Mauritius and the Chagos Islands 2024: Celebrate the Justice and Plan for a Possible Resource Curse

Professor Matthew McCartney
Head of Research, Africa Urban Lab (AUL)
matthew.mccartney@aul.city

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KEY TAKEAWAYS

In October 2024 the United Kingdom finally agreed to abide by various legal decisions and to return sovereignty of the Chagos Islands to Mauritius. So far, the positive narrative surrounding the legal case has glossed over the economic implications for Mauritius.

This policy brief argues that the Chagos deal may create resource curse-like conditions in Mauritius as a result of the rental-cum-compensation payments for the Diego Garcia naval base.

This policy briefs joins with Mauritius in celebrating the justice of the Chagos deal, but urges Mauritius not to be distracted by legal success and to start planning for a possible resource curse.

Mauritius should create a sovereign wealth fund (SWF). The SWF could spend the income it generates from its investments in helping to turn the University of Mauritius into a world class university. Mauritius needs investment in knowledge creation more than physical factories and infrastructure.

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Executive Summary

One of the vestiges of global imperialism and Cold War politics came to an end in October 2024 with the decision to by the United Kingdom to abide by various legal decisions and return sovereignty of the Chagos Islands to Mauritius. The solution wasn't easy and required several high-profile legal defeats, global opposition, and a change of government in the UK. The media reporting in the UK has been, with some exceptions very positive, and many have proclaimed the result to be a win-win-win-win solution. Continuing concerns revolve around the lack of consultation among Chagossians, the geopolitical threat to the US presence in the Indian Ocean relative to China, and the implications of the recent victory of Donald Trump to the US presidency. So far, the positive narrative surrounding the legal case has glossed over the economic implications for Mauritius.

This policy brief asks two questions:

1. What is the resource curse and will the Chagos deal subject Mauritius to a potential resource curse?

2. How can Mauritius avoid the resource curse?

This policy brief argues that the Chagos deal may create resource curse-like conditions in Mauritius as a result of the rental-cum-compensation payments for the Diego Garcia naval base. Despite the lack of real data on the financial implications of the recent deal, a resource curse is a real possibility for Mauritius, especially because the rental payments could have a significant impact on the total government budget. The resource curse literature supports the argument that a variety of resource windfalls, including foreign aid or a rental payment for a naval base, can cause resource curse type impacts.

This policy brief also focuses on the alleged economic benefits to Mauritius. Economic success in Mauritius over the last five decades has been predicated on promoting manufactured exports, followed by further economic diversification. Mauritius should use the windfalls from the Diego Garcia rental to boost education and knowledge-based industries on the island. This would allow Mauritius to continue moving up the value chain and propel them towards sustainable long-term economic growth.

This policy briefs joins with Mauritius in celebrating the justice of the Chagos deal, but urges Mauritius not to be distracted by legal success and to start planning for a possible resource curse.

This policy brief outlines three key action points:

- There are worrying signs that institutional quality in Mauritius has been declining since 2014. Mauritius needs to monitor this situation carefully and focus on the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies. Any rental payment for Diego Garcia must be received, allocated, and spent in the full glare of public and parliamentary transparency and accountability.

- Mauritius is already investing enough to sustain reasonably rapid economic growth. There is a danger that boosting investment, especially through the centralized direction of the state will create unused and wasteful industrial and infrastructure white elephants. Instead, Mauritius should save its Diego Garcia rents, rather than engaging in a state-mediated efforts to boost domestic investment, increasing current consumption on imported consumer goods, or raising public sector salaries.

- Mauritius should consider recycling the revenue to the local population or creating a sovereign wealth fund (SWF). The SWF could spend the income it generates from its investments in helping to turn the University of Mauritius into a world class university. Mauritius needs investment in knowledge creation more than physical factories and infrastructure.

1. Introduction: An Empire Where the Sun Never Sets (on Court Cases)

In 1968, a dismembered Mauritius gained independence from Britain. The 60 Chagos islands had been shorn from the rest of Mauritius in 1965 and turned into the British Indian Ocean Territory. In the feverish Cold War era of the early 1960s, not long after the Cuban Missile crisis, Britain and America had established a military base on the largest atoll of the Chagos - Diego Garcia - that was ideal for the purpose. The island offered a natural harbor, was large enough to host a sizeable military presence, and was strategically located between East Africa and Southeast Asia[1]. The base had easy access to four of the most important "choke points" in international shipping lanes: the Bab-el-Mandeb, the Straits of Hormuz, the Malacca Straits and the Cape of Good Hope. B52s flew regular sorties from Diego Garcia during the 1991 Iraq War.[2]

Where the military rationale smiled international law frowned. Mauritius had been embroiled in court with the UK since the 1970s. The legal process culminated in the late 2010s, with a 2015 ruling by the permanent court of arbitration, a 2019 ruling by the International Court of Justice, and a 2019 UN General Assembly vote (116 to 6) for Britain to leave Chagos and for the islands to be reunited with Mauritius.[3] To further compound the illegality of continued colonial occupation, between 1965 and 1971, the British government had forcibly depopulated the 1,000 plus civilian inhabitants of the Chagos islands. Those who had been displaced resettled in Mauritius, the Seychelles, and the town of Crawley in the UK, many in poverty. Again, the law ruled against the former occupiers. In 2000, two UK High Court judges declared these expulsions to have violated international and British domestic law.[4]

Aided by the election of a new Labour government in the UK in October 2024, the UK announced it would finally give up its sovereignty of the Chagos islands, and return them to Mauritius. The deal was announced as a rare "win-win-win-win moment in international relations, with all the relevant actors able to claim a meaningful victory: Britain, Mauritius, the US, and the Chagossians."[5] For Britain it was the moment to resolve a lingering imperial injustice; for Mauritius a reunification; for Chagossians a slightly truncated right to return[6]; and for the US (and UK) the military base on Diego Garcia was granted formal legal recognition via an agreed 99-year lease under Mauritian sovereignty.[7] There was

initially no objection from the US, where President Biden labelled the agreement as "historic" and amounted to a "peaceful and mutually beneficial outcome" while protecting a key military base which "plays a vital role in national, regional, and global security."[8]

It wasn't quite unanimous. The BBC reported some disquiet among UK-based exiled Chagossians who felt betrayed because they had not been consulted at any stage in the negotiations.[9] There was also some debate in the UK media about the wider geopolitical implications of the deal. The Chagos deal has raised new questions about the string of 14 other overseas British dependencies, including Bermuda, the Caymans, and Montserrat. A recent editorial in the left-leaning UK-based Guardian newspaper argued that, after the Gulf states, they have become "the world's greatest havens of illegal, unsourced and untaxed wealth" and should become independent and subject to international law as sovereign states.[10] On the other hand, an editorial in the right-leaning UK Daily Telegraph newspaper accused the Labour government of pursuing "juvenile, half-witted anti-colonialism" and having "betrayed our strategic interests, delighted our enemies, weakened our alliance with the United States."[11] Concerns revolved around the potential that China could gain access to Diego Garcia.[12] After the victory of Donald Trump in the 2024 US election, there was some disquiet about whether his administration would accept the deal. Incoming US Secretary of State Marco Rubio and Defense Secretary Pete Hegseth were both[1] reported to have "criticised the Chagos plan."[13] After meeting with Donald Trump, UK Foreign Minister David Lammy said "I'm very confident that when the new administration looks at the detail of this deal that they will stand behind it because Donald Trump knows what a good deal looks like."[14]

For Mauritius, the discussion focused on the outcomes of the legal process, declaring the result to be a victory for Mauritius. The implied economic benefits of the negotiations, have been glossed over and referenced only briefly by media and other commentators. In exchange for permission to operate the naval base on Diego Garcia, Britain will provide "a package of financial support" to Mauritius[15] that will include "annual payments and infrastructure investment."[16] The total sum has not been released or perhaps even negotiated yet, but in Mauritius, Alan Ganoo the Land Transport and Light Rail Minister, declared in October 2024 that the rent-cum-compensation will amount to "many billions of rupees" and as a result "Mauritius will become one of the biggest developing countries."

1 At the time of writing (November 2024) neither had been confirmed in their appointments.

This policy brief focuses on these apparent economic benefits to Mauritius. Economic success in Mauritius over the last five decades has been predicated on first promoting manufactured exports and then further economic diversification into high-end services. A large annual payment of rent-cum-compensation for the Diego Garcia naval base could introduce a distortion known as the 'resource curse' into Mauritian economic development, politics, and policy making. This policy brief asks two questions:

1. What is the resource curse and will the Chagos deal subject Mauritius to a potential resource curse?

2. How can Mauritius avoid the resource curse?

This policy briefs joins with Mauritius in celebrating the justice of the Chagos deal but urges Mauritius not to be distracted by legal success or caught waiting for Donald Trump to be inaugurated as President in January 2024. Mauritius should start planning for a possible resource curse.

2. The Resource Curse and the Mauritian Economic Miracle

This section introduces and explains the idea of a resource curse, describes the Mauritian economic miracle after the 1970s which was structured around moving away from natural resource-based production (sugar), and asks whether Mauritius may now face an impending resource curse as a consequence of the Chagos legal victory.

2.1 What is the Resource Curse?

Until independence in the 1950s and 1960s, European colonization in Africa and Asia was criticized for having created a 'drain of surplus.' The accusation was that European colonizers used their imperial-sovereign control of trade, financial flows, and taxation policy to acquire natural resources (especially oil) at low prices. In return, they exported to those colonies and other countries more expensive manufactured goods. After independence, many newly independent countries sought to gain more domestic control over natural resources to maximize their local-national economic benefits. By the late-1950s "virtually every hard-rock mineral and petroleum firm in the developing world was foreign-owned, by the end of the 1970s virtually all had been nationalized."[17] Zambia, for example, nationalized its copper mines in the early 1970s and used the revenues to fund infrastructure, provide social services, and build an extensive network of local industrial firms to supply the inputs needed by the mining firms. The mantra was that resources were good and the benefits of resources had been 'stolen' during the colonial era.

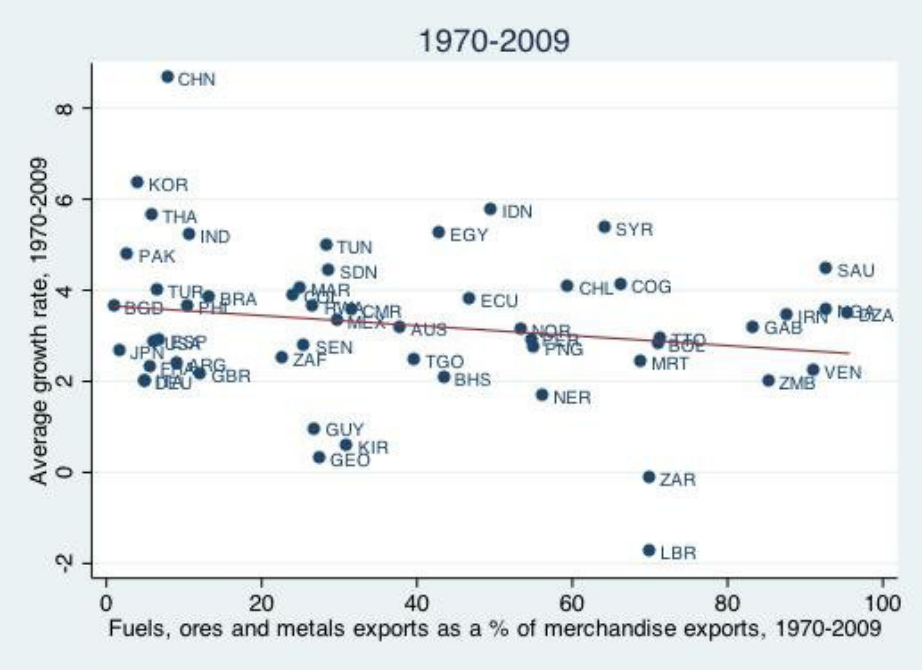
After independence exporters of natural resources faced a new problem. Economists Raul Prebisch and Hans Singer argued in the early 1950s that prices of natural resource exports would tend to decline over time relative to prices of manufactured exports. This was caused by the lower price and income elasticity of demand for primary goods compared to manufactured goods.[2] This it was claimed would lead to slower demand growth for natural resources over time Technical progress would likewise reduce the need for raw materials, for example by replacing copper wires in telephone technology with

2 This is known as Engel's Law, the empirical finding that households spend a lower fraction of their income on food and other basic necessities as they get richer.

fiber optics. There has been general empirical support for this theoretical proposition since. Various measures of the terms of trade declined for primary products (relative to manufactured products) between the 1950s and 1990s and these price falls were only partly offset by an increased volume of primary sector output and exports.[18] The policy implication was that the benefits of natural resources would fade over time and that developing countries should aim to diversify into manufacturing.[19] For the case of oil and other minerals, however, there were no such fears. These non-renewable natural resources were in fixed supply and were gradually being depleted which would increase their prices over the long-run. The sharp oil price spikes in 1973 and 1979 seemed proof of this theory.[20]

Over time the world accumulated numerous puzzling anecdotal case studies on the trials and successes of resource-based economies. By the 1980s it was evident that economic growth 'losers' such as Nigeria, Zambia Sierra Leone, Angola, and Venezuela were all resource-rich. The Asian tigers, Korea, Taiwan, Hong Kong, and Singapore were all resource-poor, while many other growth winners such as Botswana, Canada, Australia, and Norway were rich in resources.[21] These puzzling ambiguities between resources and growth can be seen in figure one, that shows the relationship between economic growth over four decades and the exports of fuels, ores and metals as a fraction of total merchandise exports.

Figure One: Statistical relationship between mineral exports and growth.



Source: Frankel 2012:3

To the surprise of the resource-optimists, the overall relationship is slightly negative, but the divergent case studies noted above ensures that the relationship is not very strong.[22] The most semina l and influential study was that by Jeffrey Sachs and Andrew Warner in the mid-1990s which found that, after controlling for the impact of initial per capita income, trade policy, government efficiency, investment rates, and other variables, economies with a high ratio of natural resources to GDP in 1971 experienced less economic growth between 1971 and 1989.[23]

The idea of the Resource Curse was born! However, the term 'resource curse' is something of a misnomer. What matters is not resources per se but that a country gains a large windfall in export or government tax revenue from point resources such as oil, minerals, plantation crops (sugar, bananas), or other sources such as foreign aid – or in the case of Mauritius, from the rent of a naval base. These sources of the resource curse contrast to more diffuse resources such as smallholder agriculture where the ownership, production, exports, and tax revenue are spread more widely, geographically and in terms of control. There is supporting evidence that it is point resources not resources in general that create a resource curse.[24]

Twenty years later "considerable evidence" has been amassed for the resource curse which has been found to hold across different types of natural resources, different measures of institutional quality, and different time periods[25]. The most notorious example was that of Nigeria. Nigeria began earning oil revenue in 1965 and over the next 35 years, Nigeria's cumulative revenues from oil after deducting payments to the foreign oil companies amounted to $350 billion at 1995 prices. Over those decades, Nigeria's per capita GDP fell from $1,113 in 1970 to $1,084 in 2000, by when Nigeria was among the 15 poorest countries in the world. Between 1970 and 2000, the poverty shares of the population (living on less than US$1 per day) increased from 36% to just under 70%, in absolute terms this implied that the number of poor people had increased from 19 million in 1970 to 90 million in 2000[26].

However, countries experiencing windfalls from point resources are not necessarily doomed to fail. In fact, since the early 2000s there has been a sustained boom in global commodity prices, such as oil and copper. Many countries have experienced two decades of rapid economic growth, driven by high commodity prices and exports and a resulting boom in foreign direct investment (FDI) into the sector. The World Bank and private consultancies such as McKinsey are today arguing that such extractives-led economic growth can this time be sustained. The dominant narrative today is that countries can avoid the resource curse by following rules of best practice.[27]

2.2 The Mauritian Economic Miracle

In 1961, Professor James Meade, the Nobel Prize winning economist, castigated the economic potential of Mauritius.[28] Meade wrote that Mauritius was almost wholly dependent on growing sugar, which itself was vulnerable to weather (regular cyclones) and declining prices in the main European export markets.[29] Contrary to Meade, between 1973 and 1999, average annual GDP growth in Mauritius was almost 6% p.a., compared to 2.4% for the whole of Africa. By 1998, after these decades of sustained economic growth, Mauritius was one of only two African countries ranked inside the global top fifty in terms of per capita incomes.[30] Economists started referring to the 'Mauritian Economic Miracle.'

After forty years, it was evident that the vulnerability highlighted by Meade had instead been both compulsion and opportunity. Compulsion because Mauritius had no easy options, such as exporting oil or copper, and had to undertake the challenging national task of transforming the country into an exporter of manufactured goods. Opportunity because even as the Mauritian Miracle was being celebrated in the mid-1990s, a new generation of scholars had discovered just why James Meade was so wrong. Easy development options for developing countries in the 1960s had not generated sustained economic growth and wider social development, such as in Mauritius, but had instead created a resource curse.

Key to the Mauritian Miracle was economic diversification away from sugar, largely through the creation of the Mauritius Export Processing Zones (MEPZ) in 1971. Sugar constituted 70% of export earnings from Mauritius in 1977.[31] Success has many fathers and scholars have variously lauded a "Swiss-Mauritian entrepreneur Jose Poncini who opened a factory assembling watch jewels from imported components using imported machinery in 1965"; "Professor Lim Fat of the University of Mauritius who proposed the creation of an EPZ in a lecture after a visit to Taiwan in 1969"; and Finance Minister Gaetan Duval who pushed the MEPZ legislation through government and parliament.[32]

The MEPZ offered investors various tax concessions (including access to duty-free imported components and capital equipment), reduced bureaucracy to import and export, and a cheap, non-unionized, unemployed and largely female potential labor force. Initial investors were firms primarily from Hong Kong that were seeking to avoid the quotas and tariffs placed on Hong Kong exports to European markets. European investors followed, attracted as well by the bilingual (French and English) population of Mauritius.[33] Manufactured production in the MEPZ's expanded by 30% p.a. in the mid-1980s and by 1990 there were nearly 600 firms located in the MEPZs accounting for over 60% of national exports.[34]

The MPEZ sector was dominated by the textile and clothing sector and Mauritius became the 3rd largest global exporter of woolen knitwear. At its peak in 1998, manufacturing constituted 24% of the Mauritian economy.[35] The shift into manufactured exports created annual employment growth of more than 5% p.a. over the 1980s. Between 1977 and 1989, MPEZ employment increased from 20,000 to 90,000 helping reduce unemployment from 20 to 3% over the decade[36]. The growth of employment among previously unemployed women created new spending power among the very poorest households. By the mid-1990s, primary school enrolment had reached 100% (25% above all-Africa), life expectancy at birth more than 70, and income inequality had been declining since the early 1960s.[37]

2.3 Will Mauritius Face a Resource Curse in 2024?

In Bolivia between 1975 and 1984, revenue from natural resource exports increased by 12% of GDP. In Mexico between 1978 and 1983, oil revenues increased by 6% of GDP.[38] In 2022, Mauritius had a total GDP of $12.9 billion, so to reach comparable levels it would require a rent on Chagos and Diego Garcia of between $600 million to $1.3 billion a year. It is difficult to find evidence of how much the UK or US do or would likely pay for a naval base equivalent to Diego Garcia. In November 2024, UK Foreign Office official Jenny Chapman was quoted as saying "We never reveal the cost of basing our military assets overseas—we never have, we never will, and I do not think other nations do either."[39] There is some scattered evidence available on such costs. In the late-1990s the US was paying about $180 million a year for the use of Clark Air Base, Subic Bay Naval Base and four smaller installations in the Philippines. Negotiations in 1991 floundered as the US was prepared to pay $360 million a year for a ten-year lease, while the Philippine government sought $825 million a year for an eight-year lease.[40] In November 2023, the UK government did publish figures showing that its military base in Cyprus cost £256 million annually.[41]

The financial rent-cum-compensation for the Diego Garcia naval base has not yet been divulged or perhaps even negotiated. A Mauritian Minster has been quoted as saying this will run into "billions of rupees" (tens of millions of US dollars at the current exchange rate). A media report in the UK-based Daily Mail newspaper seemed to confirm this estimate saying that the "The UK will pay 'tens of millions' of pounds a year to lease a crucial military base on the Chagos Islands on behalf of the US" and also that "Senior sources told the Mail that the bill for Diego Garcia……. could even run into the low hundreds of millions."[42]

The rent would likely be paid to the government of Mauritius, so an appropriate comparison would be to compare the rent to the government's annual tax revenue. In 2019, Mauritius raised about 20% of GDP in taxation, equivalent to about $2.6 billion. A rent of $130 to $260 million would increase government revenue by between 5 and 10%. This may pose a large enough windfall to precipitate resource curse-like conditions. However, there are some important caveats and contextual dynamics that must also be considered.

3. How the Resource Curse Works and Policy Solutions for Mauritius

This section discusses how a potential Chagos induced resource curse may emerge in Mauritius and the resulting policy recommendations.

3.1 Volatile Commodity Prices

One common explanation for the resource curse is irrelevant for the case of Mauritius., that is the volatility of commodity prices[43]. The reason for resource-induced price volatility are the low short-run elasticities of supply and demand for natural resources. For a given increase in price, demand for food or oil does not fall much in the short run, people have to eat; economies need oil to function and the capital stock of a country (its power supply for example) is built around a particular energy source. Higher commodity prices do not motivate much increase in supply in the short run, it takes time to increase planting and harvesting, or to drill new oil wells. As a result, when there is a shock, such as a bad harvest (reducing agricultural output) or a cold winter (increasing the demand for energy), the price has to rise a lot to clear the market[44]. Those point resources noted above, especially oil and natural gas, but also aluminum, bananas, coffee, copper, and sugar have experienced very volatile international prices.

Volatile prices create sudden booms which may motivate more long-term investment in that sector (drilling oil wells) and generate increased government tax revenue, a sudden bust may leave a trail of wasted investment and bankruptcy, and large budget deficits as governments find themselves easily able to boost spending during the boom but unable to reduce spending when commodity prices fall.

Policy Recommendation: volatile commodity prices are irrelevant for Mauritius, who will negotiate a treaty that includes a multi-year lease for Diego Garcia at an agreed dollar price.

3.2. The Dutch Disease

The model of the Dutch Disease was inspired by the experience of the Netherlands, which discovered offshore gas deposits in the 1950s and subsequently experienced a decline in their manufacturing sector. As a country begins exporting a natural resource, those wishing to buy the export have to purchase the local currency, this causes an appreciation of the local currency which in turn makes other exports (such as manufacturing) less competitive[45]. Another mechanism is that the wealth flowing from resource exports increases the demand for non-traded goods, such as real-estate and shopping malls. Think here of oil company executives buying expensive apartments, dining in fancy restaurants, and buying imported brand-name clothes. This in turn may pull resources such as land and labor from the traded (manufacturing) into the non-traded (construction or retail) sector.[46] In Nigeria for example, the output of exportable cash crops, notably oil palm and rubber, declined by 75% between 1970 and 1981[47].

The key policy suggestion is firstly for countries to prevent an appreciation of their domestic currency and secondly, over time to promote a diversification of the economy out of the primary sector.

A country may prevent its currency from appreciating by increasing the domestic money supply through foreign exchange interventions. To prevent inflation, they may also introduce sterilization policies, such as raising reserve requirements on banks. If the commodity boom proves to be long-lived the country may allow a gradual appreciation of the currency[48].

Over the longer term, the great example of resource-induced diversification is the nineteenth century United States. During the late nineteenth century, the US, particularly California, became a large oil producer and exporter. The US promoted the industrialization of the oil sector itself through large-scale investments in exploration, transportation, geological knowledge, and the technologies of extraction, refining, and utilization.[49] The availability of cheap oil also stimulated a wider industrialization and California emerged as the high-tech, automobile-oriented hub of the US economy. Another example is that of Norway which was able to utilize its historic skills endowment in shipbuilding to become a full partner in oil exploration and drilling. By insisting on joint ventures and training up petroleum engineers (at the Norwegian Technical University and Rogaland Regional College) the Norwegian industry acquired expertise in building deepwater drilling platforms[50].. Mauritius itself offers a good example, where tax and export revenues from sugar in the 1970s were used to build new infrastructure and the SEZ facilities to enable the economy to diversify into manufactured textile exports.

Such efforts do not always work. In Nigeria, the government used oil revenues to promote the manufacturing sector, but this was an inefficient process and the new enterprises were not productive and cost-effective enough to export and remained dependent on subsidies to survive. When the world oil price declined in the 1980s, the manufacturing sector in Nigeria collapsed[51].

Policy Recommendation: unlike the traditional resource curse which involves the export of a commodity (like oil) and places upward pressure on the domestic exchange rate, there is no equivalent of the Dutch Disease for Mauritius today. Mauritius will receive the rent for Diego Garcia in hard currency, likely the dollar. These dollars can be used to increase imports or be added to foreign exchange reserves without creating any upward pressure on the rupee exchange rate.

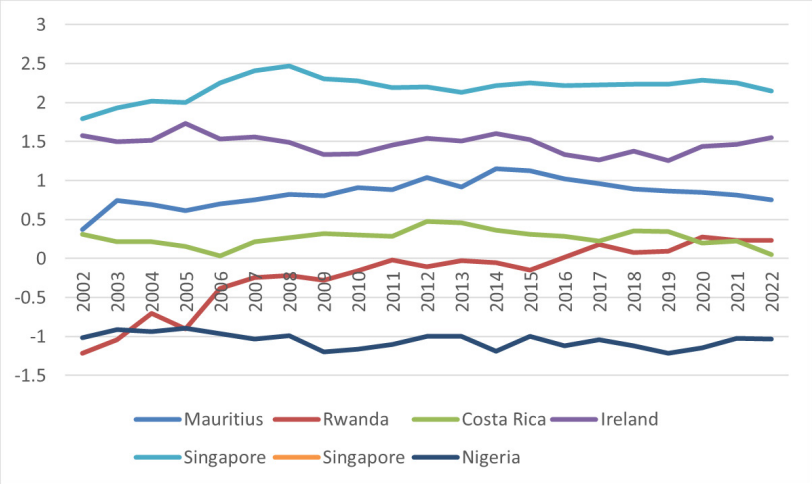
3.3. Institutions as Protection and Institutional Decay

The resource curse literature has found that the negative impacts of resource exports are concentrated in those countries with bad institutions. One study distinguishes the two regimes as being countries with 'grabber friendly' institutions which promote rent-seeking, corruption, and political favoritism, and 'producer friendly' institutions that promote transparency, long-term investment, and competitive open markets[52]. Those countries who have turned a potential resource curse into a resource benefit have included Botswana (diamonds) and Norway (oil) that already had good (producer-friendly) institutions in place at the time the resource was discovered/ production began. Rigorous statistical evidence shows that institutional quality (measured in relation to variables such as bureaucratic quality and government corruption) can reduce the negative impact of resources on economic growth[53]. Another study finds that in aggregate natural resources have a strong, robust and negative effect on growth between 1970 and 1998, but once institutions are controlled for there is either very little effect of natural resources on growth or even a positive effect[54].

Figure Two shows a measure of government effectiveness from the World Bank for Mauritius and four comparator countries (Ireland, Singapore, Costa Rica, and Rwanda) that are all relatively small in terms of land area and population and have been noted success stories in attracting FDI and promoting rapid economic growth[55]. The index produces a measure between +2.5 (the best) and -2.5 (the worst) and captures "perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political

pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies".[56] Figure Two shows that Mauritius has relatively good institutions, not of the standard in Ireland or Singapore, but good relative to (improving) Rwanda and Costa Rica and much better than Nigeria.

Figure Two: Government Effectiveness in Mauritius, Four Comparator Countries, and Nigeria



Source: World Bank (2024).

There is a second impact, institutions do not just mediate the impact of resources on economic outcomes, they are also directly impacted by resources. High levels of resource revenues reduce the need for states to tax citizens to raise revenue, so reducing the need for politicians to invest in building the state's bureaucratic capacity. Elected politicians may seek to dismantle well-functioning institutions such as budget transparency or rules governing the use of natural resource, in order to gain access to resource rents[57]. One study finds that fuels and minerals have a systematic and robust negative impact on growth via their negative effect on reducing institutional quality[58]. Another study provided a rigorous test of this hypothesis and found that a sudden surge of revenue to local governments in Norway reduced public sector efficiency, measured in terms of the output of public services (care for the elderly, primary and lower secondary education, day care, welfare benefits, child custody, and primary health care) from a given volume of spending.[59] Importantly for this discussion of Mauritius, the evidence shows that revenue from natural resources has a similar impact to windfall revenues derived from other sources (including potentially the rent on a naval base)[60].

Beyond state functioning the resource curse may also undermine the functioning of democratic institutions, what Oxford University Professor Paul Collier called "the survival of the fattest"[61]. Global evidence shows that the greater a country's oil income, the less likely it has been to undergo a democratic transition. States with lots of oil and no democratic transitions are often in the Middle East and North Africa but also include Russia, Angola, Uganda, and Gabon.[62] Democracy is not just about elections; it is also about limits on how power is used. Electoral competition forces political parties to attract votes in the most cost-effective manner; under normal circumstances that is in delivering public services such as education and infrastructure more effectively than rival politicians. Where resource-funded patronage is an option politicians can instead buy off a larger set of potential challengers and reduce dissent[63]. Resource funded states are freed from the need to levy domestic taxes and so become less accountable to the societies they govern[64].

Policy Recommendation: at ft first glance Mauritius has little to worry about. The country has good institutions so it should be able to turn a Diego Garcia resource curse into a resource blessing.

Policy Recommendation: Institutions are not fixed. There are also worrying signs that institutional quality in Mauritius has been declining since 2014. In 2014 Mauritius had broadly equivalent institutional quality to Ireland, there is now a big gap between the two countries. Mauritius needs to monitor this situation carefully and focus on the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies. Any rental payment for Diego Garcia must be received, allocated, and spent in the full glare of public and parliamentary transparency and accountability[65].

3.4. Saving and Investing Resource Windfall

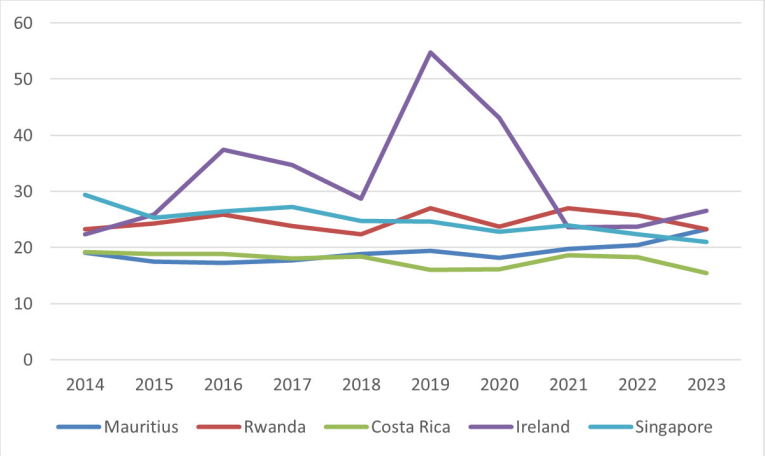
A key link between the resource curse and economic sustainability is the question of whether resource revenues are being consumed or saved and invested. Countries receiving resource windfalls, especially those with weak institutions and dysfunctional political systems have found budgetary prudence difficult to achieve. A study using cross-country data between 1980 and 1995 finds that resource-abundant countries tend to have a negative savings rate (-2.6% of GDP on average) and resource-poor countries a positive savings rate (+9.2% of GDP on average)[66]. Those countries that have used resource abundance to finance current consumption have experienced slower economic growth. The resource curse is entirely explained in one study by the interaction between resource availability and government consumption[67].

Investing rather than consuming the proceeds of natural resource wealth is no panacea for economic growth. There is a long history of centralized resource wealth being used to promote inefficient industrial import substitution[68]. In Nigeria there was a massive surge in investment, by an annual average growth of 14% p.a. in the 1970s. The country's capital stock saw a three-fold increase over eight years. This massive increase in investment was led by the public sector. Capacity utilization in state-owned enterprises which averaged about 77% in 1975, started declining, and fell to 50% in 1983, and then further to around 35%. This meant that two-thirds of government created industrial capacity was being wasted. The most famous example is that of the Ajakouta steel complex in the 1970s, while costing hundreds of millions of dollars never produced a commercial ton of steel[69]. The government-led effort to utilize the proceeds of resources in Latin America to boost domestic investment in the 1970s changed the balance of political power. The effort created a political constituency of manufacturers and unionized industrial workers who enjoyed profits and employment from the newly created industries. Those industries were inefficient and dependent on continued government subsidies, but were politically influential so the government became locked into a decades long wasteful policy configuration.[70]

There is no rationale for Mauritius to use the Diego Garcia rent to undertake a massive increase in investment. Figure Three shows that investment in Mauritius is slightly lower, but entirely comparable to the four other successful small countries[71] Lower-income developing countries typically require investment of 30-35% of GDP to sustain rapid economic growth. Mauritius has already built the ports, housing, airports, roads, and factories it needed to sustain textile-led manufacturing export growth between the 1970s and the 1990s.

Today, Mauritius, as in the case of Singapore or Ireland, can sustain rapid economic growth in knowledge-intensive service sector with investment around 25% of GDP.

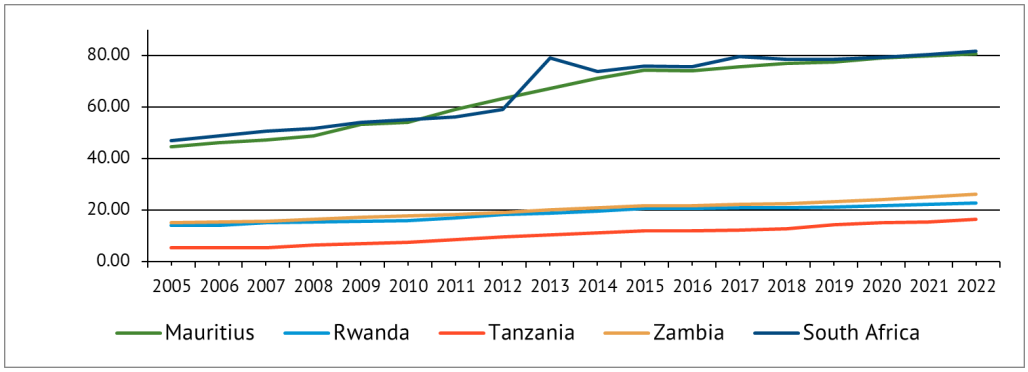
Figure Three: Gross capital formation (% of GDP)



Source: World Bank (2024).

Further evidence of this can be seen in the specific case of infrastructure investment. The Africa Infrastructure Development Index (AIDI) Index covers the period between 2000 to 2018 and comprises indicators related to electricity, transport, ICT, and water and sanitation[72]. Figure Four shows that Mauritius has a massive advantage over almost all African countries other than South Africa. The favorable picture diminishes once Mauritius is compared to global standards, but this indicates steady improvements are needed, not a massive investment in infrastructure provision.

Figure Four: Infrastructure in Mauritius and Four African Countries



Source: AIDI (2024)

Policy Recommendation: Mauritius should save the rental revenue from the Diego Garcia naval base, rather than increasing current consumption on imported consumer goods or by raising public sector salaries.

Policy Recommendation: Mauritius is already investing enough to sustain reasonably rapid economic growth. There is a danger that boosting investment, especially through the centralized direction of the state will create unused and wasteful industrial and infrastructure white elephants.

4.5. Private Saving and Foreign Saving

Section 4.4 concluded that Mauritius should save its Diego Garcia rents, but not utilize those savings to engage in a state-mediated effort to boost domestic investment. There are two options for Mauritius to fulfil these policy recommendations. The first is to recycle the revenue to the local population and the second is to create a sovereign wealth fund (SWF).

In the US state of Alaska, the Alaska Permanent Fund saves earnings from the state's oil sector. Alaska state law says the Fund must distribute half of the investment earnings on an equal per capita basis. The system gives Alaskans a position as stakeholders in the Fund.[73] In 2003, one study proposed doing the same in Nigeria and estimated that this would then be equivalent to roughly $760 per adult, or about 43% of current per capita and double the US$1 per day poverty line.[74] The main problem with this choice is that it would require converting the dollar rental payments into Mauritian rupees, with all the attendant problems related to the Dutch Disease discussed in Section 4.2.

The second option is to create a SWF. By 2015, there were more than 50 SWFs established globally using the proceeds of extractive resource revenues. This reflected the historically high commodity prices and the increased focus on revenue management. Producer countries that have SWFs include Australia, Bolivia, Chile, Gabon, Ghana, Mongolia, and Turkmenistan. In the US, the states of West Virginia and North Dakota have established their own SWFs. Some funds are managed by the existing fiscal authorities and operate within the budget framework without revenues being earmarked for any specific purpose. Other funds are managed by specially appointed boards and operate partly or wholly outside the government's budget. Often the revenue derived from formal funds are earmarked for special purposes.[75]

The record of SWFs is mixed. Those that have been successful are in democratic or partly democratic countries that have well-functioning, transparent institutions, and a predictable, stable legal framework. A well-functioning SWF can become a visible focal point for revenue management and create a constituency motivated to monitor and further improve such management. Characteristics common to such funds are simple and transparent regulations, as well as the public availability of information about the rules, the funds, and the investments. Managers should be accountable not only to the government and to parliament, but also to the public, which in itself, increases citizens' interest in fund management.[76] While the example of the Norwegian SWF is often used as an example, Norway discovered oil when its institutions were already highly developed.[77] Management of the Botswana Pula Fund is perhaps more suitable for Mauritius, where the revenue is managed by independent professionals with instructions to pursue only the financial interests of the people of Botswana and not political goals.[78] This is likely the most promising path forward for Mauritius.

Policy Recommendation: Mauritius should save its Diego Garcia rents, but not engage in a state-mediated effort to boost domestic investment. One option is to recycle the revenue to the local population. This will create the risk of a Dutch Disease type effect that crowds out domestic manufacturing.

Policy Recommendation: Mauritius should consider creating a sovereign wealth fund (SWF), to save the Diego Garcia rents in global assets and spend the resulting income on tightly prescribed areas.

4. Conclusion and a Big Idea

One of the vestiges of global imperial and Cold War politics was (re)solved in October 2024. The return of the Chagos Islands to Mauritius is a legal triumph. The solution wasn't easy; it required decades of legal action and required several high-profile legal defeats, global opposition, and a change of government in the UK. The media reporting in the UK has been, with some exceptions, very positive and proclaimed a win-win-win-win solution by many. Commentators have focused on the positivity of a legal victory for Mauritius. Negative sentiment has been directed towards the lack of consultation among Chagossians and the geopolitical threat to the US presence in the Indian Ocean relative to that of China.

So far, the narrative about the legal case has neglected the economic implications for Mauritius, particularly the possibility of Mauritius experiencing a resource curse as a result of the rental-cum-compensation payments for the Diego Garcia naval base. Although there is a lack of real data on the financial implications of the recent deal, a resource curse is a real possibility for Mauritius, especially in relation to the size of its impact on the government budget. A crucial finding from this paper in its survey of the resource curse literature is that a variety of resource windfalls, including foreign aid or a rental payment for a naval base can cause a resource curse type impact.

The big policy conclusions of this policy brief revolved around the irrelevance of the problem of volatile commodity prices for Mauritius; the easy way in which Mauritius can avoid the problem of the Dutch Disease; the existing good institutions in Mauritius but concern about institutional deterioration over the last decade; the importance of saving rather than consuming the Diego Garcia rental payment; the dangers of boosting investment in contemporary Mauritius; and the final options of recycling the rental revenue in the form of a per-capita lump-sum annual payment to Mauritian residents, or our preferred policy option, the creation of a SWF. Moreover, by allocating resulting income to support higher education and knowledge-creation on the islands, the Mauritian government can capitalize on the Diego Garcia rent windfalls to drive long-run economic growth.

Finally, we finish with the suggestion of how the SWF could spend the income it generates from its investments. Mauritius needs investment in knowledge creation more than physical factories and infrastructure. As a middle-income country Mauritius is looking upwards and aspiring to the success of small, but high-income

countries like Singapore and Ireland. In one way Mauritius remains a long way behind. The leading higher education institute in Mauritius, the University of Mauritius, ranks between 1200-1500 in the Times Higher Education university world rankings. Here Mauritius looks more like the University of Rwanda or University of Costa Rica (both ranked outside the global top 1500) and less like Ireland's Trinity College Dublin (ranked 139th) or the National University of Singapore (ranked 17th)[79]. The investments needed to build a world-class university could be made in dollars, payments to foreign-recruited researchers, teachers, and administrators; importation of research materials and laboratory equipment, and scholarships for students. This would minimize the problem of converting dollars into rupees and so with it the problems of the Dutch Disease. Like any domestic budget process, the hiring, functioning, and management of a revamped University of Mauritius should be done within the full glare of transparent procedures, management, and accountability. A resource curse that threatens government institutions or the functioning of democracy could easily transfer its damaging impacts to the confines of a university.

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