least is not adequately distributed) in French by the secretariats of these two large regional bodies. This, in turn, requires Malagasy firms and government agencies to expend more time and effort when trying to understand the “rules” put in place by COMESA and SADC and when it comes to communicating these regulations to customs officials, bureaucrats, firm suppliers, etc.

At the same time, the Ministry official praises both COMESA and SADC for playing important roles in helping to generate investment from Kenyan, Mauritian and South African banks into Madagascar. This investment has been vital in allowing Malagasy firms to purchase capital equipment and lease new maritime transport vessels. Without membership in one of these regional bodies, the Ministry representative adamantly argues that barriers to investment (i.e. a lack of standardized banking regulations) would have been too difficult to overcome for this type of capital injection to take place. Additionally, this respondent states that COMESA membership in particular has allowed both the Comoros and Madagascar to more quickly improve their air transport linkages to East African states (namely Kenya) and this has made it easier for both countries to attract tourists on the basis of being able to offer convenient and reasonably priced air transport options.

According to the two economists at the University of Mauritius, regionalization offers mixed benefits to the WIO’s two more developed island states as well. One economist, for example, claims that for successful economies like Mauritius and the Seychelles, entering into African politico-economic bodies brings with it

the risk that these two countries will come to be identified with mainland African problems like political violence, entrenched corruption and poor standards of health. This, subsequently, could drive away investment from foreign interests not familiar with the unique stability and success these countries enjoy. The second University of Mauritius economist does not necessarily dispute this sentiment but notes that regionalization along African lines has provided Mauritius with the opportunity to develop new export sectors (i.e. the shipping of small farming inputs to Mozambique) via SADC that would not have otherwise been available. Also, SADC's attempts to promote country-to-country investment within the Southern African region has reduced investment barriers and has encouraged Mauritius to invest in Mozambique's nascent sugar industry; a sector that may eventually provide both countries with notable financial returns.

Based on the above perspectives, regional organizations thus appear to be playing an important but somewhat unclear role in aiding the development of a strong trade, business and investment climate in the WIO. On one hand, they are clearly boosting cooperation between regional islands (and between these islands and mainland African states) in terms of investment and transport. They are also facilitating communication between governments and between private sector operatives in constituent nations, as can be seen by the overtures made by Mauritian textile firms and sugar producers to their Malagasy and Mozambican counterparts when it comes to establishing "subsidiaries". At the same time, the comments of the Malagasy government official make it apparent that because African regionalism remains in its formative stages, problems may still be found in such areas as ensuring the "soundness" of communication between the member states of regional groupings (i.e. by making sure necessary documentation is made available in all appropriate languages). Also, the full implications of trade liberalization and the formation of a "common market" have not yet been fully addressed, as can be seen by the Ministry representative's worries about dropping barriers to foreign imports.

Interestingly, much of the (rather sparse) literature related to the WIO island states and African regionalization adopts a much more pessimistic tone than what could be found amongst this study's research participants. The United Nations Conference on Trade and Development (UNCTAD), for example, claims that while more cooperation is occurring amongst the WIO island states, this is not to the credit of regional bodies like the IOC but is instead simply an outcome of more aggressive bilateral negotiations occurring between regional governments (UNCTAD 2001, 49). UNCTAD also argues that whereas a small state like Singapore has used its membership in ASEAN to develop strong transport and communications linkages with much of East and Southeast Asia, countries like Mauritius have been unable to use COMESA, the IOC or SADC for the same purposes due to these organizations' inability to help foster a strong regional transport system or telecommunications infrastructure (UNCTAD 2001, 49-50).

For their part, Vines and Oruitemeka declare that bodies like the IOC need to articulate a “political vision” for why the WIO island states should seek to more closely link their economies. Currently, these writers argue, the IOC operates on the basis of addressing “niche issues” like preserving the marine environment while shying away from addressing major economic issues like trade, investment and private sector development (Vines and Oruitemeka 2008, 6). Until the IOC’s focus broadens to include these major issues, Vines and Oruitemeka are skeptical that policymakers in the Comoros, Madagascar, Mauritius and the Seychelles will see the pursuit of regionalization as a sound means to grow their economies.

Devlin and Castro (2002) contend that regionalism is not flawed because it lacks a large-scale “political vision” but simply because bodies like the IOC or SADC are not playing an active role in resolving important “nuts and bolts issues”. For instance, these authors lament the inability of the IOC to encourage the creation of a shared maritime freight company to be jointly owned by the governments of the four WIO island states. The creation of such a company, Devlin and Castro believe, would allow these countries to share (and thus reduce) their freight costs when importing capital equipment or when exporting their goods (Devlin and Castro 2002, 10). The fact that regional organizations have made little headway in convincing area governments to pursue this type of endeavour is held up by these writers as proof that regionalization itself is not likely to contribute significantly to improving the WIO island states’ trade, business and investment climate.

To some extent, judgments on the value of regional organizations like the IOC or SADC can be differentiated on the basis of whether these bodies are being considered through the prism of “functional cooperation” or “neo-functional integration”. For those analysts examining regional organizations based simply on whether or not they enhance general cooperation between a group of countries, the outlook is largely positive. By helping to facilitate inter-governmental communication and reduce barriers to investment, bodies like the IOC have helped Malagasy and Mauritian firms come together to pursue a “subsidiary” arrangement that will allow textile producers in both states to expand the range of their operations and grow their export potential. Membership in an organization like COMESA, on the other hand, has made it easier for poor countries like the Comoros and Madagascar to address particular issues that hold back their economies, such as inadequate flight connections to East African transport hubs like Nairobi.

However, for individuals who assess the value of regional organizations based on their success in promoting *in-depth* integration, more downbeat opinions will clearly be forthcoming. Communication difficulties, a hesitance to pursue full trade liberalization and worries over being “tarnished” by association with politically unstable neighbours are all concerns identified above that are preventing COMESA, the IOC or SADC from becoming fully-fledged regional

groupings in the mould of the EU or even ASEAN. These are all legitimate worries and yet the fact that these organizations are at least facilitating some amount of trade and investment growth should be seen as being extremely noteworthy. The fact that cooperation is forthcoming between Madagascar and Mauritius vis-à-vis textile production is also proof that Breytenbach's worries about overlapping production caused by a lack of complementarities (and the onset of inter-island competition as a result) is not a major worry.

As for the slowness of integration, Dabee and Reddy argued in the previous section of this report that a gradual (and negotiated) form of regionalization would likely allow the WIO island states to feel more confident as to the benefits they would achieve through forming closer economic linkages with neighbouring states. Therefore, while it is undoubtedly true that regional organizations must demonstrate an ability to competently address individual issues on a regular basis (i.e. the formation of a regional freight shipping service), the fact that these bodies are not yet forming robust supranational bonds should not be seen as an indictment of regionalization's overall value. Unlike the other institutions discussed in this section, it is likely too early to pronounce a verdict on the performance of regional organizations in building a strong trade, business and investment climate in the WIO. However, even the small successes already enjoyed by organizations like the IOC suggest that these associations should not be discounted as having a role to play in trying to improve the quality of this climate in the future.

This section has evaluated the trade, business and investment climate in the WIO island states by appraising the performance of different institutions (commercial and developmental banks, judiciaries, port authorities, government ministries and regional organizations) responsible for fostering private sector growth. Not surprisingly, this assessment revealed a number of areas in which individual WIO island states are improving their overall trade, business and investment climates as well as fields in which either subtle or dramatic improvements have to be made to ensure that opportunities for trade and investment in the region are maximized. Section six of this report will return to these issues and will suggest policy options that could be adopted by WIO island governments and foreign donors to remedy important problems and maintain the progress already made.

5. The Western Indian Ocean Island States: Assessing the Overall Trade, Business and Investment Climate from a Micro-Level Perspective

The purpose of this report's fifth section is to continue evaluating the trade, business and investment climate currently found within the WIO island states. However, whereas the previous section focused on macro-level "institutions", the

focus of the following analysis is on the “micro-level”, namely exporting firms themselves as well as the business support organizations and chambers of commerce that aim to assist them. Just as an assessment of banks, judiciaries and government ministries can be used to gauge the quality of pro-trade, pro-business and pro-investment development occurring in the Comoros, Madagascar, Mauritius and the Seychelles, so too can an evaluation of the private sector itself provide important insights into the challenges that must be overcome for these countries to develop a more competitive “trade capacity”.

Like the previous section, the following examination is based primarily on the fieldwork conducted by the researcher. Once again, however, select secondary sources are introduced where appropriate to reinforce key ideas or present alternative opinions.

Exporting Firms

As this report has hopefully made evident, the ability of exporting businesses to succeed largely depends on how well national institutions like banks and government ministries perform in putting in place policies and regulations conducive to private sector growth. However, the decisions made by firms themselves (even when influenced by external forces) in relation to marketing, staff training, equipment sourcing and cost management are also vitally important in influencing exporters’ likelihood of becoming profitable and pursuing an expansion of their activities. In the WIO, a distinction has to be made between EPZ firms who enjoy considerably more leeway in addressing these issues as a result of their (likely) foreign ownership and healthy capitalization levels vs. non-EPZ firms who lack these same benefits. In what follows, a decision has been made by the researcher to focus on the actions of both EPZ and non-EPZ firms. However, this examination of firm performance *does* exclude all foreign-owned companies operating in the WIO and instead offers a sole focus on firms run by “indigenous entrepreneurs”.

According to the General Secretary of Textile Madagascar, coping with costs without having to undertake detrimental trade-offs remains an objective that is out of reach for many Malagasy firms (especially those in the textile sector). This respondent argues that because the financial margins of her firm are so small (mostly due to transport costs), she has little choice but to direct firm investments away from such important initiatives as staff training in favour of more short-term needs (i.e. repairing broken equipment) that are necessary to simply maintain consistent levels of production and to “keep the company’s head above water”. Stated differently, this research participant is stating that Textile Madagascar must forego the types of investments required to guarantee sustained productivity and growth (improving the quality of the firm’s human capital) while instead focusing on measures designed to merely ensure the basic survival of the firm. The General Secretary expresses frustration with the fact that having to forego longer-term investments in human capital will likely prevent her firm from

moving into higher-value forms of production that could bring greater economic returns and higher wages for workers.

What is particularly striking about the General Secretary's opinions, however, is that she does not express any real belief that a satisfactory solution can be found to help firms deal with high costs while also undertaking the investments needed for firm improvements. Indeed, the current downturn in world financial markets and its resultant "credit crunch" is identified by this respondent as having the potential to drastically reduce the number of orders her firm receives from EU-based retailers. Regardless of this drop in demand, however, energy and transport costs are "fixed" and this means that the export process as a whole will eventually become unprofitable as Textile Madagascar ships a reduced level of goods to EU markets while still having to cope with the high financial burdens of production.

This respondent also contends that in most countries, firms enjoy the opportunity to consider various options (i.e. in regards to utilizing different transport methods) that may be used to reduce production and shipping costs. However, Madagascar's poor infrastructure, the General Secretary claims, limits these options and helps to guarantee that firms' costs remain high and "unmovable". Consequently, exporters in poor countries like the Comoros and Madagascar have few options available to them to deal with costs and their ability to remain competitive or have the potential to invest in their factors of production is, in the eyes of the General Secretary, dependent upon either the capacity of firms to receive government assistance (i.e. in the form of subsidies or low-interest loans) or market demand growing in such a way as to allow for firms like Textile Madagascar to earn enough foreign exchange to build up a high level of savings (which could then be invested into worker training or other firm improvements). This respondent suggests that both of these scenarios are unlikely to materialize in the near future and that chances for firms' to improve their "trade capacity" will also remain difficult to come by.

The General Secretary's pessimistic assertions surrounding the ability of exporting firms to effectively manage costs is not shared by the representative from Madagascar's *Ministère de l'Economie, du Commerce et de l'Industrie*. While acknowledging that high production and transport costs remain a major reason why his country's exporters are not achieving more commercial success, this respondent also argues that Malagasy firms (and those of the other WIO island states) are becoming more pro-active in seeking ways to address cost-based problems. This respondent, for instance, highlights the recent efforts of primary commodity exporters in the Comoros, Madagascar and Mauritius to use multilateral chamber of commerce meetings as platforms to discuss means of sharing and reducing common costs.

At these meetings, the Ministry respondent claims that firms from these three countries (with the backing of their respective governments) drafted formative

plans to create a regional freight shipping company to be owned either by island governments or by a consortium of private sector interests. The objective of this freight company, as Devlin and Castro argue, would be to allow exporting firms in the WIO island states to coordinate the joint shipping of their products so that the overall costs of freight transport could be gradually reduced for firms on an individual basis. While this initiative is not yet off the ground (and may require assistance from foreign donors to become reality), the Ministry official contends that the mere fact that discussions of this nature have taken place at all is evidence that regional firms are increasingly trying to find creative ways to manage their expenses and become more cost-competitive.

The research respondent from BMOI also points to growing levels of inter-island firm cooperation as a reason to be optimistic about the future of regional export firm performance. The BMOI representative, for example, suggests that firms in the Comoros and Madagascar have used forums such as COMESA and the IOC to jointly call for a liberalization of the regional financial sector and the easier entry of foreign (namely Mauritian and South African) banks into the Comoran and Malagasy markets. The BMOI official is of the opinion that firms in these two impoverished WIO countries view the presence of more foreign banks in their countries as a way to promote banking sector competition. This, in turn, may provide firms with some leverage in requesting that commercial banks as a whole make loans available at less onerous interest rates and with less required in terms of collateral and equity. This should make access to finance easier for Comoran and Malagasy firms over the long-term and to the BMOI official, it suggests that firms in these two states are being “aggressive” in trying to “mould the business conditions of their countries” to meet their own financial needs.

The research participant from the Development Bank of the Seychelles, on the other hand, notes recent examples of firms in her country and Mauritius sharing information on potential markets and suppliers as grounds for optimism. Specifically, this respondent points to the aforementioned Indo-Seychelles Commission and suggests that Seychellois firms using the Commission to identify market opportunities in India will often relate these opportunities to (non-competing) Mauritian firms at bilateral meetings between the two countries’ chambers of commerce or within the confines of COMESA, IOC or SADC meetings. Alternatively, this respondent also points out that Mauritian and Seychellois firms may cooperate at trade fairs in locations like the Gulf states when it comes to marketing their products, identifying potential suppliers or promoting their countries as investment locations. While the Development Bank official acknowledges that this cooperation occurs on a relatively small-scale (and never between firms competing in similar industries), she believes that it at least proves that WIO export firms are not passive in the face of important challenges and are willing to use innovative forms of cooperation (even with other countries) to grow their “trade capacity”.

The above responses imply a mixed performance for private sector firms when it comes to enhancing their own competitiveness and export potential. If the General Secretary of Textile Madagascar is to be believed, then the operating costs her firm (and presumably others) must cope with are beyond the ability of firms themselves to effectively overcome. When it comes to building a strong trade, business and investment climate in a country like Madagascar (and likely the Comoros as well), this gloomy assertion leads to the conclusion that national businesses are operating in an environment that inherently works against their interests but which cannot be changed by firms' actions alone. However, the three other respondents mentioned above suggest something different: that firms can (and are) taking active steps to cooperate, improve lines of communication and lobby for the introduction of reforms (i.e. in the banking and maritime shipping sectors) that could improve their access to capital and reduce their transport costs. WIO island state firms, in other words, can take their own steps to improve the trade environment in which they must operate.

This is not to say that firms are taking all of the steps necessary to improve their export performance. Balchin and Edwards (2008), for example, argue that smaller firms throughout the WIO (but especially in the Comoros and Madagascar) have failed to develop strong telecommunications systems. Few exporting firms (at least outside of the EPZ context) have websites or e-mail addresses and many firms do not even possess fax machines (Balchin and Edwards 2008, 20). According to these two writers, the absence of these "communication mechanisms" at firms will create a sense of hesitancy on the part of foreign investors, suppliers and even export customers who see a lack of telecommunications capacity as a sign that a particular firm is too "underdeveloped" to be a reliable business partner (Balchin and Edwards 2008, 20-21). These writers do comment that this situation is slowly changing, especially in Mauritius and the Seychelles, where the growth of IT as an "export" industry and resulting improvements in these countries' electronic connectivity are making it cheaper and easier for firms to establish websites, fax connections, etc.

The World Bank (2002) takes issue with the failure of WIO island state firms to introduce comprehensive worker training programs. While recognizing that cost-based issues may prevent (as the General Secretary of Textile Madagascar argues) firms from prioritizing human capital development, the World Bank maintains that Malagasy firms in particular are demonstrating an unwillingness to assist their country's government when it comes to contributing funds to maintain the island's few industrial training centres and polytechnic institutions (World Bank 2002, 4).

The World Bank also criticizes both Comoran and Malagasy firms for not attempting to introduce English language worker training, the lack of which is identified as having the potential to negatively impact these countries' firms when it comes to developing partnerships with overseas suppliers or consumers in

markets like COMESA and SADC (World Bank 2002, 7). Söderbom and Teal (2007) echo these criticisms when they maintain that the low quality of national technical institutes combined with the inability of many firms to competently process paperwork in English is preventing export companies in Madagascar from being able to acquire “high quality capital stock” from potential COMESA or SADC suppliers (Söderbom and Teal 2007, 9).

The view that emerges from the above perspectives is that when it comes to improving their “trade capacity” and the overall trade, business and investment climate in which they function, exporting firms in the WIO island states have a decidedly mixed record. On one hand, the Malagasy government official, the BMOI representative and the respondent from the Development Bank of the Seychelles are all insisting that firms are taking important steps in addressing key challenges like transport costs and insufficient access to capital. The secondary literature, by contrast, highlights a number of basic areas in which firms in the WIO are not performing as well as would be ideal.

If firms are indeed undertaking shared measures to introduce a common maritime freight company to serve exporting establishments across the WIO, then this is undeniably a boost to the regional trade, business and investment climate as it addresses issues of high costs caused by geographic isolation. Indeed, the introduction of a regional freight company with even a limited number of vessels would allow exporting firms to share the financial burdens associated with exporting their goods by sea (i.e. the costs of leasing and repairing vessels) and it would likely provide an impetus for the WIO island states to place collective pressure on each other to improve the quality of their respective port facilities in the hope that doing so will prevent heavy delays and “logjams” from harming the effectiveness and timeliness of an initiative that acts as a “shared investment” for all of the WIO countries.

At the same time, both the introduction of this freight service and firms’ attempts to loosen bank lending standards via encouraging market entry and competition have the potential to help firms generate economies of scale and scope. In regards to the former, any reduction in transportation expenses should make it easier for firms to engage in the bulk purchasing of inputs. The greater availability of financial instruments (i.e. lower-interest loans), on the other hand, will also help reduce the long run average costs of production and allow firms to operate on a scale that better guarantees their competitiveness. When it comes to putting in place economies of scope, firms’ attempts to secure easier access to finance for themselves might allow them to develop new products or pursue a greater number of marketing opportunities in export markets, both of which may allow firms to alter the structure of their operations, reduce their overall costs and become more competitive. In assessing the trade, business and investment climate in the WIO, these are heartening developments and they make clear that firms are taking the steps necessary to improve their long-term trade performance.

A note of caution, however, should be put forward on the issue of worker training. As the General Secretary of Textile Madagascar made abundantly clear, without improvements to their store of human capital, firms in the WIO island states will find it increasingly difficult to pursue value-added production. This, in turn, may prevent countries like India or even Mauritius from identifying the Comoros or Madagascar as partners who are capable of performing anything other than very basic forms of production. This would then leave workers in these poorer states without the opportunity to use these country-to-country partnerships as a way to access higher wages. Moreover, an inadequately trained workforce is likely to be perceived in a negative light by foreign investors seeking returns on companies that they believe have the chance of growing and improving the quality of their production. If WIO island state firms are to contribute to the creation of a strong trade, business and investment climate, then they must therefore be as aggressive in investing in their workers as they currently seem to be in trying to reduce transport costs and gain easier access to capital.

Business Support Organizations and Chambers of Commerce

For exporting firms operating in developing countries, business support organizations and chambers of commerce are imperative in helping to attract FDI and foreign portfolio investment, undertaking research on possible market opportunities and sourcing options and acting as facilitators of communication between entrepreneurs within (and between) states. These organizations are also responsible for representing the interests of the private sector in regular consultations with government officials and it is often the responsibility of these bodies to convince state actors of the importance associated with supporting the expansion of private business and export-led development. If competent, bodies that support the private sector can contribute overwhelmingly to maintaining the long-term health of the trade, business and investment climates of their countries. When found lacking, however, these same organizations may be unable to provide the types of information or public backing that private firms need if they are to fulfill their economic potential.

When it comes to the WIO island states, this study's research participants suggest that while assorted business support organizations and chambers of commerce are well-structured and (with the exception of the Comoros) well-financed, they may not always perform their roles as well as they need to if the firms they support are to succeed. The official from Madagascar's *Ministère de l'Economie, du Commerce et de l'Industrie*, for example, heralds the creation of the Economic Development Board of Madagascar (EDBM) in 2006 to act as a tool to help Malagasy exporters acquire foreign investment. However, this respondent argues that the EDBM is encouraged by the Ravalomanana government to be "safe" in its operations. When attempting to attract investment into the national textile sector, for instance, the EDBM has been "guilty" of encouraging investors to put capital into the already established cotton textile industry but it has not been as vocal in trying to encourage venture capital to be

directed towards the production of non-cotton clothing products. For the Ministry official, this is frustrating given his department's desire to see Madagascar manufacture clothing based on the use of materials that can be produced "at home" instead of utilizing imported materials like cotton which may be problematic in terms of "rules of origin" requirements set out by some export markets.

The Ministry representative is also critical of chambers of commerce throughout the WIO as well as the business support mechanisms put in place by COMESA, the IOC and SADC. Each of these bodies, this respondent contends, are too "sectoral" in focus, especially when pitching the WIO island states as locations for foreign investment. Stated differently, this individual is arguing that these organizations do a sound job in promoting particular industries (fisheries, textiles, tourism, etc.) but they are not holistically-focused enough to be successful in generating investment enthusiasm for the WIO island states on a *wholesale* basis. The project manager for MCFI agrees with these comments (as does the EU, 2007) and vociferously claims that the failure of business support organizations to market the WIO islands as a "general investment region" is also responsible for the fact that these organizations have mostly failed to convince investors to finance long-term projects in the four WIO countries. With the exception of "Cyber City", this respondent argues, private sector support associations have largely failed to convince investors to provide investment that extends beyond a five year time period. This falls far short of the MCFI representative's belief that each of the WIO island states requires foreign private sector investment that goes beyond a ten year commitment in order to establish sound physical infrastructures, to introduce improved technical education facilities, etc.

On a positive note, however, one of the economists from the University of Mauritius praises his country's Chamber of Commerce for its ability to provide timely and accurate information on potential overseas market and sourcing opportunities to the country's exporting firms. Indeed, the speed at which Mauritius' Chamber of Commerce is able to communicate this information to the country's export sector (especially EPZ representatives) is claimed by this respondent to play an important role in helping Mauritius to gain a leg-up on its foreign competitors in pursuing overseas trade and investment opportunities.

Business support organizations in the Seychelles, such as the Seychelles Industrial Development Corporation (SIDEK) and the Seychelles Institute of Management are given similar commendation by the respondent from the Development Bank of the Seychelles and from the EU (2007), which claims that these organizations are highly effective in communicating market information to national exporters. Moreover, SIDEK and the Institute of Management are also praised by the EU for taking important steps to help the Seychelles develop some of the WIO's strongest technical skills education programs (especially in secondary schools) (EU 2007, 49). In the opinion of the EU, a well-trained

Seychellois workforce will keep the country competitive and innovative in its industrial growth over the long-term.

Finally, Adrianasolo (2008) reinforces the view of the Malagasy ministry official in commenting that the country's private sector support organizations are too "conservative" in their approach to attracting foreign investment. However, she believes that Madagascar's microfinance institutions, namely the Malagasy National Microfinance Coordination Unit (CNMF), have a meaningful role to play in helping the country's smaller-scale export entrepreneurs (even if they are not users of microfinance) make up for these shortcomings. In particular, this writer claims that the lessons organizations like the CNMF provide to Malagasy "micro-entrepreneurs" vis-à-vis how to access different financing options and how to market themselves to consumers, can be provided to exporters as well. After all, if Madagascar's small (domestically-oriented) enterprises are successful in gaining foreign financial assistance (which Adrianasolo claims is the case), then perhaps a group like CNMF can become an important business support organization for Madagascar's export sector as well (Adrianasolo 2008, 4-5).

The existence of so many business support organizations in the WIO (whether they are entirely effective or not) bodes well for the trade, business and investment climate in this region. Considering that many nearby African countries like Ethiopia and Malawi are routinely criticized for lacking non-governmental organizations (NGOs) and chambers of commerce committed to private sector development in their countries, the presence of a number of business support bodies in the WIO island states should allow these countries to be seen in a more positive light by those concerned with private sector growth. Foreign investors and potential trading partners in particular should see the activities of associations like the EDBM and SIDEC as evidence that the WIO countries are serious about supporting their private sector export firms over the long-term.

The speed at which these support organizations are able to communicate important market and sourcing information to the firms they assist (at least in Mauritius and the Seychelles) should, as the University of Mauritius economist argued, provide firms in these states with a competitive edge over firms in other countries whose access to this information may be more constrained. The willingness of organizations like SIDEC to put in place skills training programs, on the other hand, implies that in the Seychelles, real efforts are being made to create a workforce with the knowledge base needed to contribute to a host of export-based industries like IT, finance and light manufacturing. If business support organizations and chambers of commerce can put in place this type of training in secondary schools, then this may even remove the need for Seychellois firms themselves to provide this training to the workers they hire, thus allowing for some amount saving on costs to occur. It was mentioned at the beginning of this report that since island states are not readily able to improve the quantity of human capital at their disposal, they must focus on improving its

quality. The initiatives undertaken by SIDEC suggest that it is possible for business support organizations to contribute to meeting this goal.

At the same time, if the WIO island states are to prosper within a globalizing world economy, then they must be capable of attracting venture capital into new and unique industries like an expansion of IT or the development of new types of industrial production. For this to occur, the business support organizations and chambers of commerce who actively market their states (and their firms) to foreign interests must be particularly bold in encouraging enthusiasm for these types of investments. For this reason, the “conservatism” of an organization like the EDBM is troubling. With the demise of preferential trade agreements, it is not enough for a country like Madagascar to promote investment into longer-standing industries like cotton textile production as enhanced competition from China, India and even mainland African countries will likely make Madagascar less competitive in this type of production over time. Instead, the EDBM must be willing to promote the merits of alternative industries which (even if they never become economic mainstays) are needed to promote economic diversification.

Finally, regional organizations (especially the IOC) would seem to have a role to play in addressing the concerns of the Malagasy government official vis-à-vis “sectoral” versus “holistic” investment promotion. While it is clearly the case that the WIO island states are successful in attracting investment into select industries like primary product production, fisheries and textiles, the ability of these states to become more competitive in the sphere of offshore finance or IT likely depends on the capacity of these regional groupings to help promote the WIO as an overall “investment region”. The Gulf Cooperation Council has performed this role exceptionally well on behalf of the Middle Eastern Gulf states (i.e. Abu Dhabi, Bahrain, Dubai and Qatar) and each of these locations benefit from their associations with one another and by being seen by investors as comprising a sound regional grouping for investment purposes. Replicating this image for the WIO island states will be difficult given the developmental disparity between Mauritius and the Seychelles (already seen as positive investment locations) and the Comoros and Madagascar (which are mostly seen by investors in a negative light). However, the creation of a strong *regional* trade, business and investment climate would seem to depend on these regional organizations and the business support officials that work within them making greater efforts at holistically-based regional investment promotions.

6. Improving the Trade, Business and Investment Climate in the Western Indian Ocean: Possible Policy Options and Donor Interventions

At the beginning of this report, it was suggested that the sharp developmental differences that exist between the different WIO island states would mean that

they would each focus on different priorities in regards to developing their respective trade, business and investment climates. The previous two sections generally reinforce this perspective. The extreme underdevelopment of the Comoros' economy and infrastructure, for example, means that this country's attempts to promote private sector growth will necessitate a focus on developing key institutions (i.e. banks), ensuring political stability, bringing its legal code into line with international norms (i.e. in regards to bankruptcy laws) and establishing even a basic physical infrastructure. For Madagascar, key institutions are in place but are often not effective (such as banks, judiciaries and export promotion agencies) and thus it is institutional *reform* which may be most important to pursue here. Madagascar's physical infrastructure is arguably the single most important factor holding back the country's development as a stronger export and investment performer. Improving roads and the provision of public utilities should thus be seen as being essential for Madagascar to become more competitive.

By contrast, both Mauritius and the Seychelles possess successful economies and their responsibilities vis-à-vis furthering their trade, business and investment climates lie with improving upon minor deficiencies. Enhancing the capacity of national ports, making commercial banks friendlier to smaller export firms and continuing to pursue economic diversification should be the key objectives for policymakers in these countries. Where common areas of concern can be found between the four WIO island states, the most notable appear to be in the area of finance and making sure that exporters can access capital in a timely manner. Given the high production and transport costs faced by each of these islands, easy access to start-up and working capital is clearly a pre-condition for developing an improved region-wide "trade capacity".

In what follows, a limited number of policy proposals (based on this report's research findings) are put forward as possible avenues to improve the WIO island states' trade and investment performances. A decision has been made to divide these recommendations into two categories: 1) policy suggestions that can be implemented by WIO island state governments and 2) policies that foreign donor agencies can (and will likely have to) help put in place with the cooperation of WIO governments and firms.

Recommended Policy Plans for Regional Governments

In each of the four WIO countries, governments must take substantial steps to reform their banking sectors so that they become more amiable to the interests of emerging export firms. In the Comoros and Madagascar, the first steps taken in this regard should involve a lowering of interest rates on business loans. Madagascar's prevailing interest rate of 18% on such loans is not predatory but remains too high to entice firms to consider commercial banks as reliable sources of financial assistance. It may be the case that a lowering of interest rates will increase short-term inflation (especially if interest rates are reduced – as they should be – on personal loans as well). However, given Madagascar's

recent history of tight monetary policies and general success in preventing large price increases, allowing inflation to rise at reasonable levels may be acceptable for a period of time.

Ideally, collateral requirements should also be reduced in the Comoros and Madagascar, even if this means simply bringing these figures in line with the demands made by other sub-Saharan African countries. Meanwhile, in Mauritius and the Seychelles, equity requirements remain a barrier to firms' ability to access loans from commercial banks and these should be reduced downward from their current levels of 40%-50% to somewhere around 20%-25% (which is the general range of equity demands in some key Southeast Asian markets).

None of these policy shifts should be especially problematic. However, if banks show a reluctance to adhere to government recommendations on the above matters, then it would be worthwhile for policymakers to work through an organization like SADC to push for a quicker pace of regional financial liberalization. This would encourage the entry of new banks into the WIO island markets (especially South African institutions that are already beginning to develop a foothold in the region). Two major benefits would arise from this: 1) it could encourage greater competition within these island states' banking sectors and may force the region's commercial banks to be less complacent when it comes to developing financial products for the private sector and 2) the potential partnering of WIO banks with a South African counterpart could help improve the capitalization levels of the local institutions and this may make banks in a state like Mauritius less hesitant to provide loans.

Earlier, this paper made note of how successful certain business support organizations, chambers of commerce and government ministries had been in Madagascar (through *GasyNet*), Mauritius and the Seychelles vis-à-vis communicating market and sourcing information to export firms. At the same time, it was noted that regional organizations like COMESA and SADC were less successful (largely due to language issues) in acting as communication conduits to businesses in the WIO states. The formation of a "regional chamber of commerce" under the auspices of the IOC can both enhance these successes and make-up for important shortcomings. Because WIO chambers of commerce appear to be successful in disseminating information at the national level and because there is already a fairly high degree of communication occurring between the WIO islands' chambers of commerce (at least between those of Mauritius and the Seychelles), it does not seem out of the question to suggest that these bodies could pool some of their efforts towards creating a supranational entity that provides this same level of service to firms on a region-wide basis.

A WIO chamber of commerce supervised by the IOC would have the added advantage (unlike assistance provided by COMESA and SADC) of possessing a common *lingua franca* (French) and this could eliminate many of the problems

firms have when trying to understand the (English language) information provided to them by business support agencies in the two larger African regional blocs. Most important, however, is that a regional chamber of commerce can promote greater communication between firms and business support organizations throughout the WIO and this could then be used by firms to help each other identify common markets and economical sourcing options. It could also, as a result of possessing members from all four WIO islands, act as a regional body charged with marketing the merits of the WIO as an overall “investment region”. Clearly, the details of what a regional chamber of commerce would look like have to be further defined. However, the creation of such an organization remains within the policymaking power of the WIO governments and is an option they should each consider.

The high standards of port authority management in the WIO island states is something these countries should take pride in. However, maintaining these standards will likely require more effort on the part of area governments to guarantee the quality of their trade facilitation measures. On one hand, this will require WIO governments to be aware of SPS and other product standards requirements put in place by foreign markets (and to communicate these to firms). However, quality performance in terms of trade facilitation also involves preventing corruption amongst customs officials as well as ensuring that these officials are well-trained, motivated and aware of their duties.

Addressing these latter concerns is something that regional governments can do easily by allocating a greater portion of their national budgets towards the hiring and training of customs personnel, port security officers, etc. Ideally, part of this cash could be spent on bringing in officials from a number of key export markets (i.e. the EU, India, Japan, United States, etc.) to provide training/lessons to regional customs officers on topics like product safety or SPS regulations so that these officials are fully aware of what standards-based problems they may encounter and how to cope with them. If this training is successful, the region’s export process should be sped up. This is especially true if such training could be provided to customs officers in the Comoros (whose “operational slowness” is typically identified as a constraint on that country’s export performance).

Corruption amongst customs officials is not a major problem in the WIO region and it is being brought under control in countries, like Madagascar, where it was once a meaningful issue. However, the Comoran and Malagasy governments should provide higher wages to these officials in order to stamp out what remains of corrupt practices and as a way to encourage their customs officers to be more efficient in carrying out their tasks.

The above examples are by no means all the policy steps that WIO island state governments can take to improve the trade and investment performances of their countries. However, these are all very simple policy efforts that could be accomplished quickly and by expending only a minimal amount of political

capital. More important, however, is that they would have a quick and (in the opinion of this researcher) decisive impact on improving export and investment outcomes in the WIO. A lowering of interest rates, collateral demands and equity requirements would make commercial banks more accessible and attractive to export firms in search of capital. This, subsequently, would ensure that firms themselves were in possession of the finance they need to grow their operations, provide training to their workers or acquire needed inputs.

Creating a “regional chamber of commerce” would enrich the communication occurring between WIO firms when it comes to marketing and sourcing information and such a body could act as a de facto export promotion agency capable of marketing the entire WIO as a sound “investment region”. Finally, providing more money to the salaries and training of national customs officials would help maintain strong levels of port authority performance in the WIO and would improve overall levels of trade facilitation by boosting worker morale and developing greater awareness of foreign product standards demands.

Recommended Policy Plans for Foreign Donor Agencies

It is possible that some of the policy efforts required to improve the trade, business and investment climate of the WIO island states will demand capital expenditures that these countries cannot afford on their own. In these cases, external donor agencies such as various NGOs, the African Development Bank, the United Nations Development Program (UNDP) or the World Bank may have a role to play in providing necessary advice and finance. For the most part, foreign donor interventions should be geared around helping the four WIO countries improve their physical infrastructures and human capital capabilities, both of which could be expensive to address for national governments whose treasuries are often limited in their spending power.

The upgrading of technical training centres and polytechnic institutions would be a worthwhile intervention, especially in Madagascar. On one hand, interventions in this area could simply involve foreign agencies helping to renovate campuses, providing machinery (i.e. computers, high-quality tools, sewing machines, etc.) or just helping to raise funds for the maintenance of these training centres and for the paying of salaries. Ideally, however, donor interventions geared around technical education improvements should address human capital directly and there should be a sustained effort by donors to try and arrange for “trained experts” to be sent to these institutions to help improve the quality of teaching and to recommend administrative reforms necessary to make these centres work more efficiently. Potentially, donors should even arrange for some “experts” to be seconded to these institutions for a prolonged period of time so that they can take on teaching roles and fill important vacancies.

As was made apparent earlier in this report, the poor quality of roads in the Comoros and Madagascar remains a significant barrier to the movement of

exportable goods in these countries from their points of production to port facilities. Given the extremely high costs of undertaking road building or upgrading, foreign donor agencies may have a role to play here as well. Funding the costs of road construction (or at least sharing them with national governments and/or port authorities) and helping to make available necessary supplies (i.e. by arranging for the donation of concrete and machinery) would be a very useful donor intervention that an organization like the African Development Bank could try to speedily arrange. Moreover, given that road building has the potential to absorb a large amount of labour (at least on a temporary basis), this type of intervention could also generate increased employment and wages.

Finally, donors should make concerted efforts to help the WIO island states realize the goal of creating a shared maritime freight company. As argued by Devlin and Castro as well as the Malagasy government official, this initiative would help each of these four countries coordinate the joint shipping of their products to reduce their overall costs. However, the initial capital expenditure required to organize the leasing of vessels, the acquisition of licenses, the hiring of management staff, etc. would be considerable and donors like the World Bank should therefore consider a fair loan package that would allow these countries to take on these costs without having to face severe financial struggles in the process.

Not surprisingly, there are a number of other ways in which foreign donors could help the four WIO island states improve their trade, business and investment climates. However, the above recommendations address some of the most critical issues facing these states (inadequate worker training, physical infrastructure and high transport costs) and should thus be seen as priorities for future development.

7. Conclusions and Suggestions for Future Research

The objective of this report has been to evaluate the trade, business and investment climate of the Comoros, Madagascar, Mauritius and the Seychelles from both an institutional and firm-level perspective. To accomplish this goal, this study provided an overview of the economic, historical and political trends which have influenced the overall development of these countries since they achieved their independence. Here, it was established that the Comoros and Madagascar remain heavily underdeveloped due to the lingering effects of factors like political instability, a legacy of misguided socialist policies and an export dependence on primary commodities. Mauritius and the Seychelles, by contrast, enjoy relatively diversified economies; something that can be credited to the fairly enlightened social policies and overall political systems that these countries created throughout the 1980s and 1990s. This study then went on to outline many of the challenges globalization poses to island states like those of the WIO. A number

of problems clearly exist, such as difficulties attaining economies of scale and scope and the need to deal with high transport costs. However, it was also argued that the WIO island states could pursue “linkages” with metropolitan economies or greater integration into regional or sub-regional bodies like the IOC and SADC to cope with these problems and become more globally competitive.

The study then examined the quality of various “institutions” throughout the four WIO island states. It was noted here that all of these countries face problems when it comes to the quality of their banking systems and physical infrastructures but that these are far more pronounced in poverty-ridden countries like the Comoros and Madagascar. These latter two countries also possess a number of shortcomings vis-à-vis their judicial systems. Government ministries throughout the region (with the exception of the Comoros) are performing well in attempting to facilitate an improved trade, business and investment climate. Regional organizations, meanwhile, also have a role to play in this regard but the parameters of this role have not yet been established.

For their part, exporting firms are taking increasingly bold steps to improve their own operations, despite the difficult challenges (i.e. in terms of costs, logistics, etc.) that they face in their daily operations. However, firms could improve their competitiveness and attractiveness to investors if they put greater efforts into securing basic telecommunications capabilities like Internet connectivity. Finally, business support organizations and chambers of commerce are performing important roles in communicating relevant information to the exporters they assist but they could do more to encourage investment towards innovative (rather than “already established”) industries and they must be more aggressive in marketing the WIO as a wholesale “investment region”. Finally, this report offered a number of policy recommendations that governments and/or foreign donor agencies could undertake in order to improve the trade, business and investment climate of the WIO island states.

The analysis above should allow for the answering of the one key question that motivated this report’s research. Specifically, is the trade, business and investment climate of the WIO island states sound enough to help these countries avoid the fate of economic marginalization in a globalizing world economy? In the opinion of this researcher, the answer is yes but only if current progress is maintained and if some important steps are taken to reverse substantial shortcomings. Both Mauritius and the Seychelles have performed remarkably well in diversifying their economies, encouraging investment, building a strong infrastructure and guaranteeing sound measures for trade facilitation. The fact that these countries are seeking enhanced partnerships with emerging economic powers like India offers proof that these states are serious about maintaining their competitiveness and expanding their economies. It is highly unlikely, therefore, that these two countries will find themselves facing any type of economic marginalization in the near future. However, it will always be necessary for these countries’ firms and political leaders to continue to be on the

lookout for new and unique forms of economic activity that can provide jobs and maintain this success over the long-term.

In Madagascar, a more mixed analysis is forthcoming. The trade, business and investment climate in this country is poor. However, progress is being made in terms of making sure that export information is widely disseminated and when it comes to boosting the quality of port management. Madagascar's problems relate mainly to the quality of its *institutions* (banks, judiciaries, etc.) and without substantial steps being taken to overhaul these, it is difficult to see how the country can really expand its economy, pursue export diversification or become an attractive investment location. Madagascar is unlikely to become marginalized in the global economy. However, because it is equally unlikely to expand its "economic might", a dependence on specific trading relationships (i.e. with France and Germany) should be expected to continue. The Comoros, on the other hand, is already a marginal global economic player and this will not change soon. Political uncertainty, a poor infrastructure and the inefficiency of trade facilitation measures will tragically conspire to keep the Comoros poor and economically dependent on global market prices for key crops like ylang-ylang.

When it comes to opportunities for future research, a number of notable issues should be explored. First, because time constraints prevented this researcher from visiting the Comoros, any project seeking to consider this country's trade, business and investment climate from an *in-depth* perspective (i.e. a study which conducts interviews with Comoran government officials, firms, port authorities, etc.) would be worthwhile and could shed light on issues that this study has commented on only briefly. Further research should also be carried out on the types of economic cooperation occurring between the WIO island states. For instance, Mauritius' textile investments in Madagascar and sugar-based investments in Mozambique are not commonly discussed within either academic or policy-based literature. However, they suggest an interesting dynamic of south-south cooperation whose potential success (or lack thereof) may be important when considering the economic policy possibilities available to other island states.

Finally, the WIO island states are each outliers when it comes to their membership in African regional groupings like COMESA and SADC. They are (with the exception of Madagascar) geographically small and lightly populated. These countries are also French-speaking and enjoy stronger ties to regions like the Indian subcontinent than their mainland African counterparts. Investigating how the WIO island states can benefit from membership in these groups (given these differences) and the role they can play in forging greater cooperation between East/Southern Africa and South Asia would be worthwhile exploring. The long-term importance and role of the IOC, whose activities remain fairly limited in scope, is also a research topic worthy of consideration. Based on this report's research findings, opinions towards the IOC are largely favourable amongst firms and government officials in the four WIO island states. Identifying

how the IOC can capitalize on this goodwill for the benefit of its members would therefore seem to be important.

Each of the above topics could, like this report has endeavoured to do, put forward a number of new and important observations on the quality of the trade, business and investment climate in this region. Most of the WIO island states are making strong progress towards sustaining pro-trade and pro-private sector growth. To preserve this momentum, development researchers should invest the time to study these islands further and should not hesitate to offer creative ideas on how they can improve their economic fortunes.

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Appendix

The following includes a **selection** of the questions posed to this study’s research participants. They are categorized based on the individual respondent.

University of Mauritius Economists

1. From your perspective, what have been the broad-based successes of regional EPZs and what challenges remain to be overcome vis-à-vis the ability of EPZs to enhance regional “trade capacity”, investment flows, etc.? In the case of Mauritius in particular, to what extent have the EPZs been successful in helping local firms attract needed technology investments and has their presence made it easier for Mauritian firms to access operating capital either locally or from abroad?
2. To what extent can a wealthier regional economy such as Mauritius direct its own investment towards supporting the production activities of poorer states like Madagascar? This may be of particular relevance to the textile sector, where cheaper labour costs have shifted production away from Mauritius to lower-wage regional economies. From an investment perspective, what role is Mauritius playing in the wider region (i.e. technology transfers, passing along expertise, etc.)?
3. To what extent is some degree of economic convergence between Indian Ocean island states possible in the future? For example, is it possible for organizations like the Indian Ocean Commission (IOC) to begin promoting the region as a whole as a destination for foreign direct investment (i.e. attracting investment into textile manufacturing in Madagascar, the development of financial services in Mauritius, etc.)? Stated differently, is it possible for the island states to each play to their present comparative advantages to attract regional investment as a whole or do national rivalries make such prospects unlikely?
4. Based on current trends, to what extent is Mauritius placing itself in a position to benefit from the growth of India (and to some extent China) as important players in the Indian Ocean region? For instance, what steps are being taken by Mauritius (and other island states) to attract investment from Indian firms or conversely, what opportunities are being exploited by Mauritian investors to expand their activities into markets such as India?

5. In a similar vein to the above question, does membership in SADC/COMESA offer real benefits in terms of helping countries like Mauritius attract FDI? Alternatively, is a country like Mauritius in a position where it is better-served by disassociating itself from regional mechanisms like SADC and marketing itself to investors separately? Is this a pattern that could be followed by other regional states (i.e. the Seychelles)?

MCFI Project Manager, Mauritius

1. What challenges do firms like yours face when it comes to exporting? Do you believe that these challenges are also faced by other Mauritian exporters? Why do you believe that these challenges exist and what can be done (by government, by foreign donors, by your own firm) to deal with them?
2. Comment upon the pro-trade nature of Mauritian institutions. Are the country's port authorities competent enough to put in place sound trade facilitation measures? Are chambers of commerce and other business support organizations effective in providing you with information on markets and sourcing opportunities? Do you rely on these institutions for at least some of your market research or does the firm perform all of these functions itself?

Representative from the Development Bank of the Seychelles

1. What are the main problems faced by Seychellois firms when it comes to meeting their export potential? Why do these problems arise? What is being done by the Seychelles' government to address these issues vis-à-vis policymaking efforts?
2. To what extent are DFIs like the Development Bank of the Seychelles important when it comes to ensuring the availability of capital to (smaller-scale) exporters? What advantages (i.e. in terms of interest rates, collateral or equity requirements, etc.) does the Development Bank offer to exporters that the Seychelles' commercial banks do not offer?
3. What improvements can be made to building the "trade capacity" of the Seychelles? Stated differently, what would you like to see the national government, foreign donors or even your own institution do make the country more competitive, speed up the export process and improve general trade facilitation measures? How will building this "trade capacity" contribute to the wider development of the Seychelles?

BMOI Representative, Madagascar

1. Provide an overview of the types of services this financial institution provides to small businesses (particularly those with an export-orientation). In particular, what types of financial assistance (loans, credit, etc.) do you provide to small businesses when it comes to helping entrepreneurs access start-up capital? From your perspective, what barriers may exist that prevent you from offering loans to Malagasy small businesses? How can these barriers be overcome?
2. Discuss your institution's lending practices as they relate to the issue of risk. How does your bank assess risk when considering which potential businesses to lend to? Do you find that your institution is in a position where it can obtain the accurate information necessary to assess risk properly? Alternatively, is information on the creditworthiness of potential clients difficult to come by? If so, does this lead your bank to lend in smaller amounts (and to fewer individuals) than you would otherwise prefer?

3. Comment upon the Malagasy banking industry's lending practices when it comes to the private versus public sectors. It has been suggested by the World Bank that Madagascar's commercial banks are often guilty of directing most of its lending credit to the government rather than to the private sector. Do you believe this is the case? If so, what can be done to ensure that in the future, national banks offer more credit to the private sector?
4. From a financing perspective, what types of enterprises would the Malagasy banking industry like to support in the future? Are Madagascar's banks focused more on ensuring the expansion of key export industries such as textiles or is there also enthusiasm for trying to finance different (and new) industries (i.e. eco-tourism) that could benefit Madagascar over a longer-term period of time? What steps are being taken by Madagascar's national banks to encourage economic diversification within the country's business sector?
5. What roles do Madagascar's national banks play in helping the country (and its business sector in particular) attract foreign direct investment? What types of partnerships do Malagasy banks have with overseas financial institutions and what are the benefits that are accrued from such partnerships? What additional steps can Madagascar's banking sector take to help promote the country as a location for future investment?

General Secretary of Textile Madagascar

1. Comment upon the nature of your firm. What do you produce? What are your primary export markets? What are the goals for your firm when it comes to profitability, productive output, etc.? How many people do you employ? By Malagasy standards, would you consider yourself to be a small or medium-sized firm?
2. What are the challenges your firm faces when it comes to improving your productive output, competitiveness, etc.? What does your firm require in terms of finance, government support, capital equipment, etc. to overcome these challenges? On a larger scale, what barriers do you believe exist for the Malagasy private sector as a whole? What can the national government do to assist Malagasy businesses (particularly exporters) grow and become more competitive both regionally and internationally?
3. What is your perspective on the quality of Madagascar's "trade infrastructure"? Specifically, are the country's transport infrastructure (ports, airports, etc.) and customs procedures adequate when it comes to allowing your firm to ship your products to your export markets in a timely manner? If not, what infrastructural improvements are necessary and which do you believe should be particularly strong priorities of the national government?
4. To what extent is your firm able to obtain capital from Madagascar's commercial banks (i.e. *BMOI* or *BNI Credit Lyonnais Madagascar*)? Are banks willing to extend loans, credit, etc. to firms such as yours quickly and in financial amounts that allow you to grow your business? If so, what level of collateral do banks require you to offer to acquire a loan? What are the interest rates typically levied on the types of loans you acquire? If banks are not willing to lend capital or extend credit, what alternative financing options (if any) are available to firms looking to acquire start-up capital or other types of finance?
5. Comment, if you can, on how your firm is able to compete with producers in nearby countries (namely Mauritius). Does your firm compete directly with firms in a country

like Mauritius or is Malagasy production entirely different in its objectives? For instance, do Malagasy textile firms tend to produce lower-value products in comparison to Mauritian firms? If so, what is Madagascar's particular "niche" when it comes to clothing and textile production? What is (and should be) Madagascar's focus of production?

Representative from the *Ministère de l'Économie, du Commerce et de l'Industrie*

1. Comment upon the recent efforts made by the Malagasy government when it comes to designing effective policies in regards to trade facilitation. In particular, what efforts are being made to regulate customs procedures, streamline documentation requirements for importers and exporters, etc.? What challenges remain for the Malagasy government in improving its performance when it comes to national trade facilitation?
2. It is apparent that Madagascar's trading relationship remains defined by the country's connections with the European Union and SADC. However, what steps are being taken by the national government to promote Madagascar's export industries (i.e. textiles, vanilla, fisheries, etc.) to important *emerging* markets like China, India and even Indonesia? From a governmental perspective, what challenges do you face in promoting Madagascar as a trading partner to these markets (and others)?
3. When it comes to improving Madagascar's transport infrastructure, particularly its port facilities, what steps is the national government taking to enhance port capacity, update obsolete equipment, etc.? In addition to a possible lack of financial resources, do any barriers exist that might prevent Madagascar from improving its port handling capacity in the future? How can these challenges be overcome?
4. From the perspective of this ministry, to what extent are Madagascar's export firms able to access accurate information on customs procedures, packaging/storage requirements and other issues related to their ability to ensure timely exports of their products? Are any government programs in place to assist those exporters who feel they may be lacking this information? What further steps need to be taken to assist small businesses enhance their trade capacity and market themselves to potential overseas trading partners?
5. From a government perspective, what challenges face Madagascar when it comes to promoting foreign investment in the country's private sector? What constraints does the government face in its own efforts to facilitate private sector development? At a policy-based level, what opportunities exist for the Malagasy government to use foreign direct investment (FDI) as a means to boost the size and competitiveness of the country's private sector (particularly in such products as textiles)?